



To
Basel Committee on Banking Supervision
Submitted via Website

Date: March 11th, 2016

Reference: Second consultation on “Revisions to the Standardised Approach for credit risk”

Dear Sir,

With reference to your second consultative document regarding “the revisions to the Standardised Approach for credit risk” as published in December 2015, we are pleased to hereby submit the views of our association, which currently represents 13 ESMA registered or certified CRAs as well as 5 CRAs registered or recognized in Russia, Switzerland, Turkey and Zambia. The short profiles of our members are attached to this letter.

Our response mainly relates to the recognition of external ratings by national supervisors in jurisdictions allowing the use of credit ratings. We notably propose that the SA should not only make reference to the IOSCO Code of Conduct Fundamentals on CRAs but also to the specific legislation on CRAs in place. We further present some comments regarding the eligibility criteria for ECAIs as well as on the mapping process. We propose that banks should be able to use ECAIs selectively for different asset classes. We further think that CRAs should remain free in defining their rating methodologies and notably whether they include government support when rating banks. While we welcome the due diligence requirements on banks in order to reduce sole and mechanistic reliance on CRAs, we think that this principle should be applied in a proportionate manner.

On recognition of external ratings by national supervisors

With reference to Paragraph 83, we welcome the clarification that “National Supervisors should take into account the criteria and conditions provided in the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies when determining ECAI eligibility”. This IOSCO Code tackles in more details the criteria regarding objectivity, independence and disclosures.

But, we would like to highlight that several jurisdictions have adopted or updated specific regulations on Credit Rating Agencies requiring registration and on-going supervision. The IOSCO Code itself targets to “bring into harmony the Code with the existing regulations”. Additionally, the IOSCO Code acknowledges that specific legislation on CRAs supersedes the IOSCO Code. More importantly, the regulations on Credit Rating Agencies give supervisors the possibility to request corrective actions by CRAs or the option to impose fines and penalties and even the withdrawal of the registration. Specific regulations on CRAs therefore add comfort to users of ratings. We therefore request that the Paragraph 83 should be amended in order to reference existing specific regulations on CRAs. Additionally, we propose that in jurisdictions allowing the use of credit ratings the list of eligible External

Credit Assessments Institutions (“ECAIs”) is being aligned with the list of Credit Rating Agencies registered as such with supervisors. While this is the case in the European Union, the EU example is on a global basis rather the exemption than the rule – this adding substantial complexity and increasing barriers to entry for CRAs.

On the eligibility criteria

Objectivity: This criterion states that “rating methodologies (...) must have been established for at least one year and preferably three years”. In some jurisdictions, such as the European Union, the registration of a Credit Rating Agency is mandatory before the issuance of credit ratings. CRAs based in such jurisdictions will therefore not be able to provide such a historic coverage – consequently, the European Union grants automatic recognition as an ECAI to any CRA registered or certified with the European Securities and Markets Authority (ESMA).

Independence: we agree that an “ECAI should be independent and should not be subject to political or economic pressures that may influence the rating”. The EU regulation on CRAs therefore includes several organizational, procedural and governance requirements, including on management of potential or actual conflicts of interests, in order to meet that objective. But, the EU regulation does not require the legal separation of rating activities from other businesses.

International access: unless the ECAI status is granted on an international, cross-border basis (implying the cross-recognition of ECAIs across jurisdictions), we think that this criterion sets a new barrier-to-entry into the market. Additionally, we would like to recall that some agencies operate under the investor-pays model – ratings assigned by these agencies are neither publicly available nor private as these ratings need to be acquired by the users.

Disclosures: this criterion requires ECAIs to disclose “the actual default rates experienced in each assessment category and the transitions of the ratings”. Given that some CRAs may have very focused activities and therefore a low number of public ratings, we think that such disclosures could be misleading – we therefore propose to include some proportionality here.

Resources: as formulated, this requirement implies that CRAs will always be in contact with the rated entity – this is not necessarily the case. Additionally, while we welcome that rated entities participate in the rating process, the quality of information received from the rated entity may substantially vary in quality, coherence and depth.

Credibility: we welcome the clarification that “an ECAI does not have to assess firms in more than one country” to be eligible for ECAI recognition. This important clarification gives a role to CRA specialized on specific countries and market segments.

On requirements listed in the footnotes

- On footnote 58: point 2 is practically impossible to be implemented... CRAs operating under the investor-pays model will be highly affected by such an decision (a “financial interest” is a very broad definition)
- On footnote 58, point 3: while we acknowledge that in some jurisdictions this disclosure is required, we think that this requirement is excessive in view of the “independence criteria” requiring the separation of rating activities and other activities.

- On footnote 58 point 4: a “preliminary rating” has a different meaning in Europe. Additionally, we think that CRAs should be able to provide to unrated issuers a general view on their credit quality (not a credit rating) as this will allow issuers to familiarize with ratings.
- On footnote 58 point 5: with reference to the “independence requirement”, we think that rating analysts and the rating committees will potentially not be aware of the CRA having a direct or indirect interest into the rated entity.
- On footnote 59 point 2: this requirement goes beyond the legislation on CRAs in Europe. We doubt that the disclosure of this type of information is of any benefit to users of ratings and think that it creates only an additional reporting burden on CRAs.
- On footnote 59 point 3: the threshold of 10% is higher than the 5% threshold applicable in Europe. Independently of the level of the threshold, this requirement impacts only on smaller CRAs who are more likely to cross the threshold – small CRAs may therefore need to disclose publicly who their clients are while large CRAs would not have to do so.

On the mapping process

With reference to paragraph 85, we very much welcome the clarification that the mapping of an ECAIs ratings should “cover the full spectrum of risk weights”. Since the risk weights increase with decreasing credit quality and that a CRAs rating scale is meant to cover the whole range of possible outcomes (from highest to lowest credit quality), we fully agree that ECAI ratings should cover all risk weights. Other solutions would only create additional difficulties:

- Leaving out one intermediary risk weight by “down-mapping” an intermediate rating category would distort the meaning of a CRA ratings scale and would lead to far enhanced cliff effects (as risk weight would raise more).
- “down-mapping” the highest CRA ratings category to the second risk weights would mean that such a CRA could not be able to rate the highest quality issuers as this can lead only to higher capital requirements and thereby to higher funding costs to the issuer.

Paragraph 87 states that “banks must use the chosen ECAIs and their ratings consistently for all types of claims where they have been recognized by their supervisor as an eligible ECAI”. We instead think that banks should be able to select different ECAIs for different market segments and that the selection of an ECAIs does not necessarily need to cover all asset classes. This view is convergent with Article 138 (a) of the Capital Requirements Regulations in Europe, which states: “an institution which decides to use the credit assessments produced by an ECAI for a certain class of items shall use those credit assessments consistently for all exposures belonging to that class;”

A bank envisaging the use of an ECAI to derive Risk weights will consider the coverage, the reputation, the rating methodologies and the pricing of an ECAI. Requiring a bank to use the same ECAIs for several market segments result in increased barriers to entry and leaves out specialized CRAs focusing on one segment only.

Additionally, depending on the market segment, banks may use instead of the SA the IRB approach. As banks have discretion on which approach they use, the same should apply regarding the use of ECAIs.

Paragraph 88 requires banks to disclose which ECAIs they are using for the different asset classes. We welcome this clarification as this provides more transparency. But, this paragraph also requires banks to disclose the information regarding “aggregated risk-weighted assets for each risk weight based on the ratings of each eligible ECAI”. With reference to the rules regarding the use of multiple external ratings, we note that the risk weighted assets of a bank may differ from the risk weighted assets calculated based on the ratings of a single ECAI. We therefore propose that the bank should disclose the risk weighted assets based on all the ECAIs it effectively uses.

Banks and government support

Paragraph 17 states that ratings on bank exposures “must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government”.

While some CRAs have already excluded this potential government support in rating banks or modified their approach given the evolving European framework to “unbundle” the bank-sovereign link and that some CRAs may assign separately Financial Strength ratings (excluding government support) and Credit Ratings, we think that the proposal goes against a core element of the CRA Regulation requiring full-independence of CRAs regarding their rating methodologies.

Regarding the due diligence requirement

With reference to paragraph 17 relating to bank exposures and paragraph 33 relating to corporate exposure, the BIS requires banks to do their due diligence on these exposures – in case such a due diligence leads to an implied risk weight higher than the one associated with the ECAI rating, the bank needs to apply the higher risk weight.

We welcome this requirement on banks as it reflects the principle that banks should not to rely solely and mechanistically on external ratings. But, we propose that the envisaged approach is being applied on a proportionate level taking into account the size and complexity of the banks.

Given that a nominated ECAI needs to be consistently used over time and that ECAIs should not be “cherry-picked”, we think that a bank will carry out substantial due diligence on an ECAI before nominating the ECAI for the calculation of risk weighted assets.

Last but not least, we would appreciate clarification on how the due diligence requirement relates to the use of several ECAIs and the determination of corresponding risk weights.

Other clarifications

With reference to Paragraph 8 outlining the risk weight for Public Sector entities based on external rating, we note that unrated exposure would receive a risk weight of only 50% (while usually unrated exposures have a risk weight of 100%)

Paragraph 92 uses the terms “high-quality credit rating” and “low-quality credit rating” to refer to ratings “which map into a risk weight lower than that which applies to an unrated claim” (respectively maps into a higher risk weight”). As the terms used may create confusion, we propose to replace these by “low credit risk rating” and “high credit risk rating”.

We remain at your full disposal for any clarification or further information.

Thomas Missong
EACRA President

Adolfo Estevez Beneyto
EACRA Secretary General

About EACRA

The European Association of Credit Rating Agencies (“EACRA”), registered in Paris, was established in November 2009. The Members of the Association currently originate from 12 countries and include the following companies:

ESMA registered Credit Rating Agencies

A.M. Best Europe - Rating services Limited (AMBERS) is a subsidiary of A.M. Best Inc who have been providing ratings to the Insurance Sector since 1899. AMBERS' rating coverage includes regional, national and global insurers located throughout Europe, the Middle East and Africa.

ARC Ratings is an international rating agency with a presence in 11 countries on four continents. ARC is registered with ESMA and results from a partnership of 5 leading rating agencies operating in India, Brazil, Sub-Saharan Africa, Malaysia and Europe. This partnership has over 6000 rating clients and 400 ratings staff, giving ARC global coverage as well as vital local knowledge

Assekurata Assekuranz Rating-Agentur is the first independent German rating agency that has specialized on the quality evaluation of insurance companies

Axesor: The first Spanish Rating agency registered with ESMA. Specialized in the middle market segment, with ample coverage of the Spanish corporate market.

Capital Intelligence (CI) offers independent rating opinions on financial institutions, corporates and governments in a wide range of countries, especially the emerging markets of Asia, Europe and the Middle East.

Cerved Rating Agency: Italian Credit Rating Agency recognized ECAI by Bank of Italy

Creditreform Rating: based in Germany, a company of the Creditreform Group that is European market leader in the sector of business information was founded 2000 and is specialised in ratings of companies, bonds, funds and structured finance products across Europe.

CRIF: International Credit Rating Agency based in Italy providing both solicited and unsolicited Corporate ratings.

Dagong Europe Credit Rating, headquartered in Milan, was registered by ESMA in June 2013. It is owned by Dagong Global Credit Rating. Dagong Europe provides European and Asian investors with credit opinions on financial institutions (including insurance companies) and non-financial corporate.

Euler Hermes Rating is a European rating agency located in Hamburg, Germany. We offer credit ratings and research about debt capital market instruments of corporates of all sorts of industries, project finance ratings and credit portfolios. Euler Hermes Rating is a member of Euler Hermes Group and a company of Allianz

Scope Ratings is an independent credit rating agency founded in Berlin, Germany, in 2002. The company is specialized in ratings and analysis of corporate bonds, financial institutions, structured finance, and alternative investment funds (AIF).

ESMA certified Credit Rating Agencies

Egan-Jones Ratings Company (“EJR”) is a leading Rating Agency in the United States with a strong track record for being early and correct. We publish several hundred qualitative and quantitative reports



each month. Our reports are not just maintenance but focus on locating and reporting on active situations. EJR's track record is very compelling as we have shown an exceptional record for anticipating the direction of future credit action.

Kroll Bond Rating Agency (KBRA) was established in an effort to restore trust in credit ratings by creating new standards for assessing risk and by offering accurate, clear and transparent ratings. KBRA is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (NRSRO). In addition, KBRA is recognized by the National Association of Insurance Commissioners (NAIC) as a Credit Rating Provider (CRP).

CRAs registered or recognized according to national legislation outside of the European Union

Credit Rating Agency (CRA) Limited operates in Zambia and is licensed by the Securities and Exchange Commission of Zambia. It commenced operations in September 2014 and is the first active credit rating service provider in Zambia. CRA rates private and public sector entities, and debt instruments.

Fedafin AG : is registered with the Swiss Financial Markets Authority and acts as rating provider to the Swiss stock exchange

JCR Eurasia is an international credit rating institution based in Turkey.

National Rating Agency (NRA) is one of the leading independent rating agencies in Russia. As of today National Rating Agency has assigned ratings to over 750 leading Russian and international companies.

RusRating is a credit rating agency based in Moscow, with sister agencies in Armenia and Kazakhstan. It is accredited with the Ministry of Finance of the Russian Federation.

Other EACRA members

Ellisphere: French leader in business & marketing information and credit management solutions, providing a large range of tools and solutions to secure companies' supply chain financing and improve their development.

Informa is the Marketing, Financial and Business Information leading company in Spain, offering currently more than 3.7 million online scores on Spanish companies

The Members of the Association have very different business models (issuer-pays, investor-pays, hybrid and special models) while assigning ratings. Since January 2014, all ESMA registered or certified CRAs are considered ECAs across the whole European Economic Area.

Reference the Article 8 d on the use of multiple CRAs and ESMA's report dated December 18th, 2015, all EACRA members registered with ESMA have less than 10% market share in the EU (measured against revenues).