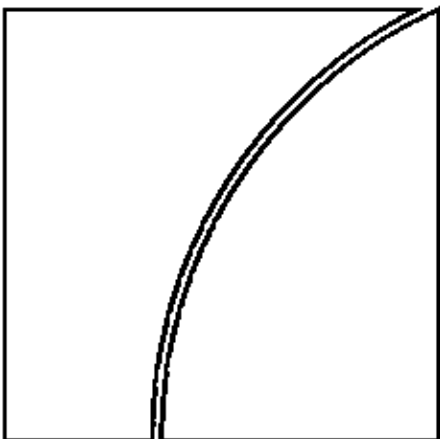


Basel Committee on Banking Supervision

The Joint Forum

Stocktaking on the use of credit ratings



June 2009



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THE JOINT FORUM

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INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS
C/O BANK FOR INTERNATIONAL SETTLEMENTS
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Stocktaking on the use of credit ratings

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I. Introduction

A. Background

In its report to the G7 titled *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*,¹ the Financial Stability Forum (FSF) requested the Joint Forum to conduct a stocktaking of the uses of external credit ratings by its member authorities in the banking, securities and insurance sectors. The request also suggested that authorities review whether their regulations and/or supervisory policies unintentionally give credit ratings an official seal of approval that discourages investors from performing their own due diligence.²

To implement the FSF request, the Joint Forum Working Group on Risk Assessment and Capital (JFRAC) prepared and circulated to member authorities a questionnaire on the use of credit ratings in their jurisdictions. The questionnaire was designed to elicit information regarding member authorities' use of credit ratings in legislation (statutes), regulations (rules), and/or supervisory policies (guidance) affecting, or generated by, such authorities (collectively, LRSPs).

The questionnaire requested information on the definitions (either internal or via cross-reference to an external source) of "credit ratings," "credit rating agencies," or any related terms as well as any references to specific credit rating agencies in LRSPs. Member authorities were also asked questions regarding the usage of credit ratings and/or references to credit rating agencies (or, in either case, related terms)³ in their LRSPs, including an explanation of what each LRSP was designed to accomplish and the purpose of using credit ratings in the LRSP. Finally, the questionnaire asked member authorities to describe their assessments, if any, of unintended implications of such uses, in particular, whether the use of credit ratings has had the effect of implying an endorsement of such ratings and/or rating agencies or discouraging investors from performing their own due diligence.

JFRAC received a total of 17 surveys from member authorities, representing 26 separate agencies from 12 different countries, as well as five responses describing international frameworks. A list of survey respondents is set forth in Appendix 4.

This report is intended to serve as a stocktaking of member authorities' use of credit ratings. This stocktaking is based entirely on the responses received from member authorities in response to the questionnaire circulated by JFRAC and, with the exception of the descriptions of international frameworks prepared by member authorities, does not address the use of credit ratings in any other jurisdictions. The LRSPs referenced in the report are cited as examples, representative of the compilation of member authorities' LRSPs referencing credit ratings as set forth in Appendix 5.

The report is not intended to be, and should not be construed as, an expository discussion of how credit ratings are developed, what information they are intended to convey, or how and

¹ See http://www.fsforum.org/publications/r_0804.pdf.

² The complete relevant text of the report reads as follows: "The Joint Forum will conduct a stocktaking of the uses of ratings by its member authorities in the banking, securities and insurance sectors. Authorities will review whether their regulations and/or supervisory policies unintentionally give credit ratings an official seal of approval that further discourages investors from performing their own due diligence. Authorities are aware that credit ratings play an important role in investment and risk management frameworks. The transitional implications of any changes to regulations and supervisory rules should be carefully considered."

³ For the purposes of this report, unless specifically noted, the phrase "use of credit ratings" shall refer to the use of credit ratings or related terms or the reference to credit rating agencies or related terms.

by whom they are regulated. Furthermore, the report does not express any viewpoint regarding the quality, accuracy, or any other subjective evaluation of credit ratings and does not take any position on the appropriateness of member authorities' use of credit ratings.

Pursuant to the FSF mandate, the questionnaire circulated to member authorities solicited their individual views on potential unintended consequences of their use of credit ratings in LRSPs (ie, the appearance of a "seal of approval"). In preparing their responses to this portion of the questionnaire, member authorities were not expected to conduct any independent research on the issue, but instead simply to convey their broad impressions and preliminary views. As such, the summary of these views in this report should not be construed as a definitive survey of member authorities' positions; the report expresses the range of viewpoints expressed by member authorities on the issue of the unintended consequences of the use of credit ratings in LRSPs and takes no independent position on the subject.

B. Key terms used in this report

Several key terms that are used throughout this report bear mention. The two most significant related terms for subsets of "credit rating agencies" are "nationally recognised statistical rating organisations" (NRSROs), which are regulated by the United States Securities and Exchange Commission (US SEC), and "external credit assessment institutions" (ECAIs), a term set forth in the Basel II framework.

The term "NRSRO" is defined in United States (US) legislation⁴ and is limited to credit rating agencies that have applied for and been granted registration by the US SEC. This statutory definition of NRSRO is cross-referenced extensively in US regulations as well as in the Canadian Securities Administrators' national instrument relating to the Multijurisdictional Disclosure System (MJDS).⁵

Almost half of the respondents referenced the term "ECAI," with several specifically referencing the Basel II framework and/or the Committee of European Banking Supervisors (CEBS) "Guidelines on the recognition of External Credit Assessment Institutions" (CEBS Guidelines) as the source for that term.⁶ While the amended Basel II framework⁷ sets forth criteria to be used by national supervisors for the "recognition" of ECAIs, it does not contain a definition of the term. Consistent with that framework, the Capital Requirements Directive

⁴ As defined in Section 3(a)(62) of the Securities Exchange Act of 1934, the term "nationally recognized statistical rating organisation" (NRSRO) means a credit rating agency that (A) has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration...; (B) issues credit ratings certified by qualified institutional buyers...with respect to (i) financial institutions, brokers, or dealers; (ii) insurance companies; (iii) corporate issuers; (iv) issuers of asset-backed securities...(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or (vi) a combination of one or more categories of obligors described in any of clauses (i) through (v). The credit rating agency must be registered with the SEC in order to be considered an NRSRO.

⁵ The MJDS is a reciprocal initiative adopted by the US SEC and the Canadian Securities Administrators, allowing issuers to meet their disclosure obligations in both Canada and the United States by complying with the issuer's home country disclosure standards and permitting the review of that disclosure solely by the securities regulator in the issuer's home country.

⁶ The CEBS Guidelines set forth the Committee of European Banking Supervisors' proposed common approach to the recognition of eligible ECAIs.

⁷ The November 2005 revised framework for the International Convergence of Capital Measurement and Capital Standards (Basel II framework) is available at: <http://www.bis.org/publ/bcbs118.pdf?noframes=1>.

(CRD)⁸ that implements the Basel II framework in the European Union (EU) does not define an ECAI, but instead sets forth criteria for the recognition of eligible ECAIs.⁹

A small minority of respondents indicated that their LRSPs include an explicit definition of the term “ECAI.” For instance, under the Australian prudential standards, an ECAI is defined as “an entity that assigns credit ratings designed to measure the creditworthiness of a counterparty or certain types of debt obligations of a counterparty.”

The majority of respondents indicated that their LRSPs reference specific credit rating agencies. All but one of those respondents mentioned Moody’s Investors Service, Standard & Poor’s Ratings Services, and Fitch Ratings. Several respondents indicated that the individual credit rating agencies listed in their LRSPs are formally reviewed on a regular basis, in some cases on a fixed schedule (ie, annually or every five years). Several others noted that the Basel II and/or CEBS designation procedures for ECAIs also applied to the removal of the ECAI designation. In addition, a number of respondents indicated that their LRSPs naming individual credit rating agencies could be amended through their jurisdiction’s standard legislative or regulatory process.

Finally, the Markets in Financial Instruments Directive (MiFID), an EU law designed to provide a harmonised regulatory regime for investment services, defines the term “competent rating agency” for that specific purpose as an entity that “issues credit ratings in respect of money market funds regularly and on a professional basis and is an eligible ECAI within the meaning of Article 81(1) of Directive 2006/48/EC.”

For a more detailed discussion of the definitions of terms used by respondents, see Appendix 1.

C. Basel Framework

Basel II serves as the foundation for the use of credit ratings in a significant number of member jurisdictions. These jurisdictions have implemented the Basel II framework into their domestic LRSPs to varying degrees, with most appearing to have incorporated the substantial elements of the framework into their domestic LRSPs. As alluded to above, the EU implemented Basel II via the CRD, which applies to both banks and investment firms.

Appendix 2 sets forth a more detailed description of the relevant portions of the Basel II framework.

II. Uses of credit ratings

As described in greater detail below, credit ratings are generally used in member jurisdictions for five key purposes: (a) determining capital requirements; (b) identifying or classifying

⁸ The CRD consists of Directive 2006/48/EC (available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_177/l_17720060630en00010200.pdf) and Directive 2006/49/EC (available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_177/l_17720060630en02010255.pdf). It was published in the Official Journal on June 30, 2006.

⁹ Specifically, Article 81 of Directive 2006/48/EC states that “Competent authorities shall recognise an ECAI as eligible ... only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.”

assets, usually in the context of eligible investments or permissible asset concentrations; (c) providing a credible evaluation of the credit risk associated with assets purchased as part of a securitisation offering or a covered bond offering; (d) determining disclosure requirements; and (e) determining prospectus eligibility. In general, the member authorities that responded to the survey reported a greater use of credit ratings in their LRSPs covering the banking and securities sectors than in their LRSPs for the insurance sector.

Attached to this document as Appendix 5 is a summation of all respondent answers regarding how credit ratings are used in their LRSPs.

A. Capital

1. Banking and securities sectors

This category features the broadest application of the use of credit ratings. Member authorities from every jurisdiction submitting responses indicated that their LRSPs contained provisions using credit ratings for the purpose of determining net or regulatory capital, and more LRSPs are applied to capital requirements than to any other category of use. Credit ratings were generally used in those LRSPs as a means of mapping credit risks to capital charges or risk weights. A related use for ratings in LRSPs is the determination of margin rates; for example, certain sovereign bonds and debentures may be subject to lower margin rates as a result of receiving investment grade ratings.

In the Basel II framework, external ratings are used for the purpose of enhancing the risk sensitivity of the framework, for example, by being incorporated into assessments of the credit quality of an exposure or creditworthiness of a counterparty – and thus the imposition of capital requirements. External ratings are primarily used under the standardised approach for credit risk,¹⁰ but also to risk-weight securitisations exposures. The different uses of external ratings generally correspond to probability of default treatments under the standardised approaches, and to situations where the use of internally generated ratings is impossible or difficult given, for instance, the lack of statistical data for securitised products.

In most cases, for member jurisdictions that have incorporated the Basel II framework, the external ratings that can be used for the purpose of determining regulatory capital are limited to those provided by rating agencies recognised by national supervisors as ECAs. Supervisors assess whether these criteria are fulfilled and aim at identifying rating agencies that issue ratings that are sufficiently sound and robust to warrant using them to determine the appropriate regulatory capital levels. Supervisors are also in charge of articulating the conditions and details for the use of ratings (eg, in the EU, for the mapping of external ratings to the regulatory risk-weights or credit quality steps).

All members of the EU have implemented the CRD, which implements the Basel II framework for both banks and investment firms. Within the EU, the decision as to whether or not to recognise an ECAI is within each member's discretion, although the "joint assessment process" set forth in the CEBS Guidelines is designed to achieve a consistent approach among EU member states.

In Australian LRSPs for authorised deposit-taking institutions, mappings of credit ratings are used to calculate regulatory capital risk weights for certain credit risk and securitisation exposures, as set out in the Basel II framework.¹¹

¹⁰ The Basel II framework's standardised approach is discussed more fully in Appendix 2.

¹¹ Prudential standard APS 120 Securitization.

In Canada, all banks have implemented the Basel II framework and hence external ratings are used to assess the credit risk of an exposure.

In Japan, credit ratings issued by Designated Rating Agencies (DRA) are used to estimate market risks and counterparty risks for the purpose of calculating the capital adequacy ratios for securities companies.¹² Japan also noted that for calculating the capital adequacy ratios for banks and other deposit-taking institutions, credit ratings issued by ECAs are used subject to the Financial Services Agency (JFSA) ordinance under the Banking Act.

In the United States, which features the most widespread use of credit ratings in LRSPs that establish capital requirements in the securities and banking sectors, the use of credit ratings for capital purposes is almost exclusively restricted to those issued by credit rating agencies designated as NRSROs through the US SEC's registration process.¹³

2. Insurance Sector

In the European Union, the existing insurance and reinsurance directives do not contain any provisions that place reliance on credit rating agencies. There is no explicit credit risk charge for the solvency margin in the Solvency I framework. The solvency margin in the Solvency I framework is not the sum of different capital charges related to different risks, but a single capital charge calibrated to reflect all the risks an insurance company faces.

Nevertheless, the importance of credit quality is taken into account in the rules applying to asset allocation; but they are not based on the use of credit ratings.¹⁴ For instance, Article 24 of Directive 2002/83/EC establishes rules for investment diversification without any reference to credit ratings. An insurance company must diversify the assets that cover its liabilities towards policyholders and limit its investments in certain asset classes as a percentage of total liabilities.

However, a number of member jurisdictions' national laws implementing the investment rules of the current Solvency I Directives¹⁵ do refer to, or place reliance on, ratings in order to determine whether a certain asset is authorised or eligible to cover technical provisions. Moreover, in a number of member jurisdictions, (re)insurance undertakings are required, as part of their internal reinsurance policy, to pay special attention to the financial strength of their reinsurers, using ratings as a proxy.

For example, in the Netherlands, when pension funds reinsure their assets, they must maintain buffers to cover the risk of the reinsurance company defaulting on its obligations. The size of these buffers depends on the credit spread of the reinsurance company. As a gesture to the sector, on its website, De Nederlandsche Bank publishes credit spreads that (smaller) pension funds can use when they cannot obtain market data. In the United Kingdom, the Insurance Prudential Sourcebook¹⁶ provides a table with "listed rating agencies" (A.M. Best Company, Fitch Ratings, Moody's Investor Service, Standard & Poor's Ratings Services), including credit rating descriptions and "spread factors." With regard to

¹² See the relevant section in the Financial Instruments Business Operators Art.4(6), Art.17(3)(iii) under the Financial Instruments and Exchange Act.

¹³ 17 CFR 240.17g-1 – 240.17g-6 and Form NRSRO.

¹⁴ For instance, sovereign debt is not limited as an investment vehicle, whereas corporate bonds are subject to concentration limits by obligor.

¹⁵ See http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm#sol1.

¹⁶ INSPRU 1.3.90 & INSPRU 1.3.93.

insurance capital resources requirements, credit ratings from these firms are used in determining assumed spread stresses.¹⁷

In the United States, insurance regulators require bonds and preferred stocks to be reported in statutory financial statements in one of six National Association of Insurance Commissioners (NAIC) designations categories that denote credit quality. If an accepted rating organisation (ARO) has rated the security, the security is not required to be filed with the NAIC's Securities Valuation Office (SVO). Rather, the ARO rating is used to map the security to one of the six NAIC designation categories.¹⁸ The NAIC designations are primarily designed to assist regulators (as opposed to investors) to monitor the financial condition of their insurers.

Finally, in light of the impact that the credit market crisis had on the credit ratings of the financial guarantors and the bonds they insure, the NAIC announced that the SVO will be issuing "substitute" ratings for some municipal bonds. In doing so, the NAIC will be assessing the creditworthiness of the municipality that issued the debt. These credit ratings will be used to determine the risk based capital charge for the security. The insurance regulators indicated that the proposal will "decouple" the NAIC rating from the rating agency process.

In Canada, a significant portion of an insurer's capital requirement (especially for a life insurer) arises from its exposure to credit risk. This component of the overall insurer capital requirement is determined using asset default factors. For rated short term securities, bonds, loans and private placements, these factors are based on the rating agency grade. In its life insurer capital guideline, the Office of the Superintendent of Financial Institutions (OSFI) states that:

"A company must consistently follow the latest ratings from a recognized, widely followed credit rating agency. Only where that rating agency does not rate a particular instrument, the rating of another recognized, widely followed credit rating agency may be used. However, if the Office believes that the results are inappropriate, a higher capital charge would be required." [page 3-1-3]

Further, in Canada, asset default factors for preferred shares, where rated, are based on the rating agency grade. For financial leases where rated, and the lease is also secured by the general credit of the lessee, the asset default factor is based on the rating agency grade.

Other examples of the use of credit ratings in LRSPs governing capital requirements are found in Japan, where credit ratings issued by DRAs are used to calculate the solvency margin ratios regarding estimating credit risks for insurance companies,¹⁹ and Australia, where prudential standards for both general insurers and life insurers use credit ratings to assign counterparty grades used in regulatory capital requirements.²⁰

¹⁷ See <http://fsahandbook.info/FSA/html/handbook/INSPRU/1/3>.

¹⁸ An exception is US government bonds, which are automatically rated in NAIC designation category 1, denoting the highest quality.

¹⁹ Insurance Business Law Art.130(ii), Art.202ii, Art.272-28, the Ordinance for Enforcement of Insurance Business Law Art.87(iii)(b), Art.162(iii)(b), Art.211-60(ii)(b).

²⁰ Prudential standard GPS 114 Capital Adequacy: Investment Risk Capital Charge, Attachment B, Prudential standard LPS 2.04 Solvency Standard, Prudential standard LPS 3.04 Capital Adequacy Standard, Prudential standard LPS 6.03 Management Capital Standard, Prudential standard LPS 7.02 General Standard, Attachment 1.

B. Asset Identification

1. Banking and securities sector

The field of LRSPs cited by the second highest number of respondents was, broadly speaking, asset identification/categorisation. This includes, for example, the designation of permissible investments and/or required investments for mutual funds as well as the establishment of, and exceptions to, investment concentration limits for particular types of assets. In most cases, member jurisdictions reported that credit ratings were used in both the banking and securities sectors. In addition, the United Kingdom Financial Services Authority (UK FSA) noted that credit ratings are not used in any of its three financial sectors for asset identification.

In the EU, the Undertakings for Collective Investment in Transferable Securities Directives (UCITS Directives) on collective investment schemes²¹ does not contain provisions which make reference to credit ratings. However, Commission Directive 2007/16/EC,²² which clarifies certain definitions used in the UCITS Directives, contains two specific references to credit ratings relating to money market instruments.²³

In Japan, a securities dealer is generally not allowed to be a lead manager for a security issued by its parent or subsidiary company. However, it is exempt from this regulation if the security is rated by a DRA that is subject to the Cabinet Office Ordinance of Act on Financial Instruments Business Operators Art153(iv) under the Financial Instruments and Exchange Act.

As in the case of US capital requirement LRSPs, the extensive banking and securities LRSPs using credit ratings in the US generally restrict such use to credit ratings issued by credit rating agencies designated as NRSROs through the US SEC's registration process.

Finally, in Canada, both the OSFI and the Ontario Securities Commission (OSC) use credit ratings in their LRSPs for asset identification/categorisation purposes, for example, in OSFI LRSPs determining eligible collateral for securities lending loans²⁴ and OSC LRSPs establishing money market fund investment guidelines.²⁵

2. Insurance sector

In the United States, many state insurance laws describe permissible investments and/or concentration limits in terms of ratings and/or NAIC designations for insurance companies. For example, New York State insurance law delineates permissible investments for the portion of assets corresponding to insurance liabilities. In describing permissible investments in the obligations of American institutions (other than an insurance company), the law

²¹ The UCITS Directives are a set of European Union directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state. See Council Directive 85/611/EEC of 20 December 1985 (as amended by Directives 2001/107/EC and 2001/108/EC) on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) OJL 375, 31.12.1985, p. 3–18.

²² Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions (Official Journal L 79, 20.3.2007, p. 11–19, Official Journal L 56 M, 29.2.2008, p. 134–142).

²³ See Articles 6 and 10.

²⁴ Guideline B-4 Securities Lending - P&C Companies (Sept 1996).

²⁵ National Instrument 81-102.

indicates that such investments are permitted as long as they meet one of several criteria. The list of criteria makes at least two references to rating agency ratings. First, investment in the obligations of American institutions are permitted if they are rated “A” or higher (or the equivalent thereto) by a securities rating agency recognised by the Superintendent of Insurance. Second, such investments are permitted if such obligations are insured and, after considering such insurance, are rated “Aaa” (or the equivalent thereto) by a securities rating agency recognised by the Superintendent of Insurance.²⁶ In addition, some state insurance laws provide limitations on the types of obligations that financial guarantee insurance companies can insure. For example, New York State insurance law provides that an insurer may insure municipal obligation bonds that are not investment grade so long as at least 95 percent of the insurer’s aggregate net liability is investment grade.²⁷

In Japan, insurance regulations restrict the concentration of non-DRA rated assets to specific ratios calculated under the Insurance Business Law²⁸ and the Ordinance for Enforcement of Insurance Business Law.²⁹ Ratings are also used in the German insurance sector for asset identification as one possible criterion to determine the safety of the asset.

C. Securitisations and covered bond offerings³⁰

1. Banking and securities sectors

A significant number of respondents indicated that their LRSPs addressing securitisations and/or covered bond offerings used credit ratings, generally by requiring that securitisations offered to investors be rated by one or more credit rating agencies. The breadth of the use of credit ratings in member authorities’ LRSPs addressing securitisations varied, with some covering all securitisations and other covering only certain identified types of securitisations (eg, in Italy, only where securities are sold to non-professional investors). The UK FSA noted that ECAI ratings are used to determine the credit quality of a firm’s securitisations positions. It also noted that with regard to the “covered bond” regime, it may consider whether the counterparty has an appropriate credit rating in considering whether an asset pool is of sufficient quality. In the United States and Canada, a number of banking and securities LRSPs governing asset-backed instruments reference external ratings.

2. Insurance sector

No respondent stated that credit ratings are used in the insurance sector regulation specifically with regard to securitisations.

In practice, supervision of insurance companies necessarily takes into consideration credit ratings if insurance companies invest in or guarantee securitisation products.

²⁶ Article 14, Section 1404 a (2) (A). Note that the two criteria highlighted are only a portion of a longer list.

²⁷ Article 69, Section 6904 (b)(2).

²⁸ Art. 97-2(1), Art.199.

²⁹ Art. 48(1)(iv), Art.140(1)(iv).

³⁰ “Securitisations” generally refers to the process of pooling assets and issuing securities representing interests in that pool of assets. “Covered bonds” are debt securities issued by banks and other credit institutions, the repayment of which is secured by a ring-fenced pool of assets backing the bond.

D. Disclosure requirements

1. Banking and securities sectors

A significant number of respondents indicated that credit ratings were used in their LRSPs regulating disclosure. Such usage fell into two broad categories: requirements and exemptions. A number of respondents indicated that their LRSPs required rated entities to disclose their ratings as well as to disclose when such ratings were changed (or when they believed changes were imminent). Others noted that their disclosure LRSPs contained exceptions for credit rating agencies, eg, explicitly exempting credit ratings from requirements to disclose certain documents such as pre-sale reports.

Several jurisdictions identified unique disclosure requirements. For example, in Japan, the JFSA requires ECAs to disclose certain information regarding the securitisation exposures for credit ratings to be eligible under the Basel II framework (eg, rating criteria, rating transition matrix, and transaction-specific information).

2. Insurance sector

In Japan, DRA ratings are used to determine which disclosures must be made with regard to certain re-insurance contracts.³¹

E. Prospectus eligibility

Several respondents indicated that credit ratings play a role in their LRSPs governing prospectuses for securities offerings. For example, certain types of prospectuses, such as “short form” prospectuses, include an investment grade rating as one of the criteria for eligibility to use the form.

Among EU jurisdictions, the UK FSA noted that in the United Kingdom, there are no references to credit ratings with regard to prospectuses for equities. For debt instruments, however, the prospectus must disclose the credit ratings assigned to an issuer or its debt securities at the request or with the cooperation of the issuer in the rating process. Italian legislation allows, in certain instances, the sale of investment grade public bonds issued by OECD States and originally placed with qualified investors without the use of a prospectus.³²

In the US and Canada, the US SEC and OSC each have a number of LRSPs referring to credit ratings in the context of prospectus requirements, for example, their regulations governing the use of short-form prospectuses in securities offerings.³³

In Japan, issuers can use the “reference system” of the securities registration statement and the shelf registration system for the public offering of corporate bonds if they meet certain requirements, including that they are rated by DRAs.

³¹ Insurance Business Law Art.111(1) and the Ordinance for Enforcement of Insurance Business Law Art. 59-2(1)(iii)(c).

³² Legislative Decree No. 58 24 February 1998 (Article 100-bis, part. 4) - Consolidated Law on Finance pursuant to Articles 8 and 21 of Law 52 of 6 February 1998.

³³ Securities Act Form S-3 (17 CFR 239.13), National Instrument 44-101.

F. Other

A handful of respondents identified LRSPs allowing the use of external credit ratings as an input for an entity's own internal ratings. An equal amount cited LRSPs that use credit ratings for the purpose of stress tests to gauge credit risk.

Other uses of credit ratings in LRSPs included: the segregation/custody of customer funds; permissible activities of banks; soundness assessments for banks; as proxies for non-credit forms of risk, such as liquidity; and the designation of eligible collateral.

The German BaFin noted a specific provision of law that references credit ratings with regard to an appraisal of creditworthiness in the securities sector. In particular, a prime broker is permitted to have custody of hedge fund assets if, among other things, it has an appropriate level of "creditworthiness."³⁴ The BaFin requires, inter alia, credit ratings in order to determine if such broker is sufficiently creditworthy.

III. Member assessments and initiatives

As noted in the introduction, the questionnaire submitted to member authorities requested a description of their assessments, if any, of unintended implications of the use of credit ratings in LRSPs. The questionnaire included specific questions as to whether the use of credit ratings has had the effect of implying an endorsement of such ratings and/or rating agencies or discouraging investors from performing their own due diligence. In addition to answering these questions, members provided the working group with information concerning a number of initiatives relevant to both such an assessment and the future use of credit ratings in LRSPs.

A. Assessments on the impact of the use of credit ratings in LRSPs

No respondent reported that it had conducted a comprehensive, formal assessment of the impact of the use of credit ratings in LRSPs on investor behavior. Nonetheless, many offered their views on the question. In general, respondents were split as to whether their use of credit ratings and/or reference to credit rating agencies has had the effect of implying an endorsement of such ratings and/or agencies, although a slight majority answered in the affirmative.

Respondents answering in the affirmative were generally cautious in their analysis with only a small minority providing an unconditional affirmative response. Several respondents whose LRSPs use the term ECAI noted that while Basel II's introduction of the term was merely meant to be in line with market practice concerning the use of credit ratings issued by major credit rating agencies, the designation of those agencies as ECAs may have reinforced the tendency of the marketplace to rely on the ratings excessively. In addition, a small number of respondents noted that the eagerness of some smaller credit rating agencies to obtain the ECAI designation implied a perception that the designation carried an endorsement effect.

Several respondents indicated some additional possible unintended consequences of the use of credit ratings in LRSPs. Some respondents noted that the use of credit ratings in LRSPs could lead to increased demand for highly rated instruments issued by off-balance

³⁴ See section 112 para 3 InvG (legislation).

sheet entities, as the use of credit ratings in LRSPs may have “officialised” credit ratings for those instruments and therefore made such highly rated investments more desirable. One respondent suggested that the use of credit ratings in LRSPs may have led to increased barriers to entry for the credit rating industry, as the possible endorsement effect of designating certain credit rating agencies in LRSPs could have negative business effects on agencies not so designated. Another respondent noted that the use of credit ratings in LRSPs may have resulted in an amplified perception of credit risk as predominant, resulting in reduced attention to other kinds of risk, in particular liquidity and market risks. Finally, one respondent suggested a possible “relaxing effect” on financial institutions’ internal assessment procedures, as firms may have placed too much reliance on external ratings in lieu of performing their own thorough due diligence of investment opportunities.

Respondents expressing a belief that their use of credit ratings and/or reference to credit rating agencies in LRSPs has not had any untended “endorsement” effects, generally stressed the purely technical nature of their LRSPs’ use of credit ratings. Several respondents indicated that their ECAI recognition/designation process was based purely on the verification of a credit rating agency’s compliance with published criteria and thus did not imply any endorsement. In addition, a majority of respondents expressed their belief that their use of credit ratings and/or reference to credit rating agencies did not discourage investors from performing their own due diligence. Several respondents indicated that while there may have been investor over-reliance on credit ratings, it was not clear whether the use of credit ratings in LRSPs played a material part in such over-reliance.

B. New Initiatives relating to credit ratings

1. Banking and securities sector

The US SEC noted that it has issued proposed rule amendments that would eliminate references to NRSROs and their ratings from most of its LRSPs, stating that by doing so, it would “remove any appearance that the Commission has placed its imprimatur on certain ratings.” The OSC indicated that it was in the process of considering replacing the word “approved” in its LRSPs employing credit ratings with the word “designated” in order to “avoid misconceptions regarding regulatory endorsement of credit ratings or credit rating agencies.” The OSC also noted that the Canadian Securities Administrators have published a paper for consultation (until February 2009) that seeks to reduce reliance on credit ratings in Canadian securities legislation by considering possible alternatives to the use of credit ratings or removing the references to credit ratings.³⁵

On July 31, 2008, the European Commission (EC) published two working documents for consultative purposes. The first document sought public views on a draft proposal for a regulation with respect to the authorisation, operation and supervision of credit rating agencies.³⁶ Following the public consultation, the EC adopted the proposal on November 12, 2008, in the hope that the Council of the European Union and the European Parliament would adopt the final proposal before the next European Parliament elections in June 2009.

³⁵ Among other things, the proposal would also (1) implement a regulatory framework applicable to credit rating agencies that would require compliance with the IOSCO code of conduct - essentially a comply or explain requirement; (2) require disclosure of all information provided by an issuer to a credit rating agency and used by the credit rating agency in determining and monitoring ratings (the framework being considered would define approved credit rating agencies as NRSROs); and (3) amend the current short term debt exemption to make it unavailable for distributions of asset backed short term debt.

³⁶ The full text of the proposal is available at:
http://ec.europa.eu/internal_market/securities/agencies/index_en.htm.

The main objective of the EC proposal is to ensure that ratings are reliable and accurate pieces of information for investors. Credit rating agencies will be required to deal with conflicts of interest, have sound rating methodologies and increase the transparency of their rating activities. The proposal also introduces a registration and surveillance procedure for credit rating agencies whose ratings are used by credit institutions, investment firms, insurance, assurance and reinsurance undertakings, collective investment schemes and pension funds within the EU.

The second document, of particular relevance to the Joint Forum's project, identifies in broad terms the references made to ratings in the existing EU legislation and looks at possible approaches to the potential problem of excessive reliance on ratings.³⁷ The EC proposed three possible (but not mutually exclusive) approaches: (1) require regulated and sophisticated investors to rely more on their own risk analysis, especially for (relatively) large investments; (2) require that all published ratings include 'health-warnings' informing of the specific risks associated with investments in these assets; and/or (3) examine the regulatory references to credit ratings and revisit them as necessary.³⁸

In August 2008, the JFSA added new supervisory "checkpoints" for financial institutions in order to avoid uncritical reliance on credit ratings when contemplating investment in structured products. The checkpoints seek to encourage an understanding of rating methodologies and relevance (eg, what does the rating really mean for purposes of the investment?) as well as establishing better risk management functions within the organisations. Since April 2008, in order to meet the checkpoint for the sales of securitisation products, the JFSA ensures that distributing institutions are effectively carrying out the collection, risk valuation and disclosure of the underlying securitised assets, as well as assessing the risk factors associated with securitised products without relying solely on credit ratings. The JFSA's Financial System Council has pointed out the necessity to review the use of DRA credit ratings for the purpose of the reference system and the shelf registration system for public offerings of corporate bonds.

In December 2008, the JFSA's Financial System Council has also reported that credit rating agencies should be regulated under the framework of the registration system.

2. Insurance sector

Under current LRSPs, US insurers ceding to reinsurers must obtain collateral from non-US licensed reinsurers in order to reflect the statutory accounting credit for reinsurance, but no collateral is required when ceding to US licensed reinsurers. Florida recently promulgated rules allowing ceding insurers to take full credit for reinsurance with reduced collateral for reinsurance placed with financially strong foreign reinsurers from qualifying jurisdictions. In this rule, a preliminary filter, not an absolute criterion, is based on acceptable ratings from recognized rating agencies. New York is finalizing a similar rule. Within the frameworks, the reinsurer's credit ratings serve as a maximum cap on the amount of collateral reduction that is available; further analysis and due diligence can, for a given rating for a specific reinsurer, increase the amount of required collateral.

³⁷ The full text of the consultation paper is available at:
http://ec.europa.eu/internal_market/consultations/docs/securities_agencies/consultation-overreliance_en.pdf.

³⁸ The comment period on both consultative papers ended on September 5, 2008. The proposal to regulate credit rating agencies (Article 34), as adopted by the EC on November 12, 2008, requests the Commission to submit in [3 years] after the entry of the regulation into force a report to the European Parliament and the Council of the European Union that would assess the application of the regulation, including an assessment of the reliance on credit ratings in the EC.

On a broader scale in the United States, a new *Reinsurance Regulatory Modernisation Framework* has been adopted by the NAIC's Reinsurance Task Force. This framework, which is subject to ratification by the NAIC, would change the manner and extent to which US ceding companies³⁹ can reflect offsets in their statutory financial statements for reinsurance ceded.

Under the proposed framework, reinsurers (both US and non-US) will be assigned to one of five rating categories determined by US insurance regulators based on a number of factors, similar to the New York and Florida frameworks. Importantly, one of those factors is the reinsurer's financial strength rating provided from a recognized credit rating agency. In particular, the lowest rating received by the rating agencies will be used by the regulators to establish the maximum rating of a reinsurer (eg, the maximum amount of collateral reduction).⁴⁰ The assigned rating category determines the extent to which the reinsurer is required to collateralise its obligations in order for US cedants to take credit for that reinsurance.⁴¹

In July 2007, the EC proposed a revision of EU insurance law that would replace 14 existing directives with a single directive designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers. Under the new system, known as Solvency II, insurers would be required to take account of all types of risk to which they are exposed and to manage those risks more effectively. In addition, insurance groups would have a dedicated 'group supervisor' that would enable better monitoring of the group as a whole. In February 2008, the EC published an amended proposal.⁴² The EC's goal is to have the new system in operation by 2012.

Currently, there are no references to external credit ratings or ECAs in the latest Directive proposal. The most recent (fourth) draft Quantitative Impact Study (QIS4),⁴³ however, would use credit ratings as a proxy for financial strength.⁴⁴ As this remains a work in progress, however, it is unclear what the final capital requirements will be. The precise design of capital requirements in Solvency II, including the possible counterparty default risk capital charge, will be set out in the future level 2 implementing measures to be developed by end 2010.

A more detailed description of the possible use of credit ratings in the future Solvency II framework is provided in Appendix 3.

³⁹ A "ceding" company refers to an insurance company that transfers a risk to an insurance or reinsurance company.

⁴⁰ Other criteria used by the regulators includes (among several other items) the business practices of the reinsurer in dealing with its ceding insurers, the reinsurer's reputation for prompt payment and a review of the reinsurer's financial statements in the NAIC required format.

⁴¹ The proposal calls for federal enabling legislation to facilitate incorporation of the concepts of mutual recognition and reciprocity into the by eliminating any legal concerns with respect to inclusion of these concepts under a state-based implementation approach.

⁴² See: http://ec.europa.eu/internal_market/insurance/docs/solvency/proposal_en.pdf.

⁴³ See: http://ec.europa.eu/internal_market/insurance/docs/solvency/qis4/technical_specifications_2008_en.pdf.

⁴⁴ In the current draft, credit ratings would be used mainly to compute the capital requirements of different risks, ie, the market spread risk and market risk concentrations risk in the Solvency Capital Requirement (SCR) market risk module, and the counterparty default risk in the SCR counterparty risk module.

IV. Conclusion

The stocktaking of the use of credit ratings in the legislation, regulations, and/or supervisory policies (ie, LRSPs) of the 26 agencies, representing 12 different jurisdictions, that delivered responses to JFRAC's questionnaire reveals a wide spectrum of use. Member authorities' responses displayed significant variations both in the breadth and number of the LRSPs referring to credit ratings as well as in the categories of LRSPs in which they were used.

In general, in the jurisdictions covered by the survey, credit ratings are used predominantly in LRSPs in the banking and securities sectors, with more limited use in insurance sector LRSPs. Geographically, the North American LRSPs used references to credit ratings – specifically, to credit ratings issued by NRSROs – significantly more than in the LRSPs of the EU, Australia, and Japan. In addition, US and Canadian LRSPs had more in common with one another, while the LRSPs of the EU, Australia, and Japan shared similarities to one another.

Notwithstanding the general differences in the way credit ratings are used in the LRSPs of the member authorities that responded to the questionnaire, the survey revealed notable similarities among the respondents as well. The category of determining regulatory capital clearly displayed the broadest extent of the use of credit ratings in LRSPs, both in numbers of LRSPs and in the number of jurisdictions in which they are used. The second most significant category of use was identifying or classifying assets, usually in the context of eligible investments or permissible asset concentrations. The remaining major categories of use were providing a credible evaluation of the risks associated with assets purchased as part of a securitisation offering; determining disclosure requirements; and determining prospectus eligibility.

While no member authority had conducted a formal assessment of the impact of the use of credit ratings in LRSPs on investor behavior, almost all appear to have considered the issue. Respondents were split as to whether their use of credit ratings and/or reference to credit rating agencies has had the effect of implying an endorsement of such ratings and/or agencies; however, a slight majority answered in the affirmative.

Finally, as noted above, the US, Canada, the EU, and Japan are considering proposals that may lead to various changes in the use of credit ratings in the LRSPs of those jurisdictions.

Appendix 1

Definitions of key terms

The terms “credit rating” and “credit rating agency” are defined only by a minority of respondents, primarily in regulations (with the US SEC defining both terms in legislation). Several respondents noted that the definitions were “implicit” in their regulations or that familiarity with the terms is understood.

The two most significant related terms for subsets of “credit rating agencies” are the US SEC’s “nationally recognised statistical rating organisation” (NRSRO) and Basel II’s “external credit assessment institution” (ECAI). “NRSRO” is defined in US legislation, and that definition is cross-referenced extensively in US regulations as well as the Ontario Securities Commission’s definition of “rating organisation.” While Basel II sets forth criteria to be used by national supervisors for the “recognition” of ECAIs, it does not contain a definition of the term. Almost half of the respondents referenced the term “ECAI” in their responses to this question, with several referencing the Basel II framework and/or the Committee of European Banking Supervisors (CEBS) “Guidelines on the recognition of External Credit Assessment Institutions” (CEBS Guidelines) as well. A small minority indicated that their LRSPs include an explicit definition of the term “ECAI.” For instance, under the Australian prudential standards, an ECAI is defined as “an entity that assigns credit ratings designed to measure the creditworthiness of a counterparty or certain types of debt obligations of a counterparty.”

The Markets in Financial Instruments Directive (MiFID) includes the term “competent rating agency” as one that “issues credit ratings in respect of money market funds regularly and on a professional basis and is an eligible ECAI within the meaning of Article 81(1) of Directive 2006/48/EC.” Article 81(1) is contained with the EU Capital Requirements Directive (CRD) that implements the Basel II framework and, consistent with that framework, does not define an ECAI, but instead sets forth criteria for the recognition of eligible ECAIs. Specifically, Article 81 states that “Competent authorities shall recognise an ECAI as eligible ... only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.”

The term “investment grade” and its variants (eg, “non-investment grade”) are also defined by almost half of the respondents, with those definitions almost evenly divided between those that define the term by reference to specific ratings from specified entities (eg, at or above a Baa rating from Moody’s) and those that define it by reference to categories of ratings and/or entities (eg, rated in one of the four highest categories by an NRSRO).

Other related terms included subsets of credit ratings such as “approved ratings,” “applicable external ratings,” and “credit rating grades” as well as subsets of credit rating agencies such as “approved rating organisations” and “designated rating organisations.” One respondent defined the terms “solicited rating” and “unsolicited rating.”

The US SEC’s definition of the term “NRSRO” is cross-referenced in a number of US banking regulations as well as several Canadian securities regulations.

As noted above, almost half of the respondents referenced the term “ECAI” in their responses to question I.A.2, with several referencing the Basel II framework and/or the Committee of European Banking Supervisors (CEBS) “Guidelines on the recognition of External Credit Assessment Institutions” (CEBS Guidelines) as well. While the majority of

respondents clarified their implementation of Basel II, in several cases the responses were unclear on this point.

The majority of respondents indicated that their LRSPs reference specific credit rating agencies. All but one of those respondents mentioned Moody's Investors Service, Standard & Poor's Ratings Services, and Fitch Ratings, with the exception being a US OTS regulatory bulletin, which referenced the former two entities only. DBRS Limited and Japan Credit Rating Agencies were each cited by several respondents, while Rating and Investment Information, Inc., Mikuni & Co., Fedafin AG1, and AM Best were each cited by one respondent.

In several cases, it was unclear as to whether a respondent was indicating that individual credit rating agencies were mentioned directly in an LRSP, (eg, "approved rating organisation" means each of DBRS Limited, Fitch Ratings Ltd., Moody's Investors Service, Standard & Poor's and any of their successors.) or that the LRSP used a term generally, with a list of credit rating agencies meeting the criteria for that term contained elsewhere (eg, "Investment grade corporate debt security shall mean any security that...is rated in one of the four highest ratings categories by at least one Nationally Recognised Statistical Ratings Organisation.")

Several respondents indicated that the individual credit agencies listed are formally reviewed on a regular basis, in some cases on a fixed schedule (ie, annually or every five years). Several others noted that the Basel II and/or CEBS designation procedures for ECAIs also applied to the removal of the ECAI designation. Finally, a number of respondents indicated that their LRSPs naming individual credit rating agencies could be amended through their jurisdiction's standard legislative or regulatory process.

The majority of respondents cited the ECAI designation procedures set forth in Basel II as the basis for their selection of the specific entities, with several referencing the CEBS Guidelines as well. The US SEC cited its 2007 regulations establishing a voluntary registration program for NRSROs. Several other respondents referred to industry consultation or widespread market use as the basis for their use of specific agencies in LRSPs.

Appendix 2

Structural overview of Basel II

The different uses of external credit ratings

This section does not aim at being exhaustive but rather at explaining the main usages of ratings.

Pillar I (Minimum Capital Requirements)

Credit risk

Credit ratings are widely used for the calculation of capital charges for credit risk in order to differentiate the exposures in a risk-sensitive manner and set the capital charges accordingly. External and/or internal ratings might be used under the revised framework, but as a general principle, Basel II promotes the use of internal ratings, in the context of the internal ratings based approach.

Under the **Internal-Rated based Approach**, the risk sensitivity of the regulatory capital requirements is attained through the use of internally produced credit ratings models for all the different exposures class (sovereign, bank, corporate, retail and equity). External ratings are not supposed to be used for the calculation of capital charges (with the exception of securitisation exposures –see below). However, the implementation of the IRB approach might result in some marginal indirect uses of external ratings; the main use is within the area of models validation in, for instance, benchmarking exercises.

Consequently, external ratings are primarily used in the context of the **standardised approach**. In the standardised Approach, the risk sensitivity of the regulatory capital requirements is attained through the recourse to external credit ratings for exposures within the corporate, sovereign and bank exposure class. Institutions may only use the external ratings provided by rating agencies recognised by supervisors (see. Section 4 below), with the exception of exposures to sovereign where banks might directly use the ratings provided by export credit agencies.

In practice, the risk weights applied to sovereign, banks and corporate exposures are differentiated according to the individual external credit assessment of each exposures. The Basel II framework provides tables that pre-map regulatory determined risk-weights to sets of credit ratings scales from authorised rating agencies, enabling the simple determination of an exposure's risk weight (tables mapping external ratings and risk-weights are specific to each exposure class). For example, for corporate exposures, the risk weights applicable might vary from 20 percent to 150 percent depending on the credit assessment of the exposure (see table below), whereas under the Basel 1 framework a 100% risk-weight was applied to all corporate exposures.

| | | | | | |
|--------------------------|-------------|----------|-------------|-----------|---------|
| Credit assessment | AAA to AAA+ | A+ to A- | BBB+ to BB- | Below BB- | Unrated |
| Risk Weight | 20% | 50% | 100% | 150% | 100% |

(Extract from paragraph 66 of the Revised Framework)

Credit risk mitigation rules define how funded credit protections (collateral) and unfunded credit protections (guarantees and credit derivatives) can be recognised. They are applicable to the standardised approach and to some extent to the IRB foundation approach. Credit risk mitigation rules refer to authorised external ratings in order to:

- Identify the eligible credit protection (for example, only the guarantees provided by an entity with a rating higher than a predetermined threshold might be recognised)
- Adjust the extent of the recognition of the credit protection (for example, haircuts proportionate to the credit quality of the issuer are applied to collateral under the comprehensive approach).

The **securitisation framework** differs from the general credit risk rules in the way that both the standardised and the IRB approach use authorised external credit ratings.

- For banks using the standardised Approach, the risk sensitivity of the regulatory capital requirements is attained through the recourse to authorised external credit ratings for the subset of authorised securitisation transactions.
- For banks using the Internal Ratings based Approach, the risk sensitivity of regulatory capital requirements is attained through the recourse to authorised external credit ratings within the Ratings-based approach and to a lesser extent within the Internal Assessment Approach, and through a regulatory setting within the SF (Supervisory formula) when credit ratings cannot be inferred.

The prescribed long term and short term tables that pre-map regulatory determined risk-weights to sets of credit ratings scales from authorised ECAs for the standardised and the IRB approaches differ; the IRB table is more granular and its risk weights are different from that of the standardised approach.

Market risk

When considering market risk measurement, external ratings are only used for the calculation of the **specific risk capital charges** arising from debt position under the standardised approach for market risk.

In a way similar to what is done within the frame of the credit risk rule, different risk weights are applied to the trading book debt positions according to the external ratings of the issuer. The rules on specific risk also refer to a notion of *qualifying category*, which is notably (but not only) based on its turn on the fulfilment of attaining an “*investment-grade*” credit rating from credit rating agencies.

Under the Internal Model Approach, the risk sensitivity of regulatory capital requirements is attained through the use of internally designed risk management models that are subject to supervisory approval. Given that these models usually focus on general market risk, the treatment of the capital charge for the area of specific risk measurement will be made separately if the internally designed models do not encompass on top a modelling of specific risk. A fallback on authorised external credit ratings is possible, or else a broader treatment within the Incremental Risk Capital charge.

Operational risk

Under all the different approaches used to measure operational risk, there is no use of external ratings, with the exception of the treatment of risk mitigation techniques in the Advanced Measurement Approach (in line with the overall treatment of risk mitigation

techniques under the credit risk rules, the protection provider must have a rating above a defined threshold).

Pillar II (Supervisory Review Process)

There is no specified use of external ratings in the context of the Supervisory review process.

Pillar III (Market Discipline)

Pillar III requirements contain specific qualitative disclosure requirements (among others) with respect to the use of external credit assessment institutions (ECAIs) and Export Country Agency (ECAs).

- Credit Risk: *Disclosures for Portfolios subject to the standardised and supervisory risk weights in the IRB approaches (see table 5 of the Revised Framework)*. Qualitative disclosure (a) Names of ECAIs and ECA used, types of exposures for which each ECAI, ECA is used, alignment of alphanumerical scale with each bucket or evidence of compliance with the mapping published by relevant supervisors.
- Securitisation: *Disclosure for standardised and IRB Approaches (see table 9 of the Revised Framework)*. Qualitative disclosure (c) Names of the ECAIs used for securitisation and types of securitisation exposures for which each agency is used.

Authorised external ratings and the notion of “ECAI” (External Credit Assessment Institution)

Definition of ECAI and the principle of the “recognition”

External ratings that can be used for the capital purposes, according to the Basel II framework, are limited to the ratings provided by recognised External Credit Assessment Institutions (ECAI). Supervisors are in charge of the recognition of ECAI.

The ECAI recognition process has two main dimensions:

- Identification of the rating agencies that provide external ratings suitable for capital calculation purposes. The BCBS has defined criteria in this respect (see. 4.1 below) and supervisors are in charge of assessing whether those criteria are satisfied by the rating agencies willing to be recognised as ECAI.
- Mapping of the external ratings to the risk-weights (or credit quality steps in the EU CRD implementation) defined by the Basel II framework (see. 4.2 below)

The ECAI recognition process does not constitute a form of regulation of ECAIs by supervisors or a form of licensing of rating agencies. It simply aims at the determining the ratings that can be used by banks, by ensuring that the ratings are appropriate for supervisory and capital purposes.

Eligibility criteria

The key purpose of the recognition criteria is to identify rating agencies that produce external credit assessments of sufficiently high quality, consistency and robustness to be used by institutions for regulatory capital purposes. In order to achieve this goal, the Basel Committee

on banking supervision has defined criteria that should be satisfied by rating agencies. Paragraph 91 of the Basel II framework details those criteria:

- **Objectivity:** The methodology for assigning credit assessments must be rigorous, systematic, and subject to some form of validation based on historical experience. Moreover, assessments must be subject to ongoing review and responsive to changes in financial condition. Before being recognised by supervisors, an assessment methodology for each market segment, including rigorous backtesting, must have been established for at least one year and preferably three years.
- **Independence:** An ECAI should be independent and should not be subject to political or economic pressures that may influence the rating. The assessment process should be as free as possible from any constraints that could arise in situations where the composition of the board of directors or the shareholder structure of the assessment institution may be seen as creating a conflict of interest.
- **International access/Transparency:** The individual assessments should be available to both domestic and foreign institutions with legitimate interests and at equivalent terms. In addition, the general methodology used by the ECAI should be publicly available.
- **Disclosure:** An ECAI should disclose the following information: its assessment methodologies, including the definition of default, the time horizon, and the meaning of each rating; the actual default rates experienced in each assessment category; and the transitions of the assessments, eg the likelihood of AA ratings becoming A over time.
- **Resources:** An ECAI should have sufficient resources to carry out high quality credit assessments. These resources should allow for substantial ongoing contact with senior and operational levels within the entities assessed in order to add value to the credit assessments. Such assessments should be based on methodologies combining qualitative and quantitative approaches.
- **Credibility:** To some extent, credibility is derived from the criteria above. In addition, the reliance on an ECAI's external credit assessments by independent parties (investors, insurers, trading partners) is evidence of the credibility of the assessments of an ECAI. The credibility of an ECAI is also underpinned by the existence of internal procedures to prevent the misuse of confidential information. In order to be eligible for recognition, an ECAI does not have to assess firms in more than one country.

The mapping process

Once it has been assessed that a rating agency meets the ECAI recognition requirements, its credit assessments are 'mapped' by supervisors to the risk weights (credit quality steps) defined by the Basel II framework, which in turn determines the risk weight (amount of capital) to be applied to each exposure.

The 'mapping' is notably based on reference default rates (in particular the 3-year cumulative default rates evaluated over the long-term), which should ensure the stability of the mapping but also an equivalent treatment of the ratings provided by the various rating agencies. Annex 2 of the Revised Framework details the mapping process.

European specific aspects

The uses of external ratings in the CRD (Capital Requirements Directive - the European implementation of the Basel II framework) is fully consistent with the international rules. Nevertheless, two significant differences can be observed :

- in the context of the standardised approach, external ratings can also be used to risk-weight exposures to CIUs (Collective Investment Units). Specific risk-weights are provided for this exposure class.
- The risk-weight tables, that link credit assessment to risk-weight, are generally more granular.

The CEBS (Committee of European Banking Supervisors) issued in January 2006 “Guidelines on the recognition of External Credit Assessment Institutions” which:

(i) *Clarify the recognition process at the European level, by :*

- Defining a standard application form, that should be submitted to supervisors by rating agencies willing to be recognised. The content of the package should allow supervisors to assess the application.
- Creating a joint assessment process, applicable to international ratings agencies (or ratings agencies operating in more than one country).

(ii) *Present CEBS Common understanding of the ECAI recognition criteria laid down in the CRD*

A rating agency can become a recognised ECAI if a member state supervisor determines that it meets the following criteria in one or all of the three market segments (financial institutions, corporate (includes public sector) and securitisations):

- Objectivity – methodology for assigning credit assessments is systematic, rigorous, continuous, and subject to validation.
- Independence – factors taken into account include ownership and organisational structure, financial resources, staffing and expertise, and corporate governance.
- On-going review – responsive to changes in financial conditions and reviewed at least annually.
- Transparency & disclosure – methodologies need to be public so users can decide whether they are derived in a reasonable way.

In addition their credit assessments had to be:

- Credible and accepted by the market – market share, revenues, whether pricing is on the basis of credit assessments.
- Transparent & disclosed - credit assessments need to be available on an equivalent basis.

(iii) *Precise the qualitative and quantitative factors that should be used by supervisors when mapping external ratings and regulatory credit quality steps.*

Appendix 3

Use of credit ratings in the future “Solvency II” European Insurance regulatory framework

The future “Solvency II” European Insurance regulatory framework is work in progress. The Solvency II Directive Proposal is principles-based and does not refer directly or indirectly to rating agencies. However, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in cooperation with the European Commission is already working on the future implementing measures through its Quantitative Impact Studies. Information about the possible use of credit ratings in this future framework can be found in the QIS4 Technical specifications published on 31 March 2008.⁴⁵ Please note that this is not a final text.

In the latest draft, credit ratings are used to calculate the Solvency Capital requirement (SCR) which is one of the two capital requirements introduced in the Solvency II framework. The MCR (Minimum Capital Requirement) and technical provisions do not use credit ratings.

The SCR could be calculated in two ways, either through an internal model or through a standard formula. The use of credit ratings in internal models is not mentioned either in the Directive Proposal nor in QIS4 – the Directive Proposal leaves great freedom to firms in the way they elaborate their model. QIS4 details the standard formula. In the SCR calculated through the standard formula, it is suggested that credit ratings be used to calculate Market risk and Counterparty default risk. In the Market risk, credit ratings would be used to compute the spread risk and concentration risk.

Credit ratings are also likely to be used to assess the adequate credit quality of the providers of financial risk mitigation, in order to guarantee with appropriate certainty that the insurer will receive the protection in the cases specified by the contracting parties (only financial protection provided by entities rated BBB or better is likely to be considered in the assessment of SCR).

The following text summarises some of the key features of the framework that are being suggested in the QIS4 Technical specifications published on 31 March.

1. Use of credit rating in the SCR market risk module of the standard formula

Spread risk:

This module is intended to be applicable to bonds, to all tranches of structured credit products like asset-backed securities and collateralised debt obligations, and would further cover credit derivatives eg credit default swaps (CDS), total return swaps (TRS), credit linked notes (CLN), that are not held as part of a recognised risk mitigation policy. It would exclude government bonds (borrowings by the national government, or guaranteed by the national government, of an OECD or EEA state, issued in the currency of the government) as well as assets allocated to policies where the policyholders bear the investment risk.

⁴⁵ QIS4 Technical specifications are available at <http://www.ceiops.eu/content/view/118/124/>

For the purposes of determining the SCR for spread risk, companies would need to assume the more onerous (in aggregate) of a rise or fall in credit spreads. The following input information would be required :

- the external rating of credit risk exposure i ($rating_i$),
- the modified duration of credit risk exposure i (dur_i), and
- the credit risk exposure i as determined by reference to market values (exposure at default MV_i).

In cases where several ratings are available for a given credit exposure, generally the second-best rating would be applied.

The capital charge for spread risk is determined as the sum of the capital charge for spread risk of bonds, structured credit products, and credit derivatives. The capital charge for spread risk of bonds will likely be determined as follows:

$$Mkt_{sp} = \sum_i MV_i \cdot m(dur_i) \cdot F(rating_i) + \Delta Liab_{ul} ,$$

where $F(rating_i)$ is a function of the rating class of the credit risk exposure which is calibrated to deliver a shock consistent with VaR 99.5%, $m(dur_i)$ a function of the duration of the credit exposure, and $\Delta Liab_{ul}$ the overall impact on the liability side for policies where the policyholders bear the investment risk with embedded options and guarantees of the stressed scenario, with a minimum value of 0.

The capital charge for spread risk of structured credit products would be based on a similar method. For collateralised debt obligations, companies would need to ensure that the rating reflects the nature of the underlying risks associated with collateral assets.

For credit derivatives, the capital charge Mkt_{sp}^{cd} would be determined as the change in the value of the derivative (ie as the decrease in the asset or the increase in the liability) that would occur following (a) a widening of credit spreads by 300% if overall this were more onerous, or (b) a narrowing of credit spreads by 75% if this were more onerous. A notional capital charge would then have to be calculated for each event. The capital charge for derivatives should then be the higher of these two notional charges.

Concentration risk:

The definition of market risk concentrations would be restricted to the risk regarding the accumulation of exposures with the same counterparty. It would not include other types of concentrations (eg geographical area, industry sector etc.)⁴⁶.

It has been suggested that the following items be exempted from the application of this module:

⁴⁶ Assets which are allocated to policies where the policyholders bear the investment risk would be excluded from this risk module. However, as these policies may have embedded options and guarantees, an adjustment (calculated using a scenario-based approach) would be added to the formula to take into account the part of the risk that is effectively borne by the insurer. In case an undertaking owns shares representing more than 20% of the capital of another insurance or financial undertaking which: 1) were not included in the scope of consolidation or supplementary supervision and 2) where the value of that participation or subsidiary exceeded 10% of the participating undertaking's own funds, these shares would be exempted from the application the concentration risk module when using option 1 described in Annex SCR 1 –for the treatment of participations (deduction-aggregation method).

- government bonds(borrowings by the national government, or guaranteed by the national government, of an OECD or EEA state, issued in the currency of the government);
- bank deposits with a term of less than 3 months terms, of up to 3 million Euros, in a bank that has a minimum credit rating of AA; and
- assets allocated to policies where the policyholders bear the investment risk.

Risk exposures in assets would be grouped according to the counterparties involved. Where an undertaking had more than one exposure to a counterparty then its net exposure at default to the counterparty would be the aggregate of those exposures at default and the rating of the counterparty should be a weighted rating. All entities which belong to the same group should be considered as a single counterparty for the purposes of this sub-module. The net exposure at default to an individual counterparty would comprise the asset classes of equity and fixed income, including hybrid instruments junior debt, and CDO tranches.

Financial derivatives on equity and defaultable bonds should be properly attributed (via their 'delta') to the net exposure, ie an equity put option reduces the equity exposure to the underlying 'name' and a single-name CDS ('protection bought') would reduce the fixed-income exposure to the underlying 'name'. The exposure to the default of the counterparty of the option or the CDS would not be treated in this module, but in the counterparty default risk module. Also, collateral securitising bonds should be taken into account. Similarly, a look-through approach would need to be applied to assets representing reinsurers' funds withheld by a counterparty.

Exposures via investment funds or such entities whose activity is mainly the holding and management of an insurer's own investment need to be considered on a look-through basis. The same would hold for CDO tranches and similar investments embedded in "structured products."

The module would deliver as output the Capital charge for market concentration risk (Mkt_{conc}), either including or not the risk absorbing effect of future profit sharing.

The calculation would be performed in three steps:

- (a) an excess exposure would be calculated in reference to a concentration threshold, depending on the rating of a counterparty.
- (b) the risk concentration charge per 'name' would be calculated depending on this excess exposure by counterparty, the credit rating of each counterparty, and the amount of total assets where the insurer bears the investment risk.
(This stage also would take into account the overall impact of a stressed scenario on the liability side for policies where the policyholders bear the investment risk with embedded options and guarantees.)
- (c) the total capital requirement for market risk concentrations would be determined assuming independence between the requirements for each counterparty i.

For "names" which can only be found on the assets used as the reference to the valuation of the liabilities, the risk concentration charge per name 'i' would be calculated as follows: $Conc_i = \Delta Liab_{ul,i}$

2. Use of credit rating for counterparty default risk in the SCR Counterparty risk module of the standard formula

Counterparty default risk is the risk of possible losses due to unexpected default, or deterioration in the credit standing of the counterparties or debtors in relation to risk mitigating contracts, such as reinsurance arrangements, securitisations and derivatives, and receivables from intermediaries, as well as any other credit exposures which would not be covered in the spread risk sub-module.

For each counterparty, the counterparty default risk module should take account of the overall counterparty risk exposure of the insurance or reinsurance undertaking concerned to that counterparty, irrespective of the legal form of its contractual obligations to that undertaking. The main inputs of the counterparty default risk module would be the estimated loss-given-default (LGD) of an exposure and the probability of default (PD) of the counterparty. In relation to a counterparty of reinsurance contracts (or an SPV), the loss given default would be linked to the best estimate of recoverables from the reinsurance contract, the SCR for underwriting risks including or not the risk mitigating effect of the reinsurance contract and the collateral covering the loss in relation to the counterparty.

Collateral would not be allowed to be taken into account in the above calculation if it were held by the counterparty itself. If the collateral bore any default risk, it should be included in the module calculation like receivables from intermediaries and other credit exposures.

A factor of 50 percent would take into account the fact that even in case of default the reinsurer will usually be able to meet a larger part of its obligations.

In relation to a counterparty of financial derivatives, the loss given default would be defined with the same method but by taking into account the Market value of the financial derivative instead of the Recoverables and the SCR for Market risks instead of the SCR for underwriting risks. In relation to the intermediary risk and any other credit exposures, the loss given default would represent the best estimate of the credit to intermediaries and any other credit exposures respectively.

The overall loss-given default in relation to each counterparty would be the sum of the losses-given-default for reinsurance and SPVs, financial derivatives, and intermediary risk and other credit exposures.

A probability of default (PD) of the counterparty estimate is derived from external ratings according to a defined table.

Three steps would be performed:

- (a) calculation of the concentration in reinsurance, financial derivatives, receivables from intermediaries, as well as any other credit exposures via the Herfindahl index,
- (b) calculation of capital requirements per counterparty, and
- (c) aggregation.

The Herfindahl index for reinsurance exposure would be computed as

$$H = \frac{\sum_{i \in \text{Re}} LGD_i^2}{\left(\sum_{i \in \text{Re}} LGD_i \right)^2}$$

where the sum is taken over all reinsurance counterparties. The Herfindahl index H_{fd} , H_{int} , H_{oce} for the financial derivative exposures, the receivables from intermediaries, as well as any

other credit exposures would be computed in the same way, over all counterparties classified in the same category.

The implicit correlation for counterparty default would be calculated as:

$$R = 0.5 + 0.5.H.$$

The counterparty default risk requirement Def_i for an exposure i would be determined as follows, depending on the implicit correlation R :

- for an implicit correlation R of less than 1, the determination of Def_i would be based on the Vasicek distribution;
- for an implicit correlation R of 1, Def_i would be determined by multiplying the LGD by 100 times the PD.

Individual capital charges Def_i would be added up for reinsurance exposures, financial derivatives, and receivables from intermediaries, as well as any other credit exposures to get the capital requirement for counterparty credit risk, SCR_{def} .

In case of reinsurance ceded to an unrated reinsurer (i) part of the same group (internal reinsurance), the probability of default of counterparty i would be replaced, for the share of the reinsurance that is retroceded outside the group to a counterparty k by the probability of default of counterparty k . In this case the probability of default of counterparty i would still be used for the share of the reinsurance kept in retention by reinsurer i .

For intragroup reinsurance which does not meet the requirements specified in the previous paragraph, a regulatory rating should be used to determine the probability of default of the intragroup counterparty. The probability of default would depend on the solvency ratio (ratio of own funds and SCR) according to a predefined table. As a simplification, if it were proportionate to the underlying risk, the loss-given default for a counterparty and the counterparty default risk requirements might be determined on the level of rating classes rather than on the level of counterparties.

Appendix 4

List of respondents to questionnaire

Australia

Australian Prudential Regulation Authority (APRA)

Belgium

Banking, Finance and Insurance Commission (CBFA)

Canada

Office of the Superintendent of Financial Institutions (OSFI)

Ontario Securities Commission

France

Autorité de contrôle des assurances et des mutuelles (ACAM)

Secrétariat Général de la Commission Bancaire

Autorité des marchés financiers (AMF)

Germany

Federal Financial Supervisory Authority (BaFin)

Italy

Banca d'Italia

Consob

Japan

Bank of Japan

Financial Services Agency (JFSA)

Netherlands

De Nederlandsche Bank

Spain

Bank of Spain

Insurance Directorate

Comision Nacional del Mercado de Valores

Switzerland

Swiss Federal Banking Commission (SFBC)

Federal Office of Private Insurance (FOPI)

United Kingdom

Financial Services Agency (FSA)

United States

Board of Governors of the Federal Reserve System

Federal Reserve Bank of New York

Federal Deposit Insurance Corporation (FDIC)

National Association of Insurance Commissioners (NAIC)

Office of the Comptroller of the Currency (OCC)

Office of Thrift Supervision (OTS)

Securities and Exchange Commission (SEC)

Appendix 5

Compilation of Member Authorities' Usage of Credit Ratings

Australia

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (ie, what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
|---|---|--|---|----------------------------------|
| APS 120 Securitisation | Establishes for ADIs the regulatory capital risk weights to be applied to certain credit risk and securitisation exposures as set forth in Basel II. | Determination of authorised deposit-taking institution (ADI) (ie a bank) regulatory capital charges for securitisation and other credit exposures. | http://www.apra.gov.au/ADI/upload/Fin-al-APS-120-November-2007.pdf | Prudential Standard |
| GPS 114 | For general insurers, ratings are used to calculate regulatory capital | Determination of ADI (bank) regulatory capital charges – counterparty grades also cover other asset types and risk indicators | | Prudential Standard |
| LPS 2.04 | Solvency Standard | Determination of life insurers regulatory capital charges | http://www.apra.gov.au/Life/upload/LP-S-2-04_Nov2007.pdf | |
| LPS 3.04 | Capital adequacy Standard | Determination of life insurers regulatory capital charges | http://www.apra.gov.au/Life/upload/LP-S-3-04_Nov2007.pdf | |

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|----------|--|--|---|--|
| LPS 6.03 | Management capital standard | Determination of life insurers regulatory capital charges | http://www.apra.gov.au/Life/upload/LPS-6-03_Nov2007-2.pdf | |
| LPS 7.02 | Calculation of life insurers' Resiliency Reserve (component of minimum capital requirement addressing investment related risks) | For life insurers , the APRA counterparty grade (as defined by LPS 7.02) is used to determine the Credit Risk Default Factor and the Credit Risk Yield Movement for fixed interest and cash investments. Counterparty grades are also used to differentiate assets for which different asset concentration limits will apply. | | |

Belgium

In Belgium, the CRD and, hence, the Basel II framework, apply. Therefore, the regulations and guidance discussed below are supplemental to the CRD.

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (ie, what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (ie, why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
|---|---|---|---|----------------------------------|
| <u>Large exposure (LE) requirements</u> | Asset Identification | There currently is a specific national requirement for small institutions that establish higher (than the 25% own funds) large exposure limits for “correspondent banking” purposes. The objective of the LE requirements is to limit the counterparty concentration risk within the financial firms. | | Regulation |
| Own funds regulation | Other | Certain guidance on the supervisory assessment of the Belgian branches of non-EU financial institutions makes reference to the credit ratings of the mother company as one indicator for the assessment of capacity of the institution (or group) to bear the commitments of the branch. (guidance) Objective is to clarify how the CBFA internally assesses the risks and strength of the Belgian branch, thereby taking into account the group perspective. | | Guidance |

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| | Capital | Assessment of the firm's ICAAP, it is mentioned that the minimum confidence level, at which the solvency of the institution will be assessed, equals 99.9% which generally is equivalent to an investment grade rating. | | Guidance |
| Within own funds regulation | Capital | The notion of 'investment grade' is used in the standardized approach to allow lower risk weights than the ones defined by the risk tables on exposures to central governments and central banks, regional, local governments. The regulation allows financial institutions to apply lower risk weights if the competent authorities of the third country, with an external credit assessment of investment grade or higher, have a supervisory and regulatory scheme that is equivalent to the schemes of the EU and they treat the risk exposures to the central government and the central bank of that country at lower levels than the ones defined, they treat the risk exposures to the local and regional governments as exposures to the central government of that country. | | Regulation |
| | Asset Identification | For the assessment of the liquidity risk at a firm, a distinction of the quality of the (unencumbered liquid) financial assets (investment grade/ non-investment grade) is made based on the external ratings available for these assets. | | Regulation |

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| | Capital | For the assessment of country risk, the reporting requirements make a distinction between investment grade and non-investment grade. This distinction though can be made on the basis of the firm's own internal rating methodology. | | Regulation |
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Canada

References to credit ratings in OSFI guidance

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
|--|---|---|---|----------------------------------|
| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 2 - Definition of Capital (p. 23-25)</p> | <p>External ratings are used to assess the credit risk of an exposure. The rating determines the applicable risk weight assigned to that exposure which in turn determines the amount of required capital. Securitization exposures that are rated below a certain rating (e.g. B+) are deducted from capital rather than being assigned a risk weight.</p> <p>Capital</p> | <p>Securitization-related Deductions – Banks using the Standardized Approach [Chapter 2, Section 2.5.1.2, 2.5.2.2]</p> <ul style="list-style-type: none"> • For third party investors, 50% of investments in securitization exposures with long-term credit ratings B+ and below, and in unrated exposures • For third party investors, 50% of investments in securitization exposures with short-term credit ratings below A-3/P-3/R-3 and in unrated exposures • For originating banks, 50% of retained securitization exposures that are rated below investment grade (below BBB-), or that are unrated <p>Securitization-related deductions – banks using IRB approaches [Chapter 2, Section 2.5.1.3, 2.5.2.3]</p> <ul style="list-style-type: none"> • 50% of investments in securitization exposures with long-term credit ratings below BB- and in unrated exposures • 50% of investments in securitization exposures with short-term ratings below A-3/P-3/R-3 and in unrated short-term exposures | | <p>Guidelines</p> |

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| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 3 - Standardized Approach (p. 35-38)</p> | <p>External ratings are used to assess the credit risk of an exposure. The rating determines the applicable risk weight assigned to that exposure which in turn determines the amount of required capital.</p> <p>Capital</p> | <p>Under the Standardized approach, assessments from qualifying rating agencies are used to determine risk weights for claims on sovereigns and central banks, non-central government public sector entities (PSEs), multilateral development banks (MDBs), banks and securities firms and corporates.</p> | | <p>Guidelines</p> |
| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Annex 3 - Capital treatment for failed trades and non-DvP transactions (p. 64)</p> | <p>External ratings are used to assess the credit risk of an exposure. The rating determines the applicable risk weight assigned to that exposure which in turn determines the amount of required capital.</p> <p>Capital</p> | <p>In applying a risk weight to failed free-delivery exposures, banks using the IRB approach for credit risk may assign PDs to counterparties for which they have no other banking book exposure on the basis of the counterparty's external rating. Banks using the Advanced IRB approach may use a 45% LGD in lieu of estimating LGDs so long as they apply it to all failed trade exposures.</p> | | <p>Guidelines</p> |
| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 4 - Credit Risk Mitigation</p> | <p>In order to qualify as eligible financial collateral, debt securities must be above a certain level. In this way, only instruments of a certain quality qualify as collateral.</p> <p>Asset Identification</p> | <p>Qualifying criteria for financial collateral recognition :</p> <ul style="list-style-type: none"> o Simple approach Standardized banks o Comprehensive approach collateral haircuts [Chapter 4, Section 4.1.2 Para 151] o Own estimates of collateral haircuts [Chapter 4, Section 4.2.1 Para 154] <p>Qualifying criteria for guarantee recognition :</p> <ul style="list-style-type: none"> o Eligible Guarantees [Chapter 4, Section 4.1.5, Para 195] <p>Qualifying Criteria for recognizing double default in the IRB framework including "is regulated in a manner broadly equivalent to that in this Framework (where there is appropriate supervisory oversight and transparency/market discipline), or externally rated as at least investment grade" [Chapter 4, section 4.2 Para 307 ii]</p> | | <p>Guidelines</p> |

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| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 5 - Internal Ratings Based Approach</p> | <p>When determining their own internal ratings, institutions may take into account external ratings</p> <p>Capital</p> | <p>Assignment or internal ratings (IRB Approach) may use external ratings as a primary factor in assigning a rating to a borrower “however a bank must ensure that it considers other relevant information”. [Chapter 5, Section 5.8 Para 411]Criteria for own estimates of PD permit the use of rating agency data whereby the banks “may associate or map their internal grades to the scale used by an external credit assessment institution or similar institution and then attribute the default rate observed for the external institution’s grades to the bank’s grades.” [Chapter 5, Section 5.8.7 Para 462]Specialized lending subject to supervisory slotting criteria in the IRB approach have references to rating agency rating grades that are said to “broadly correspond” to the supervisory risk weight buckets [Chapter 5, Section 5.3 Para 276]</p> | | <p>Guidelines</p> |
| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 6 - Structured Credit Products</p> | <p>External ratings are used to determine the applicable risk weight assigned to a securitization exposure which in turn determines the amount of required capital</p> <p>Capital</p> | <p>Rating based Approach to securitization for Standardized and IRB banks maps Supervisory risk weights to agency ratings for securitization tranches [Chapter 6, Section 6.4.4 Para 611 to 616]</p> <p>Internal Assessment Approach for risk weighting unrated exposures to securitization vehicles in the form of enhancements, liquidity lines etc requires that the ABCP is rated by a rating agency [Chapter 6, Section 6.4.4 Para 620]</p> | | <p>Guidelines</p> |
| <p>Guideline A and A-1 Capital Adequacy Requirements (Nov 2007) (Banks)</p> <p>Chapter 8 - Market Risk</p> | <p>External ratings are used to determine the specific risk capital charge for market risk.</p> <p>Capital</p> | <p>Trading book Standardized Specific risk charges:</p> <ul style="list-style-type: none"> o For “qualifying securities” include a public rating as a qualifying criteria where rated investment-grade by at least two nationally recognized credit rating services, or rated investment-grade by one nationally | | <p>Guidelines</p> |

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| | | <p>recognized credit rating agency and not less than investment-grade by any other credit rating agency [Chapter 8, Section 8.10.1.1];</p> <p>o Treats Federal and provincial government securities the same but differentiates the risk weight for foreign central governments according to agency rating [see above reference];</p> <p>o Below investment grade securities receive same risk weight as banking book securities with exception of securitization exposures subject to deduction or unrated securitization enhancements or liquidity lines (where securitization rules apply) [see above reference]</p> | | |
| <p>Guideline A - Minimum Continuing Capital and Surplus Requirements (Nov 2006) (Life Insurers)</p> | <p>To determine the required capital, factors based on external ratings are used</p> <p>Capital</p> | <p>Asset Default Factors for short term securities, bonds, loans and private placements, where rated, are based on the rating agency grade. "A company must consistently follow the latest ratings from a recognized, widely followed credit rating agency. Only where that rating agency does not rate a particular instrument, the rating of another recognized, widely followed credit rating agency may be used. However, if the Office believes that the results are inappropriate, a higher capital charge would be required." [page 3-1-3]Asset Default Factors for preferred shares, where rated, are based on the rating agency grade. [page 3-1-5]Financial leases where rated, and the lease is also secured by the general credit of the lessee , asset default factor is based on the rating agency grade. [page 3-1-7]</p> | | <p>Guidelines</p> |
| <p>Guideline A-2 Branch Adequacy of Assets Test (BAAT) (January 2007) (P&C Insurers);</p> | <p>To determine the margin requirements for assets, three categories are used to assign capital factors. External ratings are used to define</p> | <p>The margin required for assets covers the potential losses resulting from asset default and the related loss of income, and the loss of market value of equities and the related reduction in income. To determine the margin</p> | | <p>Guidelines</p> |

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| <p>Guideline A Minimum Capital Test (MCT) (January 2007) (P&C Insurance Company Branches)</p> | <p>each category.</p> <p>Capital</p> | <p>requirement for assets, branches must apply a factor to the balance sheet values of vested and other admitted assets. For vested loans, factors are applied to amortized cost. The resulting values are added together to arrive at the margin required for assets. The three rating categories used for assigning capital factors to assets, structured settlements, letters of credit, derivatives and other exposures, or where appropriate, collateral and guarantees, are:</p> <p>1. Government Grade</p> <p>Government obligations include securities issued by, loans made to, or securities or loans guaranteed by, and accounts receivable from:</p> <ul style="list-style-type: none"> - the federal government or an agent of the Crown; - a provincial or territorial government of Canada or one of its agents; - a municipality or school corporation in Canada; <p>and,</p> <ul style="list-style-type: none"> - the central government of a foreign country where: <ul style="list-style-type: none"> - the security is rated AAA or, if not rated, - the long-term sovereign credit rating of that country is AAA. <p>2. Investment Grade</p> <p>A security is treated as Investment Grade if its rating (excluding securities that are included in the Government Grade category) meets or exceeds the rating listed in the table below. If a rating is not available, or where the rating of the security, or guarantor, is less than the rating listed in the table, it will be assigned a Not-Investment Grade factor. (Refer to Chart X for Asset/Guarantor Ratings). A P&C insurer or branch wishing to use the rating of another rating agency should seek the approval of the regulator.</p> | | |
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| | | <p>3. Not-Investment Grade</p> <p>Includes any item not included in the Government Grade or Investment Grade categories. In the case of an asset or exposure backed by a guarantee (reference Tab 2-5), the long-term issuer credit rating or, in the case of a government, the long-term sovereign risk rating, of the guarantor is used to determine the risk category. In all cases, when a credit rating is not available, the relevant Not-Investment Grade factor is applied</p> | | |
| <p>Guideline B-1 Prudent Person Approach (Jan 1993) (All Sectors)</p> | <p>When setting limits on investments and loans, institutions may use external ratings to assess the quality of the loans and investments</p> <p>Asset Identification</p> | <p>Financial institutions should set limits on investments and loans according to their quality. For example, financial institutions may use ratings from recognized rating agencies in establishing quality criteria for their investments. Internal criteria would have to be established for non-rated investments. Similarly, internal criteria should be established for assessing the credit quality of borrowers.</p> | | <p>Guidelines</p> |
| <p>Guideline B-4 Securities Lending - P&C Companies (Sept 1996)</p> | <p>To be considered eligible collateral, instruments must be above a certain rating grade</p> <p>Asset Identification</p> | <p>For securities lending within North America, eligible collateral should be readily marketable and would normally be restricted to the following assets, denominated in Canadian or US dollars:</p> <ul style="list-style-type: none"> - cash; - widely-traded debt instruments having a rating of single A (or the equivalent) or higher from a recognized, widely followed North American credit rating agency; - commercial paper rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; - acceptances of banks and trust companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; and - high quality common and preferred shares. | | <p>Guidelines</p> |

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| <p>Guideline B-4 Securities Lending - Life Companies (Feb 1997)</p> <p>Guideline B-4 Securities Lending - Banks, Foreign Bank Branches, Trust and Loan Companies, Co-operative Credit Associations (Sept 1996)</p> | <p>To be considered eligible collateral, instruments must be above a certain rating grade.</p> <p>Asset Identification</p> | <p>In addition to above Eligible collateral also includes:</p> <ul style="list-style-type: none"> - unconditional, irrevocable letters of credit that comply with the standards of the International Chamber of Commerce and which are issued by banks and trust and loan companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; and - unconditional and irrevocable guarantees of banks and trust and loan companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency. | | <p>Guidelines</p> |
| <p>Guideline B-5 Asset Securitization (Nov 2004) (Life and P&C Insurers)</p> <p>4.1 First Loss Enhancements (p. 6)</p> | <p>In determining the capital requirements for securitization exposures, an institution that provides a first loss enhancement is required to deduct the full amount of the facility from total capital for capital adequacy purposes. In determining whether a first loss enhancement is significant, one criterion relates to whether the facility covers expected losses, as evidenced by an increase in the external rating assigned to the next senior tranche.</p> <p>Capital Securitisation</p> | <p>A first loss enhancement is considered significant if it meets the following conditions:</p> <ul style="list-style-type: none"> • there is a documented and reliable credit history for the specific type of asset in each underlying pool; • the FRFI's credit process properly assesses the credit and other risks of the facility in accordance with its standard credit policy for arm's-length counterparties; and • the facility adequately covers the expected losses, for example, the facility raises the rating of the next senior tranche to at least BBB. | | <p>Guidelines</p> |
| <p>Guideline B-5 Asset Securitization (Nov 2004) (Life and P&C Insurers)</p> | <p>In determining the capital requirements for securitization exposures, where an institution provides a second loss enhancement, one of the criteria used to determine the</p> | <p>Where a FRFI provides a second or subsequent loss enhancement, the facility will qualify for treatment as a direct credit substitute (or an on-balance sheet asset at its face value) under the relevant capital adequacy rules if the facility is fully</p> | | <p>Guidelines</p> |

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| <p>4.2 Second or Subsequent Loss Enhancements (p. 6)</p> | <p>applicable capital treatment is the rating of the facility.</p> <p>Capital Securitisation</p> | <p>protected by a significant first loss enhancement and meets any of the following conditions:• at least 25% of the facility is participated to an independent third party;• the facility is explicitly rated at least BBB; or• an independent third party provides the first loss enhancement.If it does not meet at least one of these conditions, the facility will be considered a first loss enhancement.A second or subsequent loss enhancement is considered significant if it meets the following conditions:• the rating of the facility indicates a lower risk of loss than that of the underlying pool(s) and any first loss facility; and• the size of the facility is sufficient to achieve a higher rating on more senior rated tranches.</p> | | |
| <p>Guideline B-5 Asset Securitization (Nov 2004) (Life and P&C Insurers</p> <p>4.4 Ratings Based Approach (p. 10)</p> | <p>External ratings are used to determine the applicable risk weight assigned to a securitization exposure which in turn determines the amount of required capital.</p> <p>Capital Securitisation</p> | <p>A FRFI investing in or holding senior tranches or providing second or subsequent loss enhancements (that meet the conditions in section 4.2) may be able to use a ratings-based approach to determine the capital requirements for these exposures. The approach uses credit ratings from widely recognized rating agencies (For the purposes of this guideline, OSFI recognizes the following agencies: DBRS, Moody's, Standard and Poor's, and Fitch) to measure relative exposure to credit risk and determine the associated risk-based capital requirement. For rated exposures that qualify for the ratings-based approach, Annex 1 provides the risk weights and factors that correspond to the various external credit ratings.</p> | | <p>Guidelines</p> |

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| <p>Guideline B-5 Asset Securitization (Nov 2004) (Life and P&C Insurers)</p> <p>4.4 Ratings Based Approach (p. 10)</p> | <p>External ratings are used to determine the applicable risk weight assigned to a securitization exposure which in turn determines the amount of required capital.</p> <p>Capital Securitisation</p> | <p>For second or subsequent loss enhancements or liquidity facilities explicitly rated BBB (Or equivalent rating by DBRS, Moody's, Standard and Poor's, or Fitch.) and above, the 25% participation requirement is deemed to have been met through the rating process. The 25% participation (on a pari passu basis with an independent third party) requirement is intended to validate the assessment by the originating FRFI of the risk of the enhancement or liquidity facilities.</p> | | <p>Guidelines</p> |
| <p>Guideline B-5 Asset Securitization (Nov 2004) (Life and P&C Insurers)</p> <p>5.4 Investor (p. 13)</p> | <p>To determine the applicable capital treatment for securitization exposures, external ratings are used.</p> <p>Capital Securitisation</p> | <p>A FRFI investing in the most senior tranches may be able to use explicit external credit ratings to determine the capital requirement. Annex 1 provides the risk weights and factors that correspond with the various external credit ratings. When an explicit external credit rating is not available, a FRFI holding the most senior tranches should determine its capital requirement based on the relevant capital adequacy rules for similar investments. (See tab 3 of Capital Adequacy Requirements, section 3-4-1 of Minimum Continuing Capital and Surplus Requirements, or tab 2-4 of Minimum Capital Test.)</p> | | <p>Guidelines</p> |
| <p>Guideline D-1 Annual Disclosure Requirements (Oct 2006) (Banks)</p> | <p>Institutions that meet certain criteria (including criteria based on ratings from external rating agencies) are exempt from this guideline.</p> <p>Asset Identification</p> | <p>The guideline applies to cooperative credit associations, banks, FBBs, and federally regulated trust and loan companies, and to their federally regulated deposit-taking subsidiaries. It does not apply to provincially regulated subsidiaries, nor to subsidiaries that are federally regulated deposit taking institutions themselves where their • deposit liabilities are fully guaranteed by the parent and the parent is a federally regulated deposit-taking</p> | | <p>Guidelines</p> |

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| | | institution that meets the annual disclosure requirements; or • liabilities are fully guaranteed by the parent and the parent is a deposit-taking institution whose debt instruments are rated not less than "investment grade" by a widely-recognized rating agency . | | |
| <p>Draft Advisory: Securitization Expected Practices (June 2008) (All Sectors)</p> <p>5. Use of Ratings from External Credit Assessment Institutions</p> | <p>OSFI expects the banking and insurance sectors to improve practices around the use of ratings as a result of the recent market turmoil.</p> <p>Asset Identification</p> | <p>Institutions must establish prudent lending practices and procedures, and are cautioned to consider the limitations of any third-party assessment. Reliance on external ratings is not a substitute for an institution making its own assessment. When the institution's own assessment of risk is higher than implied by a rating, it must ensure that it holds sufficient capital, either via a higher minimum requirement or a higher internal capital target ratio.</p> <p>As of September 15, 2008, all securitizations must be rated by at least two ECAs in order for a company to use a capital factor based on ratings.</p> | | Guidance |
| <p>Accounting Advisory - Pillar 3 Disclosure Requirements (Sept 2006) (Banks)</p> <p>Application of Pillar 3 (p. 1-2</p> | <p>Institutions that meet certain criteria (including criteria based on ratings from external rating agencies) are exempt from this advisory.</p> <p>Disclosure</p> | <p>Additionally, and consistent with the application of the Annual Disclosure Requirements Guideline (D-1), the Pillar 3 disclosure requirements do not apply to subsidiaries that are federally regulated deposit-taking institutions where:</p> <ul style="list-style-type: none"> • deposit liabilities are fully guaranteed by the parent and the parent is a federally regulated deposit-taking institution that meets the annual disclosure requirements; or • liabilities are fully guaranteed by the parent and the parent is a deposit-taking institution whose debt instruments are rated not less than "investment grade" by a widely-recognized rating agency. | | Guidance |

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| <p>Guide to Foreign Bank Branching (March 2002)</p> <p>Section 5. Information Requirements (p. 19)</p> | <p>When applying for approval to establish a foreign bank branch, applicants must submit a copy of the most recent rating report.</p> <p>Other</p> | <p>e) Financial Information on the Applicant</p> <p>iv) a copy of the most recent report on any controlling company and the applicant by a recognized credit-rating agency;</p> | | <p>Guidance</p> |
| <p>Transaction Instructions for Applications Subject to the Deemed Approval Process - Reinsurance with Related Unregistered Reinsurer (DA No. 21) (Life and P&C Insurers)</p> | <p>When applying for approval to purchase reinsurance from a related unregistered reinsurer, institutions must submit specific information including the current rating report.</p> <p>Other</p> | <ul style="list-style-type: none"> • current rating reports for the related unregistered insurer prepared by a recognized rating agency (e.g.; Best, Standard & Poor's, etc.), if available | | |

Canada

Ontario Securities Commission

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (<u>i.e.</u> , what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (<u>i.e.</u> , why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| <p>Investment Industry Regulation Authority Organization of Canada - IIROC</p> <p>Rule 100</p> | <p>Capital</p> | <p>Capital calculation (for margin) for the self regulatory authority for broker dealers</p> <p>Bonds, debentures, treasury bills and other securities of or guaranteed by the Government of Canada, of the United Kingdom, of the United States of America and of any other national foreign government (provided such foreign government securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively) ..." are subject to lower margin rates.</p> | | |

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| <p>National Instrument 41-101</p> | <p>Sets forth General Prospectus Requirements</p> <p>Prospectus Eligibility</p> | <p>Section 1.1 defines “full and unconditional credit support” to include alternative credit support that would result in the securities being distributed receiving the same or a higher credit rating than they would have received if they were subject to a guarantee.</p> <p>Section 7.2 permits non-fixed price securities (other than rights) to be distributed via a prospectus provided that the securities have received a rating from an approved rating organization and permits the price of securities (other than rights) distributed for cash to be decreased from the initial offering price disclosed in the prospectus without filing an amendment to the prospectus to reflect the change provided (a) the securities are distributed through one or more underwriters that have agreed to purchase all of the securities at a specified price, (b) the proceeds to be received by the issuer or selling security holders are disclosed in the prospectus as being fixed, and (c) the underwriters have made a reasonable effort to sell all of the securities distributed under the prospectus at the initial offering price disclosed in the final prospectus.</p> <p>Section 10.1(4) provides that the requirement to file the written consent of an expert does not apply to an approved rating organization that issues a rating to the securities distributed under the prospectus.</p> <p>Section 10.9 of Form 41-101F1 <i>Information Required In A Prospectus</i> requires an issuer to disclose any announcement made by, or any proposed announcement known to the issuer to be made by, an approved rating organization that the organization is reviewing or intends to revise or withdraw a rating</p> | <p>Rules, policies and notices (both proposed and final) of the Ontario Securities Commission are available at</p> <p>http://www.osc.gov.on.ca/Regulation/Rulemaking/rrn_index.jsp</p> | <p>Regulation</p> |
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| | | previously assigned and required to be disclosed under this section. | | |
| National Instrument 44-101 | Short Form Prospectus Distributions Prospectus Eligibility | <p>Section 1.1 defines “cash equivalent” to include certain securities that have an approved rating from an approved rating organization. An “approved rating” is one of the factors used to determine what is “cash equivalent”, but it is not the only factor.</p> <p>Section 2.3 permits issuers to distribute by way of a short form prospectus non-convertible securities with an “approved rating”.</p> <p>Section 2.4 permits issuers to distribute by way of a short form prospectus guaranteed non-convertible debt securities, preferred shares and cash-settled derivatives (if the guarantor is not listed on an exchange, the securities can still be distributed by way of a short form prospectus if securities of the guarantor and the securities to be distributed have received an approved rating on a provisional basis).</p> <p>Section 2.6 permits issuers to distribute by way of a short form prospectus asset-backed securities with an approved rating.</p> <p>Section 7.9 of Form 44-101F1 <i>Short Form Prospectus</i> requires an issuer to disclose any announcement made by, or any proposed</p> | | Regulation |

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| | | announcement known to the issuer to be made by, an approved rating organization that the organization is reviewing or intends to revise or withdraw a rating previously assigned and required to be disclosed under this section. | | |
| National 44-102 | Instrument Shelf Distributions Prospectus Eligibility | <p>Section 2.3 allows issuers to use a shelf prospectus to distribute non-convertible securities provided the issuer has reasonable grounds for believing that the securities would receive an “approved rating”.</p> <p>Section 2.4 allows issuers to use a shelf prospectus to distribute guaranteed non-convertible debt securities, preferred shares and cash-settled derivatives (if the guarantor is not listed on an exchange, the securities can still be eligible for the shelf system if securities of the guarantor and the securities to be distributed have received an “approved rating” on a provisional basis).</p> <p>Section 2.6 allows issuers to use a shelf prospectus to distribute asset-backed securities provided the issuer has reasonable grounds for believing that the securities would receive an “approved rating”.</p> | | Regulation |

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| National Instrument 45-106 | <p>Prospectus and Registration Exemptions</p> <p>Asset Identification</p> | <p>Section 2.34 of the Instrument provides registration and prospectus exemptions for trades in debt securities of or guaranteed by a government of a foreign jurisdiction if the debt security has an “approved credit rating” from an “approved credit rating organization”.</p> <p>Section 2.35 of the Instrument provides registration and prospectus exemptions for trades in debt securities maturing not more than one year from the date of issue if the debt security has an “approved credit rating” from an “approved credit rating organization”.</p> | | Regulation |
| National Instrument 51-102 | <p>Continuous Disclosure Obligations</p> <p>Disclosure</p> | <p>Section 13.4 allows a credit support issuer to rely on the continuous disclosure record of its credit supporter for the purposes of complying with its continuous disclosure obligations. The credit support issuer must meet certain requirements, one of which is that it can only issue certain types of securities, including “designated credit support securities”. In order for a security to be considered a designated credit support security, the credit supporter must provide either “alternative credit support” or a full and unconditional guarantee of the payments to be made by the credit support issuer. To qualify, the alternative credit support must result in the securities receiving the same credit rating as, or a higher credit rating than, the credit rating they would have received if payment had been fully and unconditionally guaranteed by the credit supporter, or would result in the securities receiving such a rating if they were rated.</p> <p>Issuers are required to file MD&A relating to their annual and interim financial statements. Pursuant to section 1.6 of Form 51-102F1 MD&A, the MD&A must include a discussion</p> | | Regulation |

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| | | <p>of trends or expected fluctuations in liquidity and liquidity risks associated with financial instruments, and cites as examples provisions linked to credit ratings and circumstances that could impair an issuer's ability to undertake transaction considered essential to operations, such as the inability to maintain investment grade credit rating.</p> <p>If an issuer is required to file an Annual Information Form (AIF), pursuant to section 7.3 of Form 51-102F2 AIF, the AIF must include disclosure about any ratings received.</p> | | |
| National Instrument 71-101 | <p>The Multijurisdictional Disclosure System</p> <p>Prospectus Eligibility</p> | <p>Section 3.1 permits issuers to distribute under the Multijurisdictional Disclosure System (MJDS) debt or preferred shares that have an investment grade rating, subject to certain other conditions.</p> <p>Section 3.2 permits issuers to distribute under the MJDS debt or preferred shares that have an investment grade rating and are guaranteed by a parent, subject to certain other conditions.</p> <p>Section 6.5(2) provides that an issuer does not need the consent of a rating organization to disclose a rating or provisional rating in a prospectus or bid circular filed under the MJDS.</p> <p>Section 12.3 permits a U.S. issuer to make a securities exchange bid using the MJDS for non-convertible debt securities or non-convertible preferred securities, if the securities have an investment grade rating.</p> | | Regulation |

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| <p>National Instrument 81-102</p> | <p>Mutual Funds</p> <p>Asset identification</p> | <p>Section 1.1 defines “money market fund” to restrict the investments of money market funds. The definition “money market fund” requires that not less than 95% of its net assets must be invested in: (i) cash, (ii) cash equivalents and (iii) debt with an approved credit rating.</p> <p>Section 1.1 defines “approved credit rating” and “approved credit rating organization”. The definitions are reproduced in I.A.(2) above. Section 1.1 defines “cash cover” to limit the type of securities or other portfolio assets that may be used to satisfy the cash cover requirements relating to specified derivatives positions of mutual funds required by the Instrument. The definition of “cash cover” includes various interest-bearing securities, including commercial paper that has a term to maturity of 365 days or less and an approved credit rating and that was issued by a person or company other than a government or permitted supranational agency. The definition of “cash cover” also includes “cash equivalents”. Section 1.1 also defines “cash equivalent” and “qualified securities” to include certain securities that have an “approved credit rating” from an “approved credit rating organization”. An “approved credit rating” is one of the factors used to determine what is “cash equivalent” or a “qualified security”, but it is not the only factor.</p> <p>Section 2.7 prescribes the eligibility of counterparties to enter into derivatives transactions with mutual funds by referencing credit ratings. At the time of the transaction, the derivative or the equivalent debt of the counterparty or the guarantor of the obligations of the counterparty must have an approved credit rating. If the credit rating of the derivative or the writer or guarantor of the derivative is downgraded below the approved credit rating, the mutual fund must take “the reasonable steps required” to close out its position in an orderly</p> | | <p>Regulation</p> |
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| | | <p>and timely fashion.</p> <p>Sections 2.12 and 2.13 provide eligibility criteria for the type of collateral that can be posted by a borrower with respect to a securities lending transaction entered into with a mutual fund. Acceptable collateral includes, among other things, “qualified securities” and irrevocable letters of credit issued by a Canadian financial institution if its short-term debt has an approved credit rating from an approved credit rating organization. In addition, if cash is received by a mutual fund as collateral in relation to a securities lending transaction or as payment under a repurchase transaction, the cash can be invested in a number of things, including qualified securities.</p> | | |
| National Instrument 81-106 | <p>Investment Fund Continuous Disclosure</p> <p>Prospectus Eligibility</p> | <p>Section 3.5 permits an investment fund to aggregate its short term debt holdings with a certain credit rating in its statement of investment portfolio. Section 3.5 also requires additional disclosure in the statement of investment portfolio or the notes to that statement with respect to the decline in a credit rating of a counterparty below the approved credit rating.</p> | | Regulation |
| Companion Policy 21-101CP to National Instrument 21-101 | Marketplace Operation | <p>Section 10.1(3)(a) requires marketplaces trading corporate debt securities, inter-dealer bond brokers and dealers trading corporate debt securities outside of a marketplace to provide information about debt securities to an information processor. The information to be provided is subject to a volume cap, depending on whether the debt security is “investment grade” or not. Section 10.1(6) provides that a debt security is considered investment grade if it has received a rating at or above a certain level either from Fitch, Inc., Dominion Bond Rating Service Limited, Moody’s Investors Service, Inc. or Standard & Poor’s Corporation. For</p> | | Guidance |

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| | | investment grade corporate debt securities participants must provide the actual quantity of the security traded if the total par value of the trade is \$2 million or less, and if the total par value is greater than \$2 million it is to be reported as \$2 million plus. For non-investment grade corporate debt securities participants must provide the actual quantity of the security traded if the total par value of the trade is \$200,000 or less, and if the total par value is greater than \$200,000 it is to be reported as \$200,000 plus. | | |
| National Policy 41-201 | Income Trusts and Other Indirect Offerings Prospectus Eligibility | Section 3.5, 3.6 and 3.7 provide guidance about what a stability rating for an income trust is, whether an income trust is required to obtain a stability rating and the disclosure required if an income trust receives a stability rating. | | Guidance |
| National Policy 51-201 | Disclosure Standards | Section 3.3(2)(g) provides guidance on when a company can make a selective disclosure if doing so is in the necessary course of business. Such situations include communications with credit rating agencies provided that the information is disclosed for the purpose of assisting the agency to formulate a credit rating and the agency's ratings generally are or will be publicly available. | | Guidance |

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| <p>Companion Policy 81-102CP to National Instrument 81-102</p> | <p>Mutual Funds</p> <p>Asset Identification</p> | <p>Section 3.1 of the Companion Policy acknowledges existing decisions providing exemptive relief to international bond funds from the 10% concentration restrictions of the Instrument. Relief has been granted to purchase:</p> <p>-- 20% of the debt securities of any one issuer if those debt securities are issued or guaranteed by supranational agencies or governments other than the government of Canada, a province or the government of the United States of America and are rated "AA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations, and</p> <p>-- 35% of its net assets in the debt securities of any one issuer, if those securities are issued by issuers described in paragraph (i) and are rated "AAA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations.</p> | | <p>Guidance</p> |
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France Commission Bancaire

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/ Regulation/ Guidance? |
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| Order of 20 February 2007 relating to capital requirements for credit institutions and investment firms | Establish minimum regulatory capital requirements Capital | French transposition of the capital requirements directive (CRD) | An English version of this regulation is available online: http://www.banque-france.fr/gb/supervi/disclosure/rules/rules.htm | Regulation |
| Regulation 90-02 on own funds (see article 6.b) | Treatment of loans and commitments to senior managers and principal shareholders Capital | To prevent the abusive use of banks' resources (eg, loans with low profitability or limited economic interest for the bank), limiting potential conflict of interest and avoiding artificial creation of own funds (e.g. loans to shareholder in order to subscribe to a capital increase). In practice, all loans and commitments to senior managers and principal shareholders must be deducted from regulatory own funds. However, only the significant loans and commitments that amount for more than 3% of the own funds have to be deducted. Furthermore, the exposures toward shareholders with a rating higher than the minimum levels defined by the regulation are not deducted. The use of ratings in this context allows the regulation to target small size shareholders, individual persons and above all low quality shareholders. Indeed those kinds of shareholders are expected to expose institutions more to the risks mentioned above than others. | The English version of this regulation is available online: http://www.banque-france.fr/gb/supervi/telechar/regle_bafi/Regulation_90_02.pdf | Regulation |

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| <p>Regulation 99-10 relating to mortgage credit institutions</p> | <p>Specific rules for covered bonds issued by mortgage credit institutions</p> <p>Securitisation</p> | <p>Transposition of the CRD provisions about covered bonds.</p> <p>Designed to ensure that the assets used to secure the covered bonds are of good quality. Ratings are used to determine the extent to which funds (CIU- collective investment units according to the CRD) might be eligible to cover debt and to determine the applicable risk-weight when calculating the loan-to-value ratio of the covered bonds.</p> | <p>The English version of this regulation is available online:</p> <p>http://www.banque-france.fr/gb/supervi/telechar/regle_bafi/Regulation_99_10.pdf</p> | <p>Regulation</p> |
| <p>Order of 2 July 2007 relating to the segregation of funds of investment firms' customers</p> | <p>Segregation of funds of investment firms' customers</p> <p>Asset Identification</p> | <p>Transposition of provisions from the MiFID directive.</p> <p>Intended to ensure that the funds provided by customers are not exposed to the risks faced by the investment firms. These funds need to be deposited in an isolated account with a good quality counterparty. The regulation determines the eligible counterparties and in this context, ratings are used to identify which collective investment undertakings are eligible. Investment firms mentioned in Article L. 531-4 of the Monetary and Financial Code, other than the portfolio management companies mentioned in Article L. 532-9 of the Code, are authorised to hold funds for customers incidentally to their principal activity.</p> | <p>The English version of this regulation is available online:</p> <p>http://www.banque-france.fr/gb/supervi/telechar/regle_bafi/20070702_order3.pdf</p> | <p>Regulation</p> |

France AMF

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (ie, what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (ie, why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| French Monetary and Financial Code, Legislative Section, Book II Products, Title I Financial Instruments, Chapter IV Collective Investments, Section 2 Securitisation organisms | Trading on a regulated market or offering to the public Securitisation Offerings | Article L214-44 states that when the units, shares or debt issued by a securitisation organism are admitted for trading on a regulated market or are offered to the public, a document containing an appreciation of the characteristics and an evaluation of the risks of the units, the debt it plans to issue or to acquire and the term contracts or those regarding the transfer of insurance risk that it plans to sign must be established by an entity included on a list published by the Minister of the Economy once the AMF has provided its opinion. See below for implementing measure in regulation. | http://www.legifrance.gouv.fr/rechCodeArticle.do?reprise=true&page=1 | Legislation |
| French Monetary and Financial Code, Legislative Section, Book V Service Providers, Title IV Other Service Providers, Chapter IV Investment Research Services and Rating Agencies | Report on service provider Securitisation Offerings | Article L544-4 establishes the requirement for the AMF to publish a report annually on the role of the rating agencies, their ethical rules, the transparency of their methods and the impact of their activities on issuers and the financial markets. | http://195.83.177.9/code/liste.phtml?lang=uk&c=25&r=1012 | Legislation |

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| <p>Article 421-8 of the AMF's General Rules, Book IV</p> | <p>Debt securitisation funds</p> <p>Securitisation Offerings</p> | <p>Refers to the article L214-44 mentioned above in the Monetary and Financial Code which requires the drafting of a document containing an appreciation of the characteristics and an evaluation of the risks of the instruments issued or acquired by the securitisation organism and requires that it be communicated to the AMF at least one month before the date that the visa is desired.</p> | <p>www.amf-france.org/styles/default/documents/general/7554_1.pdf</p> | <p>Regulation</p> |
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Germany

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Circular R 15/2005 (VA) (Insurance supervision) | Supervisory guidance to insurers on their investments of the restricted assets and supplements the investment regulation applicable to insurers. Asset Identification | Credit ratings are used in the investment process (as a criterion for the determination of the safety of the investment) and in the description of BaFin's stress testing requirements on insurers. The description of BaFin's stress testing requirements gives explanations on the choice of parameters and the model when conducting a stress test. It is intended to give assistance to insurers for carrying out the specified stress tests. | http://www.bafin.de/clin_109/nn_721290/SharedDocs/Veroeffentlichungen/DE/Service/Rundschreiben/2005/rs__0515__va.html (available only in German) | Regulation |
| Section 112 para 3 InvG (legislation) (Securities supervision) | Custody of assets Other | Custody of the assets of hedge funds may also be performed by a prime broker if he fulfils several requirements, eg, if he has an appropriate creditworthiness. The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – “BaFin”) requires, inter alia, credit ratings in order to make sure that the prime broker has such appropriate creditworthiness. | http://bundesrechtjuris.de/invg/___112.html (available only in German) | Legislation |

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| <p>German Solvency Regulation</p> <p>(Banking supervision)</p> <p>(See Directives 2006/48/EC and 2006/49/EC)</p> | <p>Capital Adequacy – stipulate minimum capital requirements</p> <p>Capital</p> | <p>Uses credit assessments of recognised external credit assessment institutions for regulatory capital purposes in the standardised approach and the IRB ratings based approaches for securitizations.</p> | <p>http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_177/l_17720060630en00010200.pdf (Directive 2006/48/EC)</p> <p>http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_177/l_17720060630en02010255.pdf (Directive 2006/49/EC)</p> | <p>Legislation</p> |
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Italy

Consob - Securities Regulation

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (<i>i.e.</i> , what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (<i>i.e.</i> , why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Securitization Law requires (Article 2, para. 5) | The purpose of legislation on credit securitization is to establish rules regulating various aspects and characteristics of operations of securitization consisting in sales of existing and future credits. | Establishes the professional qualifications and independence criteria of the entities that carry out the credit rating of securitization transactions. Requires that securitization transactions are subject to credit ratings when the relevant asset backed securities are to be offered to persons other than professional investors (outside this case, the rating is issued on a voluntary basis). Also requires the disclosure in the relevant offering document of information concerning any relationship between the rating agency and the persons who, in their respective capacities, are parties to the transaction. | Web link (in Italian) to respectively the Securitization Law and the implementing Consob Regulation: http://www.consob.it/main/documenti/Regolamentazione/normativa/leg130.htm?hkeywords=&docid=2&page=0&hits=7 and http://www.consob.it/main/documenti/Regolamentazione/normativa/d12175.htm?hkeywords=&docid=4&page=0&hits=7 . | Legislation |
| Article 114, par. 8 of the Consolidated Law on Finance | Designed to define the field of application of rules on fair presentation and conflicts of interest and to entrust to Consob the task to define secondary regulations on these aspects. | Excludes the credit rating agencies from the scope of application of certain fair presentation and disclosure rules relating to the production or dissemination of investment research, evaluations and recommendations. In particular, article 114, par. 8, states that these rules do not apply to evaluation produced or disseminated by the credit rating agencies. | Web link to the Consolidated Law on Finance: http://www.consob.it/main/documenti/Regolamentazione/normativa/dlgs58_2004.htm (Italian version); http://www.consob.it/main/documenti/english/laws/fr_decree58_1998.htm (unofficial English version). | Legislation |

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| <p>Consob Regulation on Issuers (see Articles 5 and 53) and EC Regulation no. 809/2004 (see Annex V and Annex XIII)</p> | <p>Designed to set forth the mandatory information to be published in a prospectus in connection with public offering or listing of securities.</p> | <p>Prospectuses relating to the public offering and/or listing of debt securities shall include information on the credit ratings of the issuers or relevant securities (if any). Information on the rating shall also be published in prospectuses relating to the public offering of units of investment funds, shares of investment companies and financial products issued by insurance companies (see Annex 1B, to Consob Regulation on Issuers).</p> <p>The request for publication of the listing prospectus to be filed with Consob under Art. 52 of Consob Regulation on Issuers shall include information on the rating (if any) of structured bonds, convertible bonds and covered warrants or certificates, pursuant to Annex 11 to Consob Regulation on Issuers. The information on rating is mandatory in connection with the listing of ABSs.</p> | <p>Web link to the EC Regulation no. 809/2004:</p> <p>http://ec.europa.eu/internal_market/securities/docs/prospectus/reg-2004-809/reg-2004-809_en.pdf</p> | <p>Regulation</p> |
| <p>Listing Rules (LRs), issued by the Italian market operator (Borsa Italiana S.p.A.) and approved by Consob,</p> | <p>Impose certain disclosure obligations to listed issuers and issuers applying for admission to the listing.</p> | <p>Requires that where the creditworthiness of an issuer applying to the listing has been rated by a local or an international credit rating in the 12 months preceding the listing application, the rating (if public) and its updating must be notified to Borsa Italiana, which will disclose it to the market. This rule applies with reference to the listing of shares, bonds and other debt securities, covered bonds, covered warrants or certificates, structured bonds, shares of investment companies and exchange traded commodities (see respectively Rules 2.2.1(12), 2.2.5(5), 2.2.10(3), 2.2.21(4), 2.2.28(3), 2.2.37(11), 2.2.41(3)).</p> <p>Moreover, according to Rule 2.6.2(17), where the creditworthiness of a listed issuers and an individual issue has been rated by a local or an international credit rating, the ratings (if public)</p> | <p>Web link to the Borsa Italiana Listing Rules:</p> <p>http://www.borsaitaliana.it/documenti/regolamenti/regolamenti/rules300708senza.en_pdf.htm</p> | <p>Regulation</p> |

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| | | and any change thereof must be announced to the market. | | |
| Listing Rule 2.2.32(1c) and relevant Instructions issued by Borsa Italiana and approved by Consob | Such LR and relevant Instructions contemplate certain requirements for the admission to the listing of ABSs. | <p>For the purpose of their listing, asset backed securities (ABSs) must be rated on a continuing basis by at least one major credit rating agency. The rating must be at least equal to investment grade, to be intended as a rating equivalent to at least BBB- on the S&P scale.</p> <p>Borsa italiana may admit non-rated tranches to the listing provided that their redemption is guaranteed by a government or a governmental entity or agency, such that the implied rating is at least "high grade", meaning a rating equivalent to at least AA- on the S&P scale.</p> <p>Issuers of listed ABSs must disclose any rating and relevant changes to Borsa Italiana, which will disseminate it to the public (Rule 2.2.33(1)).</p> <p>In case of listed bonds, ABSs and other debt securities, the rating may be relevant for being qualified for a particular class or segment of the regulated market (see Rule 4.4.2(4), providing that, when dividing the aforementioned instruments in classes or segments, Borsa Italiana shall take into account – among others - the relevant rating, if any).</p> | | Regulation |
| Article 100-bis, par. 4, of Legislative Decree no. 58/1998, | This provision of law extends to a particular less-risky case the benefit of being excluded from the application of the public offering related obligations and prospectus requirements. | The systematic resale to retailers of debit instruments issued by OECD States and originally placed to qualified investors shall not be considered as a public offering (and, consequently is not subject to the publication of a prospectus), provided that such instruments have been awarded with investment grade by at least two primary rating agencies. | | Legislation |
| Article 114(1) of the Consolidated Law of Finance | The abovementioned Consob interpretative Communication clarifies the meaning of inside | Listed issuers and relevant controlling persons must promptly disclose to public price sensitive information (i.e. an inside information having a precise nature that, if it were made public, would be likely to have | Web link to the Consob interpretative Communication no. DME/6027054: | Interpretation |

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| | <p>information by making references to specific cases and examples.</p> | <p>a significant effect on the securities market prices). In principle, selective disclosure of inside information is prohibited. Nonetheless, in its interpretative Communication no. DME/6027054 of March 28, 2006 Consob clarified that listed issuers may selectively disclose inside information to credit rating agencies in charge of issuing a rating, provided that such agencies are subject to confidentiality obligations and have in place suitable organisational measures preventing the illegitimate circulation or exploitation of the information.</p> | <p>http://www.consob.it/main/documenti/bollettino2006/c6027054.htm</p> | |
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Italy Bank of Italy

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Legislative Decree No. 58 24 February 1998 - Consolidated Law on Finance pursuant to Articles 8 and 21 of Law 52 of 6 February 1998. | Legislative Decree No. 58 24 February 1998" is the Italian primary legislation applicable to non-bank financial intermediaries. Prospectus Eligibility | According to article 100-bis (Part 4), the systematic resale to retailers of debit instruments issued by OECD States and originally placed to qualified investors shall not be considered as a public offering (and, consequently is not subject to the publication of a prospectus), provided that such instruments have been awarded with investment grade by at least two primary rating agencies.. | http://www.bancaditalia.it/vigilanza/intermediari/normativa/leggi/dl58/dl_58_98_en.pdf ; | Legislation |
| Consolidated Law on Banking (The 1993 Banking law - Legislative Decree 385 of 1 September 1993, IV edition published on February 2007). | Consolidated Law on Banking (The 1993 Banking law) is the Italian primary legislation applicable to banks. Disclosure | According to article 53, banks shall be permitted to use credit risk assessments issued by external companies or entities in possession of the requirements provided for by the Bank of Italy, including those regarding technical qualifications and independence, that such persons must meet and the related verification procedures. This provision is the legal basis for the implementation of articles 81-83 and Annex VI of directive 2006/48/EC. | http://www.bancaditalia.it/vigilanza/banche/normativa/leggi/tub/tub_en.pdf ; | Legislation |

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| <p>Italian Securitisation law (Law 130/99 of 14.04.1999)</p> | <p>Italian Securitisation law is the Italian primary law for the securitisation.</p> <p>Securitisation Offering</p> | <p>Article 4 of the law says that when the securities relating to the securitisation transactions are offered to persons other than professional investors, the transaction shall be subject to <i>credit rating</i> by qualified third parties.</p> | | <p>Legislation</p> |
| <p><i>New regulations for the prudential supervision of banks</i></p> | <p><i>“New regulations for the prudential supervision of banks”</i> is the latest supervisory regulation on banking sector for capital requirements.</p> <p>Capital</p> | <p><i>Credit ratings</i> issued by <i>ECAIs</i> affects directly capital requirements that standard banks (i.e. non IRB banks) have to set aside against credit risk. Moreover, when taking into account the risk mitigation provided by guarantees, an <i>investment grade rating</i> is required for the guarantor.</p> <p>The entire prudential treatment of securitisation products is based on <i>credit ratings</i> that should be issued by <i>ECAIs</i> qualified into the structured finance field. External <i>ratings</i> are also to be adopted as a benchmark under the Internal Assessment Approach, which governs the prudential treatment of exposures to ABCP programs (Asset Backed Commercial Paper).</p> <p>As far as market risk is concerned, the forthcoming regulation on default and event risk in the trading book will include the risk of a rating change (so-called migration risk) as a source of risk that models have to cope with when assessing the dimension of credit risk held into the trading book.</p> <p>The <i>ECAI</i> recognition process is reported in the Section VIII (Title II, Chapter I, Part I) of the document.</p> | <p>http://www.bancaditalia.it/vigilanza/banche/normativa/disposizioni/vigprud;internal&action=_setlanguage.action?LANGUAGE=en</p> | <p>Regulation</p> |

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| <p>Bank of Italy regulation on collective investment undertakings.</p> | <p>Bank of Italy regulation on collective investment undertakings is a part of the supervisory regulation applicable to non-banking financial intermediaries</p> <p>Asset Identification & Disclosure</p> | <p>Refers to the collective investment undertakings (asset management funds), uses the term <i>rating</i> and <i>investment grade</i> (and other indicators not related to these ones) to define the financial instrument purchasable by asset management funds and SICAV. Moreover, the rule requests to fund managers to insert <i>information on the creditworthiness</i> of bond investments in the <i>prospectus</i>.</p> | <p>http://www.bancaditalia.it/vigilanza/intermediari/normativa/sgr_oicr/provv/Regolamento.pdf (only Italian version);</p> | <p>Regulation</p> |
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Japan

Financial Services Agency, Japan

Banking

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| The FSA ordinance under the Banking Act. | Capital (Capital Adequacy) | For calculating the capital adequacy ratios for banks and other deposit-taking institutions, credit ratings by ECAs are used subject to the FSA ordinance under the Banking Act. | | Regulation |
| The guideline for the financial institutions (major banks/small and middle sized and regional banks) | Other (Risk management) | In August 2008, the JFSA added new supervisory “checkpoints” for financial institutions in order to avoid uncritical reliance on credit ratings when contemplating investment in structured products. The checkpoints seek to encourage an understanding of rating methodologies and relevance (eg, what does the rating really mean for purposes of the investment?) as well as establishing better risk management functions within the organisations. | | Guidance |

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| <p>The disclosure requirements for use of credit ratings for securitization products</p> | <p>Disclosure</p> | <p>The JFSA requires ECAs to disclose certain information regarding the securitization exposure for credit ratings to be eligible under the Basel II framework (e.g. rating criteria, rating transaction matrix, transaction-specific information).</p> | | <p>Guidance</p> |
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Japan

Financial Services Agency, Japan

Securities

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (ie, what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (ie, why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| The Estimation criteria for market risks, counterparty risks and general risks on the Financial Instruments Business Operators Art.4(6), Art.17(3)(iii) under the Financial Instruments and Exchange Act | Capital (Capital Adequacy) | For calculating the capital adequacy ratios for security companies, credit ratings by DRAs are used to estimate market risks and counterparty risks | | Regulation |
| Cabine Office Ordinance of Act on Financial Instruments Business Operators Art153(iv) under the Financial Instruments and Exchange Act | Asset identification (Permissible activities) | A security dealer is not allowed to be a lead manager for the security that its parent or subsidiary company issues, however, the dealer is exempt from this regulation in the case where a security is rated by DRAs. | | Regulation |
| The guidelines for financial instruments business supervision | Securitization (Securitization product sales) | Since April 2008, as one of the checkpoints for securitization product sales in the guidelines for Financial Instruments Business Supervision, the JFSA ensures that financial instruments firms (Distributors) properly carry out the | | Guidance |

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| | | collection, risk valuation, and disclosure of underlying assets and other risk factors of securitized products without relying only on credit ratings. | | |
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Japan

Financial Services Agency, Japan

Insurance

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Insurance Business Law Art.130(ii), Art.202 ii , Art.272-28, the Ordinance for Enforcement of Insurance Business Law Art.87(iii)(b), Art.162(iii)(b), Art.211-60(ii)(b) | Capital (Capital adequacy) | For calculating the solvency margin ratios regarding estimating credit risks for insurance companies, credit ratings by DRAs are used. | | Regulation |
| Insurance Business Law Art. 97-2(1), Art.199 and the Ordinance for Enforcement of Insurance Business Law Art. 48(1)(iv), Art.140(1)(iv). | Asset Identification (Investment eligibility) | The regulation restricts insurance companies to invest in assets without designated ratings by DRAs to the specific ratio. | | Regulation |
| Insurance Business Law Art.111(1) and the Ordinance for Enforcement of Insurance Business Law Art. 59-2(1)(iii)(c) | Disclosure requirements | Ratings by DRAs are used for the disclosure requirement for re-insurance contracts. | | Regulation |

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| | | the reference system, are able to use the shelf registration system as well subject to the Financial Instruments and Exchange Act, Art.23-3(1), Art.5(4). | | |
| <p>The Cabinet Office Ordinance for Disclosure of Corporate Information, Note (13)(I) for Form 2, etc.</p> <p>the Cabinet Office Ordinance for Disclosure of Information on Issuers of Foreign Government Bonds, Note (12) for Form 2 etc.</p> <p>the Cabinet Office Ordinance for Disclosure of Information on Specific Securities, Note (4) b for Form 4, etc.</p> | Prospectus eligibility | Ratings by DRAs are required to be disclosed in securities registration statements, prospectuses and supplemental prospectuses for the shelf registration. | | Regulation |

Japan

Financial Services Agency, Japan

Other Regulations

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Cabinet Office Ordinance, Order on Bank's Shareholdings Purchase Corporation, Art. 19(i), Art. 20-4(i) | Asset Identification (Permissible activities) | The Banks' Shareholding Purchase Corporation can purchase, as its special stock purchases scheme, only the stocks of issuers with designated ratings by DRAs | | Regulation |
| Ordinance for Enforcement of Act on Securitization of Assets, Art.26(2)(v) | Asset Identification (Permissible activities) | Ratings by DRA are used as one of the conditions for determining the due dates for submission of modification documents of securitization planning. | | Regulation |
| Ordinance for Enforcement of Act on Securitization of Assets, Art.77(ii) | Asset Identification (Permissible activities) | Obtaining ratings designated by the Commissioner of the Financial Services Agency from DRAs is one of the requirements for issuing specific short-term securities. | | Regulation |
| Ordinance for Enforcement of Act on Securitization of Assets, Art.91(ii) | Asset Identification (Permissible activities) | Obtaining ratings designated by the Commissioner of the Financial Services Agency from DRAs is one of the requirements for issuing promissory notes | | Regulation |

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| Ordinance for Enforcement of Act on Securitization of Assets, Art.47 | Other (Permissible activities) | DRAs other than those who granted ratings for any securitized products of the relevant Specific Purpose Company can provide evaluation of the value of the specific securitized assets. | | Regulation |
| Ordinance for Enforcement of Valuation for Investment Trust Assets, Act.59(ii) | Asset Identification (Permissible activities) | Ratings designated by the Commissioner of the Financial Services Agency granted by the DRAs are used as one of the conditions for determining the due dates for the preparation of investment reports. | | Regulation |
| Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations, Act.25(ii) | Asset Identification (Permissible activities) | Ratings by DRAs are used for an exemption from the requirement of submitting investment reports. | | Regulation |
| Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations, Act.192(2)(i), Act.192(3)(i) - | Asset Identification (Permissible activities) | Obtaining ratings by DRAs is one of the requirements for issuing short-term investment corporate bonds. | | Regulation |

Netherlands

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (<u>i.e.</u> , what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (<u>i.e.</u> , why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/ Regulation/ Guidance? |
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| Solvency Requirements for credit risks | Capital Adequacy | To determine capital requirements on various credit risks. | | Regulation |

Spain Insurance Regulation

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| <p>Orden EHA/339/2007, de 16 de febrero, por la que se desarrollan determinados preceptos de la normativa reguladora de los seguros privados” And Reglamento de Ordenación y Supervisión del Seguro Privado (Regulation and Supervision Private Insurance Regulations)</p> | <p>In relation with the first of the situations mentioned the regulation implements certain aspects of Spanish legislation about supervision of insurance companies like the requirements and the types of derivatives and structured products that the company can invest in and the requirements of the methods of interest rate immunization in order to allow the insurance company to use a higher rate of interest to estimate mathematical provisions.</p> | <p>Credit ratings and credit rating agencies are referred to in the following rule: “Orden EHA/339/2007, de 16 de Febrero.</p> <p>On the other hand, another reference is made by our regulations on ratings: The rating as an aspect to be considered in a particular situation. This is in relation with the recognition of the credits towards the reinsurance companies or towards the SPVs as an asset covering technical provisions.</p> | <p>(http://www.dgsfp.meh.es/sector/documentos/PUBLICACIÓN%20BOEOR.PDF)</p> | <p>Regulation</p> |
| <p>Article 1</p> | <p>The purpose of using credit ratings and referring to credit rating agencies is to get that insurance companies’ investments have a certain minimum rating in order to</p> | <p>Establishes the requirements that the agents who quote bonds and the derivatives’ counterparties must comply with. One of these requirements is that agents and derivatives’ counterparties have to have a certain minimum rating.</p> | | <p>Legislation</p> |

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| <p>Article 2 and 3</p> <p>Article 6</p> <p>Article 11</p> | <p>improve their solvency. Moreover, the investments' rating is taken into account in methods of interest rating immunization in order to penalize the portfolios that have lower ratings.</p> | <p>Regulates the methods of interest rate immunization: cash flow matching and duration matching. These articles require that the assets have a minimum rating of BBB. Moreover the rating of the investments is taken into account in order to calculate the maximum interest the insurance companies can use to estimate their mathematical provisions.</p> <p>The derivatives' counterparties have to have a minimum rating of BBB.</p> <p>Establishes the requirements of marketable structured products. The minimum rating that structured products which contain credit derivatives have to have is AA. If the structured products don't contain credit derivatives the minimum rating is A.</p> | | |
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Spain Securities Regulation

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Royal Decree 291/1992 | Disclosure | Prospectus for the public offer and admission to trading of securities will reflect the credit rating assigned, full name of the rating agency, meaning of the rating, rating date and, as the case may be, if the rating agency has been recognized by the CNMV. | | Legislation |
| Law 19/1992 | Disclosure | <p>Bonds from a <u>mortgage securitization fund</u> must be evaluated by a rating agency recognized by the CNMV and such rating must be inserted in the prospectus of the bonds of the mortgage securitization fund.</p> <p><u>Asset backed securitization funds of the credits of the nuclear moratorium</u> that are placed in Spain and to Spanish resident investors which are not institutional investors must be assigned a credit rating by a CNMV's recognized rating agency.</p> | | Legislation |
| Royal Decree 926/1998 | Prospectus eligibility | <u>Asset backed securitization funds</u> the issue of bonds of the asset backed securitization fund must be evaluated by a rating agency recognized by the CNMV and such rating | | Legislation |

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| | | must be inserted in the prospectus and in all advertisements. In addition, the CNMV might require bonds of the main class to have a minimum rating grade in order to approve the prospectus. | | |
| Order 1064/2003 dated April 29 | | Rules regarding the collaboration of the Kingdom of Spain with respect to <u>securitisation funds of credits against small and medium companies</u> , the Kingdom of Spain only guarantees 80% of the part of the bonds of the securitisation fund that are assigned a rating of AA, Aa or equivalent by a CNMV's recognized rating agency. | | Regulation |
| Law 35/2003 | | When the depositary of a collective investment undertaking has been rated by a rating agency recognized by the CNMV, this fact must be included in the <u>depositary's half-year and quarterly reports</u> . | | Legislation |
| CNMV's Circular 1/2001 | | The credit rating of an investment fund, if available, has to be included in the <u>prospectus</u> . | | Regulation |
| Royal Decree 1393/1990 of Collective Investments Schemes | | A <u>limitation</u> is set of 15% on the <u>investments</u> made by the collective investment institutions in securities issued or guaranteed by one issuer. This limitation is raised to a 35% on the investments made in securities issued or guaranteed by OCDE members with a solvency rating, given by a market recognized CRA, no lower than that of the Spanish Kingdom. | | Legislation |
| Article 4.1 b) of the Order 10 June 1997 and CNMV's Circular 3/1998 | Asset Identification/ | Only certain financial counterparties that have a favourable credit rating assigned by a CNMV's recognized rating agency may enter into OTC derivative transactions with Spanish undertakings for collective investment. For these purposes, a favourable credit rating is: (i) To be deemed to have sufficient solvency, the counterparties of the Spanish UCI in OTC transactions need to be | | Legislation and regulation |

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| | | <p>assigned a favourable credit rating, for the term and the currency of the transaction, by a rating agency recognised by the CNMV, provided that there is no CNMV's recognised rating agency that assigns a lower credit rating. In that case, an additional credit rating of another recognised rating agency would be required.</p> <p>(ii) Favourable credit rating in the long term would be that which means at least a strong capacity of the entity to meet its payment obligations when due.</p> <p>(iii) Favourable credit rating in the short term would be that which means at least an adequate capacity of the entity to meet its payment obligations when due.</p> | | |
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Spain Banking Regulation

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| <p>Basel II framework</p> <p>Circular 3/2008, de 22 de mayo, del Banco de España, a entidades de crédito, sobre determinación y control de los recursos propios mínimos (an official translation into English of this Circular is not available yet):</p> | <p>Capital Adequacy</p> | <p>Credit ratings are used to determine the capital requirements for various credit risk exposures.</p> | <p>http://www.bde.es/normativa/circu/c200803.pdf</p> | <p>Regulation</p> |

Switzerland

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
|---|---|--|---|----------------------------------|
| Basel II framework | Capital Adequacy (for banks and securities firms) | Credit ratings are used to determine the capital requirements for various credit risk exposures. | | Regulation |
| Collective Investment Schemes | Capital requirements, qualifying counterparties, qualifying collateral, prudence, counterparty credit risk, credit risk mitigation | To determine 1) whether an instrument is a qualifying instrument for purposes of collateral; 2) whether an instrument is a qualifying FI instruments; 3) a Qualifying OTC market Player; 4) limits for certain investment classes | | Regulation |

U.K.

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
|---|---|--|---|----------------------------------|
| Basel II framework ECAIs are recognized under the Capital Requirement Regulations 2006 (SI 2006/3221) | Capital Adequacy | Credit ratings are used to determine the capital requirements for various credit risk exposures. | http://fsahandbook.info/FSA/html/handbook/BIPRU/3/3 http://www.fsa.gov.uk/pubs/international/ecais_standardised.pdf http://www.fsa.gov.uk/pubs/international/ecais_securitisation.pdf | Regulation |
| <i>TS.II.B.24</i> | Capital | <i>Expected loss through default on reinsurance recoveries</i> - Firms consider rating judgements as one of several possible sources of information (eg credit spreads and financial accounts) when assessing the probability of default and the LGD for reinsurers. | | Regulation |
| <i>TS.IX.F</i> | Capital | <i>Credit spread risk</i> - For the purpose of assessing the capital requirement in respect of unexpected defaults or widening of credit spreads for corporate bonds and structured products, the specified calculation includes different factors according to the credit rating relating to the instrument. These factors were derived from an analysis of historical data relating to instruments in each separate rating | | Regulation |

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| | | category, (the risk of default and the potential widening in spreads being greater for lower rated instruments) | | |
| TS.IX.G | Capital and concentrations | <i>Concentration risk</i> -For the purpose of assessing the capital requirement in respect of unexpected defaults or widening of credit spreads for large exposures in excess of a specified threshold ⁴⁷ to individual counterparties, the specified calculation includes different factors according to the credit rating relating to the counterparty. These factors were derived from an analysis of historical data relating to counterparty risk, (the risk of default and the potential widening in spreads being greater for lower rated instruments) | | Regulation |
| TS.X.A | Capital | <i>Counterparty default risk</i> - For the purpose of assessing the capital requirement in respect of unexpected defaults for exposures to reinsurers and other counterparties (eg general debtors and derivative counterparties) not covered by the above credit spread risk module, the specified calculation is based on an algorithm that includes different factors according to the credit rating relating to the counterparty. These factors were derived from external data about probabilities of default for different rating categories. | | Regulation |

⁴⁷ The size of the threshold for the purpose of this calculation was also related quite broadly to the underlying rating category

U.S. SEC Credit Rating Usage

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (<u>i.e.</u> , what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (<u>i.e.</u> , why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Securities Act Form F-1 (17 CFR 239.31) | Registration statement for securities of certain foreign private issuers | Permits foreign private issuers registering offerings of investment grade securities (as rated by at least one NRSRO) to provide financial information in accordance with Item 17 of Exchange Act Form 20-F (exemption from more burdensome requirement of Item 18). | http://www.sec.gov/about/forms/formf-1.pdf | Regulation (form) |
| Securities Act Form S-3 (17 CFR 239.13) | Short-form registration statement for eligible domestic issuers | Alternate means of establishing eligibility to register offerings on Form S-3: primary offerings of non-convertible debt securities that do not meet required public float criteria and asset-backed securities may be eligible for registration on the form if rated investment grade by at least one NRSRO | http://www.sec.gov/about/forms/forms-3.pdf | Regulation (form) |
| Securities Act Form F-3 (17 CFR 239.33) | Short-form registration statement for eligible foreign private issuers | Alternate means of establishing eligibility to register offerings on Form F-3: primary offerings of non-convertible debt securities that do not meet | http://www.sec.gov/about/forms/formf-3.pdf | Regulation (form) |

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| | | <p>public float criteria listed on form may be eligible for registration on the form if rated investment grade by at least one NRSRO.</p> <p>Permits foreign private issuers registering offerings of investment grade securities (as rated by at least one NRSRO) to provide financial information in accordance with Item 17 of Exchange Act Form 20-F (exemption from more burdensome requirement of Item 18).</p> | | |
| Securities Act Form S-4 (17 CFR 239.25) | Registration statement for securities of domestic issuers issued in certain business combination transactions | Allow registrants that meet the registrant eligibility requirements of Form S-3 and are offering investment grade securities (as defined under Form S-3) to incorporate certain information by reference | http://www.sec.gov/about/forms/forms-4.pdf | Regulation (form) |
| Securities Act Form F-4 (17 CFR 239.34) | Registration statement for securities of foreign private issuers issued in certain business combination transactions | <p>Allow registrants that meet the registrant eligibility requirements of Form F-3 and are offering investment grade securities (as defined under Form F-3) to incorporate by reference certain information</p> <p>Determines eligibility to provide financial information under less burdensome requirements: permits foreign private issuers registering offerings of investment grade securities (as rated by at least one NRSRO) to provide financial information in accordance with Item 17 of Exchange Act Form 20-F (exemption from more burdensome requirement of Item 18).</p> | http://www.sec.gov/about/forms/formf-4.pdf | Regulation (form) |
| Securities Act Form F-9 (17 CFR §239.39): | Registration statement for certain investment grade preferred securities of certain Canadian issuers | Determines eligibility to use form: may use form for investment grade debt or investment grade preferred securities (as rated by at least one NRSRO or an | http://www.sec.gov/about/forms/formf-9.pdf | Regulation (form) |

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| | | Approved Rating Organization as defined in National Policy Statement No. 45 of the Canadian Securities Administrator) that are offered for cash or in connection with an exchange offer, and which are either non-convertible or not convertible for a period of at least one year from the date of issuance. | | |
| Securities Exchange Act Schedule 14A (17 CFR 240.14a-101) | Information required in proxy statement. | Allows registrants that meet the registrant eligibility requirements of Form S-3 to incorporate by reference certain information required in a proxy statement when actions to be taken concerns investment grade securities (as defined under Form S-3) | http://edocket.access.gpo.gov/cfr_2008/aprqr/pdf/17cfr240.14a-101.pdf | Regulation |
| Section 3(a)(41) of the Securities and Exchange Act of 1934 (15 USC 78c(a)(41)) | Exchange Act definition of "mortgage related security" | Defines a mortgage-related security as, among other things, "a security that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization." | http://www4.law.cornell.edu/uscode/html/uscode15/usc_sec_15_00000078---c000-.html | Legislation |
| Securities Act Rule 415(a)(1)(vii) (17 CFR 230.415(a)(1)(vii)) | Delayed or continuous offering and sale of securities | Provides that certain mortgage related securities (see above) are permitted to be offered on a delayed basis under Rule 415. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.415.htm | Regulation |
| Securities Act Rule 138 (17 CFR 230.138) | Certain communications deemed not to be an offer for sale or offer to sell a security: publications or distributions of research reports by brokers or dealers about securities other than those they are distributing | A broker's or dealer's publication about securities of a foreign private issuer that meets F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities is deemed not to be an offer for sale or offer to sell a security | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.138.htm | Regulation |
| Securities Act Rule 139 (17 CFR 230.139) | Certain communications deemed not to be an offer for | A broker's or dealer's publication or distribution of a research report about an | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.139.htm | Regulation |

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| | sale or offer to sell a security: publications or distributions of research reports by brokers or dealers distributing securities | issuer or its securities where the issuer meets Form S-3 or F-3 registrant requirements and is or will be offering investment grade securities pursuant to General Instruction I.B.2 of Form S-3 or F-3, or where the issuer meets Form F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities is deemed not to be an offer for sale or offer to sell a security | | |
| Securities Act Rule 168 (17 CFR 230.168) | Certain communications deemed not to be an offer for sale or offer to sell a security: certain communications of regularly released factual business information and forward-looking information | The regular release and dissemination by or on behalf of an issuer of communications containing factual business information or forward-looking information where the issuer meets Form F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities is deemed not to be an offer for sale or offer to sell a security | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.168.htm | Regulation |
| Securities Act Regulation AB Item 1100(c) (17 CFR 229.1100(c)) | ABS issuer filings: presentation of certain third-party financial information | If a significant obligor meets the registrant requirements for Form S-3 or Form F-3 and the pool assets relating to the obligor are non-convertible investment grade rated securities (as defined in Form S-3 or Form F-3), then an ABS issuer's filings may include a reference to the financial information of the obligor on file with the Commission rather than presenting the full financial information of the obligor. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1100.htm | Regulation |
| Securities Act Regulation AB Item 1101(a) (17 CFR 229.1101(a)) | ABS issuer filings: definition of "ABS informational and computation material" | Definition includes the "anticipated ratings" of asset-backed securities being offered | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1101.htm | Regulation |

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| Securities Act Regulation AB Item 1103(a)(9) (17 CFR 229.1103(a)(9)) | ABS issuer filings: transaction summary and risk factors | Requires disclosure of whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies and, if so, disclosure of the identity of each rating agency and the minimum rating that must be assigned | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1103.htm | Regulation |
| Securities Act Regulation AB Item 1109 (17 CFR 229.1109) | ABS issuer filings: trustees | Requires disclosure of any actions required by the trustee, including whether notices are required to rating agencies, among other entities | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1109.htm | Regulation |
| Securities Act Regulation AB Item 1112 (17 CFR 229.1112) | ABS issuer filings: disclosure of certain financial information regarding significant obligors | If the obligations of the significant obligor as they relate to the pool assets are backed by the full faith and credit of a foreign government and the pool assets are investment grade securities (as defined in Form S-3), no financial information disclosure is required | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1112.htm | Regulation |
| Securities Act Regulation AB Item 1114 (17 CFR 229.1114) | ABS issuer filings: disclosure of significant credit enhancement providers | If the obligations of the credit enhancement provider are backed by a foreign government and the enhancement provider has an investment grade rating (as defined in Form S-3), no financial information disclosure is required | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1114.htm | Regulation |
| Securities Act Regulation AB Item 1120 (17 CFR 229.1120) | ABS issuer filings: ratings | Requires disclosure of whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies, whether or not NRSROs and, if so, disclosure of the identity of each rating agency and the minimum rating that must be assigned. Any arrangements to have such rating monitored while the | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.1120.htm | Regulation |

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| | | asset-backed securities are outstanding also must be described. | | |
| Item 10(c) of Regulation S-K (17 CFR 229.10(c)) | Commission policy on security ratings | Describes Commission policy on disclosure concerning ratings and sets out its views on matters to be considered in disclosing securities ratings in Commission filings: permits, but does not require, issuers to disclose in filings security ratings assigned by credit rating agencies to classes of debt securities, convertible debt securities, and preferred stock, and provides guidelines for doing so | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr229.10.htm | Regulation |
| Securities Act Rule 436(g) (17 CFR 230.436(g)) | Consents required in special cases | Provides that a security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock is not a part of a registration statement prepared or certified by a person or a report or valuation prepared or certified by a person within the meaning of sections 7 and 11 of the Securities Act. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.436.htm | Regulation |
| Securities Act Rule 134(a)(17) (17 CFR 230.134(a)(17)) | Communications not deemed a prospectus | Permits the disclosure of security ratings in certain communications deemed not to be a prospectus or free writing prospectus | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr230.134.htm | Regulation |
| Rule 100(b)(2) of Regulation FD (17 CFR 243.100(b)(2)) | General rule regarding selective disclosure | Disclosures to an entity whose primary business is the issuance of security ratings are excluded from coverage provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr243.100.htm | Regulation |
| Investment Company Act Rule 2a-7 (17 CFR 270.2a-7) | Governs the operation of money market funds: contains maturity, quality, and diversification | Provides minimum quality investment standards for money market funds: limits a fund's portfolio investments to securities that have received credit ratings from any | http://www.law.uc.edu/CCL/InvCoRIs/rule2a-7.html | Regulation |

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| | conditions | two NRSROs (one if only one has rated the security) in one of the two highest short-term rating categories or comparable unrated securities; restricts money market funds to securities that the fund's board of directors determines present minimal credit risks (requiring that such determination "be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO") | | |
| Investment Company Act Rule 3a-7 (17 CFR 270.3a-7) | Excludes structured finance vehicles from the Act's definition of "investment company" subject to certain conditions | Requires that structured financings offered to the general public are rated by at least one NRSRO in one of the four highest ratings categories (with certain exceptions for ABS sold to accredited investors and qualified institutional buyers) | http://www.law.uc.edu/CCL/InvCoRIs/rule3a-7.html | Regulation |
| Investment Company Act Rule 5b-3 (17 CFR 270.5b-3) | Permits a fund to treat a repurchase agreement as an acquisition of the securities collateralizing the repurchase agreement | Among other conditions to allow fund to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of sections 5(b)(1) and 12(d)(3) of the Act, the collateral for the repurchase agreement consists entirely of (i) cash items, (ii) government securities, (iii) securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the "Requisite NRSROs" or (iv) unrated securities that are of a comparable quality to securities that are rated in the highest rating category by the Requisite NRSROs | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr270.5b-3.htm | Regulation |
| Investment Company Act Rule 10f-3 (17 CFR 270.10f-3) | Permits a fund that is affiliated with members of an underwriting syndicate to purchase securities from the syndicate if certain conditions | Defines municipal securities that may be purchased during an underwriting in reliance on the rule to include securities that have an investment grade rating from at least one NRSRO or, if the issuer or the | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr270.10f-3.htm | Regulation |

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| | are met | entity supplying the revenues or other payments from which the issue is to be paid has been in continuous operation for less than three years one of the three highest ratings from an NRSRO | | |
| Investment Advisers Act Rule 203A-2(a) (17 CFR 275.203A-2(a)) | Exemptions from prohibition on Commission registration | Exempts an investment adviser that is a nationally recognized statistical rating organizations (as term is used in (c)(2)(vi)(E), (F), and (H) of 17 CFR 240.15c3-1) from prohibition on registration | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr275.203A-2.htm | Regulation |
| Investment Advisers Act Rule 206(3)-3T (17 CFR 275.206(3)-3T) | Establishes a temporary alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients | An adviser generally may not rely on the rule for principal trades of securities if the investment adviser or a person who controls, is controlled by, or is under common control with the adviser is the issuer or is an underwriter of the security, but rule does not apply for trades in which the adviser or a control person is an underwriter of non-convertible investment-grade debt securities (defined as rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations) | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr275.206(3)-3T.htm | Regulation |
| Securities Exchange Act Rule 3a-1 (17 CFR 240.3a1-1) | Exemption from the definition of "Exchange" under Section 3(a)(1) of the Act. | Establishes "investment grade corporate debt securities" and "non-investment grade corporate debt securities" as distinct classes of securities for purpose of rule (in determining whether an ATS has dominant status in a class of securities) | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.3a1-1.htm | Regulation |
| Regulation ATS Rule 301(b)(5) (17 CFR 242.301(b)(5)) | Requirements for alternative trading systems: imposes "fair access" requirement, whereby an ATS that exceeds certain volume thresholds in any class of securities must | Establishes volume thresholds for investment grade corporate debt securities and non-investment grade corporate debt securities (as those terms are defined in Regulation ATS Rule 300) (17 CFR 242.300)) | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr242.300.htm | Regulation |

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| | establish written standards for granting access to trading on its system and not unreasonably prohibit or limit any person in respect to access to the services it offers | | | |
| Regulation ATS Rule 301(b)(6) (17 CFR 242.301(b)(6)) | Requirements for alternative trading systems: requires an ATS that exceeds certain volume thresholds in any class of securities to comply with standards regarding the capacity, integrity, and security of its automated systems | Establishes volume thresholds for investment grade corporate debt securities and non-investment grade corporate debt securities (as those terms are defined in Regulation ATS Rule 300) (17 CFR 242.300)) | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr242.301.htm | Regulation |
| Securities Exchange Act Form ATS-R (17 CFR 249.638) | Quarterly report of alternative trading systems activities | Requires each ATS to report the total unit volume and total dollar volume in the previous quarter for various categories of securities, including investment grade and non-investment grade corporate debt securities (as defined in General Instruction B to the form) | http://www.sec.gov/about/forms/formats-r.pdf | Regulation (form) |
| Securities Exchange Act Form PILOT (17 CFR 249.821) | Initial operation report, amendment to initial operation report and quarterly report for pilot trading systems operated by self-regulatory organizations | Requires quarterly reporting of the total unit volume and total dollar volume in the previous quarter for various categories of securities, including investment grade and non-investment grade corporate debt securities (as defined in General Instruction B to the form) | http://www.sec.gov/about/forms/formpilot.pdf | Regulation (form) |
| Securities Exchange Act Rule 10b-10(a)(8) (17 CFR 240.10b-10(a)(8)) | Requires broker-dealers to disclose Specified information in writing to customers at or before completion of a transaction. | Requires broker-dealers providing transaction confirmations for debt securities, other than a government security, to disclose that the security is unrated by a nationally recognized statistical rating organization, if | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.10b-10.htm | Regulation |

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| | | such is the case | | |
| Securities Exchange Act Rule 15c3-1 (17 CFR 240.15c3-1) | Broker-dealer net capital requirements | In computing their net capital, broker dealers may apply smaller haircuts (percentage deduction of market value) to commercial paper rated in one of the three highest rating categories by at least two nationally recognized statistical rating organizations and to nonconvertible debt securities and preferred stock rated in one of the four highest rating categories by at least two nationally recognized statistical rating organizations. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-1.htm | Regulation |
| Securities Exchange Act Rule 15c3-1 Appendix A (17 CFR 240.15c3-1a) | Net capital treatment of options | Defines “major market foreign currency” as the currency of a sovereign nation whose short-term debt is rated in one of the two highest categories by at least two nationally recognized statistical rating organizations and for which there is a substantial inter-bank forward currency market. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-1a.htm | Regulation |
| Securities Exchange Act Rule 15c3-1 Appendix E (17 CFR 240.15c3-1e) | Alternative approach to computing net capital deductions for certain broker-dealers | Allows broker-dealers to employ NRSRO ratings to calculate credit risk weights of counterparties. Broker-dealer may apply for Commission approval to determine credit ratings using internal calculations for counterparties that are not rated by an NRSRO, and may use such internal credit ratings in lieu of ratings issued by an NRSRO for purposes of determining credit risk weights. | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-1e.htm | Regulation |
| Securities Exchange Act Rule 15c3-1 Appendix F (17 CFR 240.15c3-1f) | Alternative approach to computing net capital deductions for OTC derivatives dealers | Allows OTC derivatives dealers to employ NRSRO ratings to calculate credit risk weights of counterparties. OTC derivatives dealers may apply for Commission approval to determine credit ratings using internal calculations for counterparties that | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-1f.htm | Regulation |

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| | | are not rated by an NRSRO. | | |
| Securities Exchange Act Rule 15c3-1 Appendix G (17 CFR 240.15c3-1g) | Conditions for broker-dealers to compute capital deductions under Appendix E | An ultimate holding company that does not have a principal regulator must determine credit ratings and credit risk weights according to the provisions of Appendix E and must notify Commission within 24 hours if, among other conditions, it becomes aware that an NRSRO has determined to reduce materially its assessment of the creditworthiness of a material affiliate or the credit rating(s) assigned to one or more outstanding short or long-term obligations of a material affiliate | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-1g.htm | Regulation |
| General Instructions to Securities Exchange Act Form X-17 A-5, Part IIB (17 CFR 249.617) | Financial and Operational Combined Uniform Single (FOCUS) Report for OTC derivatives dealers | Pursuant to Appendix F (see above), allows OTC derivatives dealers to employ NRSRO ratings to calculate credit risk weights of counterparties. | http://www.sec.gov/about/forms/formx-17a-5_2b.pdf | Regulation (form) |
| Note G to Exhibit A of Securities Exchange Act Rule 15c3-3 (17 CFR 240.15c3-3a) | Provides the formula for the determination of broker-dealers' reserve requirements | Allows a broker-dealer to include as a debit in the formula the amount of customer margin related to customers' positions in security futures products posted to a registered clearing or derivatives organization that maintains the highest investment grade rating from an NRSRO | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr240.15c3-3a.htm | Regulation |
| Regulation M Rule 101(c)(2) (17 CFR 242.101(c)(2)) | In connection with a distribution of securities, prohibits a distribution participant or an affiliated purchaser of such person, directly or indirectly, to bid for, purchase, or attempt to induce any person to bid for or purchase, a | Exempts from the provision nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities, that are rated by at least one nationally recognized statistical rating organization, as that term is used in 17 CFR 240.15c3-1, in one of its generic rating categories that signifies investment grade | http://edocket.access.gpo.gov/cfr_2008/aprqr/17cfr242.101.htm | |

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| | covered security during the applicable restricted period | | | |
| Regulation M Rule 102(d)(2) (17 CFR 242.102(d)(2)) | In connection with a distribution of securities effected by or on behalf of an issuer or selling security holder, prohibits such person, or any affiliated purchaser of such person, directly or indirectly, to bid for, purchase, or attempt to induce any person to bid for or purchase, a covered security during the applicable restricted period | Exempts from the provision nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities, that are rated by at least one nationally recognized statistical rating organization, as that term is used in 17 CFR 240.15c3-1, in one of its generic rating categories that signifies investment grade | http://edocket.access.gpo.gov/cfr_2008/aprqrtr/17cfr242.102.htm | |
| Securities Exchange Act Rule 17i-8(a)(4) (17 CFR 240.17i-8(a)(4)) | Notification provisions for supervised investment bank holding companies | A supervised investment bank holding company must notify Commission within 24 hours if, among other conditions, it becomes aware that an NRSRO has determined to reduce materially its assessment of the creditworthiness of a material affiliate or the credit rating(s) assigned to one or more outstanding short or long-term obligations of a material affiliate | http://edocket.access.gpo.gov/cfr_2008/aprqrtr/17cfr240.17i-8.htm | Regulation |

U.S.

Banking Agencies Use of Credit Ratings

LRSPs are listed for each banking agency and grouped into the following categories: Statutes, Regulations, and Guidance. Inter-agency LRSPs are included in a separate section at the end of the table.

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (i.e., what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (i.e., why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| Federal Deposit Insurance Act – Section 7 (b) Assessments (E) Information Concerning Risk of Loss and Economic Conditions (i) Sources of Information | This section establishes resources the FDIC will use to monitor insured depository institutions. Other | The Act references any information available from “credit rating entities” as one of the numerous sources of information the agency will use for purposes of determining risk of losses at insured depository institutions and economic conditions generally affecting depository institutions. | | Statute |
| Assessments 12 CFR Part 327 | The regulation discusses the time and manner of payment of the assessments by insured institutions, describes the classification of depository institutions for risk, and outlines the process for review of assessments. | Use of long-term debt issuer ratings could be considered a reflection of a depository institution’s financial strength and stability, and should be available for large financial institutions. Further, the use of the long-term debt issuer ratings is also restricted to the strong and well-managed large institutions (Risk Category 1). -- “Long-term debt issuer rating” is defined as a | | FDIC Regulation |

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| | Other | <p>current rating of an insured depository institution's long-term debt obligations by Moody's Investor Services, Standard & Poor's, or Fitch ratings. A long-term debt issuer rating does not include a rating of a company that controls and insured depository institution, or an affiliate or subsidiary of the institution. A current rating shall mean one that has been confirmed or assigned within 12 months before the end of the quarter for which an assessment rate is being determined.</p> <p>-- Assessment rates for large (\$10 billion or more in total assets) Risk Category 1 institutions, which are defined as financially sound institutions with only a few minor weaknesses and which are Well Capitalized, will have their deposit insurance assessments based on a combination of the supervisory and debt ratings method. The debt ratings method involves using the long-term debt issuer rating and converting this rating to values between 1 and 3 and converted values will be averaged. The weighted average CAMELS rating and the average of converted long-term debt issuer ratings will be used in the calculation of the final assessment amount as described in the regulation.</p> | | |
| FDIC Covered Bond Policy Statement | <p>Clarifies the FDIC treatment of covered bonds if the issuing insured institution is placed into FDIC receivership or conservatorship.</p> <p>Securitisation</p> | <p>The Covered Bond Policy Statement uses the term "AAA-rated mortgage-backed securities" and similar references to define the eligible collateral which may be included in the underlying pool of a US Covered Bond issuance. The "AAA-rated mortgage securities" should comprise no more than 10 percent of the collateral for any covered bond issuance or series, and must be secured by eligible mortgages. The reference to the highest rated mortgage-backed securities and the restrictions set forth on these bonds are used to ensure that high-quality mortgage assets are included in the underlying collateral of the covered bond pool. If mortgages or AAA-rated mortgage securities must be removed from the pool, the institution</p> | | FDIC Guidance |

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| | | <p>may substitute cash and Treasury and agency securities as necessary to manage the covered pool. The guidance specifically prohibits the substitution of resecuritized mortgage-backed bonds such as collateralized debt obligations.</p> <p>-- P. 4-6 - "AAA-rated mortgage-backed securities" and "AAA-rated mortgage securities" are referenced several times, but there is no definition of the source or nature of the source or nature of these AAA ratings. AAA-rated mortgage-backed bonds may comprise up to 10% of the underlying collateral of a US Covered Bond Issuance according to the Policy Statement. The references further specify that the underlying loans in the "AAA-rated mortgage-backed securities" must be "eligible mortgages", which are defined as performing first lien mortgages on one-to-four family residential properties, underwritten at the fully indexed rate and relying on documented income, and complying with existing supervisory guidance governing the underwriting of residential mortgages.</p> | | |
| Regulation F, Limitations on Interbank liabilities 12 CFR 206 | Prescribes standards to limit the risks that the failure of a depository institution would pose to an insured depository institution Other | <p>12 CFR 206.3(b)(3) – A bank may rely on another party, such as a bank rating agency or the bank's holding company, to assess the financial condition of or select a correspondent, provided that the bank's board of directors has reviewed and approved the general assessment or selection criteria used by that party.</p> <p>12 CFS 206.5(b) – A bank shall obtain information to demonstrate that a correspondent is at least adequately capitalized on a quarterly basis, either from the most recently available Report of Condition and Income, Thrift Financial Report, financial statement, or bank rating report for the correspondent.</p> | | FRB Regulation |

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| <p>Regulation H, Subpart G: Membership Of State Banking Institutions In The Federal Reserve System, Financial Subsidiaries of State Member Banks 12 CFR 208.71</p> | <p>Defines the requirements applicable to financial subsidiaries of state member banks</p> <p>Other</p> | <p>12 CFR 208.71(b)(ii) – Credit ratings are used as part of a set of requirements to determine the overall strength of certain large state member banks. A state member bank that is one of the largest 100 insured banks may own or control a financial subsidiary only: (i) If the bank is one of the largest 50 insured banks, the bank has an issue of long-term unsecured debt outstanding that has a credit rating of A- or better; or (ii) If the bank is within the next 50 largest insured banks (that is, 51 to 100), the bank has a long-term debt instrument that meets the test in the previous bullet or the bank has a long-term issuer credit rating of A- or better.</p> | | <p>FRB Regulation</p> |
| <p>Regulation K, Subpart A: International Banking Operations, International Operations of U.S. Banking Organizations 12 CFR 211, Subpart A</p> | <p>Defines the permissible activities and investments of foreign branches of U.S. member banks.</p> <p>Asset Identification/ Classification</p> | <p>12 CFR 211.4(a)(2) – Credit ratings are used to describe the quality of permissible investments. Foreign branches of member banks may engage in certain permissible activities, which include underwriting, buying, selling, and holding obligations of (i) any national government or political subdivision if the obligations are rated investment grade (BBB- or better); and (ii) any agency or instrumentality of any national government if such obligations are rated investment grade and are supported by the taxing authority, guarantee, or full faith and credit of the national government.</p> | | <p>FRB Regulation</p> |
| <p>Regulation Y, Subpart I: Bank Holding Companies And Change In Bank Control, Financial Holding Companies 12 CFR 225, Subpart I</p> | <p>Describes how a foreign bank application for financial holding company status becomes effective.</p> <p>Other</p> | <p>12 CFR 225.92(e)(1) – Credit ratings are used as part of a list of factors to determine whether a bank is well capitalized. In making this determination, the Board considers, among other things, the long-term debt credit ratings of the foreign bank.</p> | | <p>FRB Regulation</p> |

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| Regulation W Implementing Sections 23A and 23B of the Federal Reserve Act 12 CFR 223 Subpart H | Defines asset quality requirements in which a member bank purchases assets from an affiliate Asset Identification/ Classification | Section 223.42 (g) exempts from the quantitative limit, collateral requirements, and low quality asset prohibition of Reg. W the purchase of a municipal security from a securities affiliate if the security is rated by an NSRO among other conditions. | FRB Regulation |
| SR 00-14: Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations | Describes interagency procedures for assessing an FBO and the condition of its U.S. operations Other | Credit rating terms are used in FBO profile descriptions that correspond to Strength- Of-Support Assessment ratings. For an assessment of "1", the FBO is viewed as investment grade or equivalent. For an assessment of "2", the FBO may warrant more than normal review based on various factors including the lack of an investment grade rating. In addition, the guidance notes that credit ratings can be a useful reference point for assessing a firm's financial outlook. | FRB Guidance |
| SR 98-25: Sound Credit Risk Management and the Use of Internal Credit Risk Ratings at Large Banking Organizations | Describes the key elements of internal rating systems used to support credit risk management at large banking organizations Asset Identification /Categorisation | The guidance document notes that banks may use external credit ratings as a reference point when assigning their internal risk rating grades (e.g., senior public debt ratings issued by one or more major ratings agencies). | FRB Guidance |
| SR 98-18: Lending Standards for Commercial Loans | Provides guidance to FRS examiners on certain areas of lending practice Asset Identification/ Classification | External credit rating scales are considered one way to assess a firm's consistency in applying their internal risk rating system. The guidance document includes specific references to Standard and Poor's or Moody's as producing well-known external ratings scales. | FRB Guidance |
| SR 97-18: Application of Market Risk Capital Requirements to Credit Derivatives | Describes how credit derivatives held in the trading account should be treated under the market risk capital requirements for banking organizations | Credit ratings are used to assign risk-based capital "add-on" factors (representing potential future credit exposure) for credit derivative transactions. Higher rated credit derivatives transactions are assigned a lower add-on factor, while lower rated | FRB Guidance |

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| | Capital | transactions are assigned a higher add-on factor. The equity add-on factors are used when the reference asset is an investment grade instrument or where the reference asset is unrated but well-secured by high-quality collateral. The commodity add-on factor is to be used when the reference asset is either below investment grade or is unrated and unsecured. | | |
| SR 91-4: Guidelines for the Inspection of Investment Adviser Subsidiaries of Bank Holding Companies | Describes inspection guidelines of FRS examiners of non-bank subsidiaries that engage in investment advisory activities per Regulation Y Asset Identification/ Classification | Reliance on external credit ratings are one factor used to assess a bank's investment standards and research. The guidance document includes specific references to Moody's and Standard and Poor's as examples of acceptable financial rating services. | | FRB Guidance |
| Investment Securities ⁴⁸ 12 CFR 1 | Prescribes the permissible investment securities for national banks. Asset Identification/ Classification | The term "investment grade" is used as a qualitative proxy for a security that is not predominately speculative. Investment grade is defined as a security rated in one of the four highest rating categories by (1) Two or more NRSRO's; or (2) One NRSRO if the security has been rated by only one NRSRO. § 1.2(d) - definition of investment grade means a security rated in one of the four highest rating categories by two or more NRSROs or one NRSRO if the security has been rated by only one NRSRO. § 1.2(e) - definition of investment security as not predominantly speculative in nature if it is rated investment grade. § 1.2(f)(3) - definition of marketable includes a security sold pursuant to SEC Rule 144A and rated investment grade or the credit equivalent thereof. § 1.2(h) - NRSRO means a nationally recognized statistical rating organization. | http://www.occ.gov/fr/cfr.htm | OCC Regulation |

⁴⁸ These regulations apply to institutions regulated by the FRB, FDIC, and the OTS.

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| | | <p>§ 1.2(m)(1) - definition of Type IV security includes a small-business-related security as defined in the Exchange Act that is rated investment grade or the credit equivalent thereof, that is fully secured by interests in a pool of loans to numerous obligors.</p> <p>§ 1.2(m) (2) - definition of Type IV security includes a commercial mortgage-related security that is offered or sold pursuant to section 4(5) of the Securities Act and is rated investment grade or the credit equivalent thereof, or a commercial mortgage-related security as described in the Exchange Act that is rated investment grade in one of the two highest investment grade rating categories.</p> <p>§ 1.2(m) (3) - definition of Type IV investment security includes a residential mortgage-related security that is offered and sold pursuant to section 4(5) of the Securities Act and rated investment grade or the credit equivalent thereof, or a residential mortgage-related security as described in the Exchange Act that is rated investment grade in one of the two highest investment grade rating categories and that does not otherwise qualify as a Type I security.</p> <p>§ 1.2(n)(1) - definition of Type V security as a security that is rated investment grade, among other requirements.</p> <p>§ 1.3(e)(2) - limitation on banks purchasing and selling for their own account, small business-related securities rated in the third and fourth highest rating categories by an NRSRO.</p> <p>§ 1.3(h) - A national bank may buy and sell for its own account investment company shares that meet other requirements provided that the shares are rated investment grade or the credit equivalent of investment grade.</p> | | |
| <p>Rules, Policies, And Procedures For Corporate Activities, Subpart C - Expansion Of Activities 12 CFR 5.39</p> | <p>Establishes rules, policies and procedures of the OCC for corporate activities and transactions involving national banks.</p> <p>Other</p> | <p>The reference to credit ratings in this regulation was expressly provided in Section 121 of the Gramm-Leach-Bliley Act.</p> <p>12 U.S.C. 24a; 12 C.F.R. § 5.39(g)(3). National banks generally may conduct activities through financial subsidiaries only if they are among the top 100 largest banks and have received a credit rating from an NRSRO within the three highest investment</p> | <p>http://www.occ.gov/fr/cfr.htm</p> | <p>OCC Regulation</p> |

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| | | grade rating categories. | | |
| Securities Offering Disclosure Rules 12 CFR 16.6 | Sets forth rules governing the offer and sale of securities issued by a bank Disclosure | 12 CFR 16.6(a)(4) - a national bank may sell nonconvertible debt under reduced disclosure requirements where the bank meets specified requirements, including that the debt is rated investment grade. | http://www.occ.gov/fr/cfr.htm | OCC Regulation |
| International Banking Activities, Subpart B - Federal Branches and Agencies of Foreign Banks 12 CFR 28.15 | Implements the International Banking Act pertaining to Federal branches and agencies in the United States. Asset Identification/ Classification | 12 CFR 28.15(a)(iii). A foreign bank's capital equivalency deposits may consist of certificates of deposit, payable in the United States, and banker's acceptances, provided that, in either case, the issuer or the instrument is rated investment grade by an internationally recognized rating organization, and neither the issuer nor the instrument is rated lower than investment grade by any such rating organization that has rated the issuer or the instrument. | http://www.occ.gov/fr/cfr.htm | OCC Regulation |
| Lending and Investment Regulation 12 CFR Part 560 | Asset Identification / Permissibility | OTS uses references to credit ratings in the OTS's Lending and Investment Regulation, Part 560, and related guidance in its Examination Handbook because credit ratings, although imperfect, have been a resource to assist savings associations and examiners in the evaluation of the creditworthiness and stability of the issuer and the quality of the investment security. Such ratings, if current, are used as a first indicator of asset quality; however, institutions are expected to perform their own credit analysis, as appropriate, based on the size of the investment, market conditions, and any other information available. 12 CFR § 560.40(a)(1) - Subject to additional limitations, a federal savings association (FSA) may invest in, sell, or hold commercial paper if the commercial paper is: "(i) As of the date of purchase, rated in either one of the two highest categories by at least two nationally recognized investment ratings services [NRSRO] as shown by the most recently published rating made of such investments; or (ii) If unrated, guaranteed by a company having outstanding paper that is [rated in either one of the two highest categories]." § 560.40(a)(2) - Subject to additional limitations, a | | OTS Regulation |

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| | | <p>FSA may invest in, sell, or hold corporate debit securities if they are: “(i) Securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value; and (ii) Rated in one of the four highest categories as to the portion of the security in which the [FSA] is investing by a [NRSRO] at its most recently published ratings before the date of purchase of the security.”</p> <p>§ 560.42(d) - A FSA may invest in obligations of state and local government subject to a number of conditions, including appropriate underwriting. Underwriting is appropriate if, “[i]n the case of a security rated in one of the four highest investment grades by a [NRSRO], [the FSA’s] assessment of the obligor’s credit quality may be based, in part, on reliable ratings agency estimates of the obligor’s performance.”</p> <p>§ 560.93(d)(5) - A savings association may exceed the generally applicable lending limitations, by investing in “up to 10 percent of unimpaired capital and unimpaired surplus in the obligations of one issuer evidenced by: (i) Commercial paper rated, as of the date of purchase, as shown by the most recently published ratings by at least two [NRSROs] in the highest category; or (ii) Corporate debt securities that may be sold with reasonable promptness at a price that corresponds reasonably to their fair value, and that are rated in one of the two highest categories by a [NRSRO] in its most recently published ratings before the date of purchase of the security.”</p> <p>§ 560.121(b)(1) - A savings association that is adequately capitalized, to the extent it has legal authority to do so, may invest in obligations of a state housing corporation located in the state in which the savings association has its home or a branch office, provided that: “(1) The obligations are rated in one of the four highest grades as shown by the most recently published ratings made of such obligations by a [NRSRO]; or (2) The obligations, if not rated, are approved by [OTS].”</p> | | |
| <p>OTS Examination Handbook, Section 211: Loans to One Borrower</p> | <p>Asset Identification Permissibility</p> | <p>OTS uses references to credit ratings in the OTS’s Lending and Investment Regulation, Part 560, and related guidance in its Examination Handbook because credit</p> | | <p>OTS Guidance</p> |

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| | | ratings, although imperfect, have been a resource to assist savings associations and examiners in the evaluation of the creditworthiness and stability of the issuer and the quality of the investment security. Such ratings, if current, are used as a first indicator of asset quality; however, institutions are expected to perform their own credit analysis, as appropriate, based on the size of the investment, market conditions, and any other information available. | | |
| OTS Examination Handbook, Section 221: Asset Securitization | Asset Identification Permissibility | | | OTS Guidance |
| OTS Thrift Bulletin 73a: Investing in Complex Securities | Asset Identification Permissibility | | | OTS Guidance |
| OTS Examination Handbook, Section 540: Investment Securities | Asset Identification Permissibility | This bulletin more specifically discusses the use of rating agencies and their ratings in evaluating securities. | | OTS Guidance |
| OTS Examination Handbook, Section 221: Asset-Backed Securitization | Asset Identification /Classification /Permissibility | | | OTS Guidance |
| OTS Holding Company Handbook, Section 940: Large and Complex Enterprises (Conglomerates) | Other – this section establishes resources that the OTS uses to monitor large and complex enterprises | | | OTS Guidance |
| OTS Examination Handbook, Appendix A: Capital Components and Risk-Based Capital, Section 120 | Guidance to examiners relating to Regulatory Capital Requirements Regulation Capital | | | OTS Guidance |

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| <p>Risk-Based Capital Guidelines⁴⁹ 12 CFR 3, Appendix A</p> | <p>Risk-based capital adequacy guidelines applicable to national banks.</p> <p>Capital</p> | <p>The references to credit ratings and the term “investment grade” are used to differentiate relative risk. The use of external credit ratings issued by rating agencies as a basis for determining credit quality was consistent with the approach outlined by the Basel Committee.</p> <p>§ 1(c)(3) - Definition of asset-backed commercial paper references external ratings. § 1(c)(22) - Definition of an NRSRO § 4(a)(5) - Definition of externally rated means an instrument or obligation has received a credit rating from at least one nationally recognized statistical rating organization. § 4(a)(10) - Definition of an NRSRO - this definition is substantially the same as the definition in Appendix A, § 1</p> <p>§ 3(a)(2)(xiii)(C) - 20 percent risk weight assigned to claims on, or guaranteed by, a securities firm incorporated in an OECD country, provided the firm meets certain requirements, including having either a long-term issuer credit rating or a credit rating on at least one issue of long-term unsecured debt, from a NRSRO that is in one of the three highest investment-grade categories used by the NRSRO.</p> <p>§ 3(a)(4)(iii) - Asset-or mortgage backed securities that are externally rated receive a risk weight of 20, 50, 100, or 200 percent, depending on their external ratings.</p> <p>§ 3(b) - The second step of the two-step process to determine the risk weight assigned to an off-balance sheet item may use an external credit rating in accordance with section 4(d).</p> <p>§ 3(b)(6)(ii)(A) - An unused portion of an asset-backed commercial paper liquidity facility may be eligible for either a 50 percent or a 10 percent credit conversion factor, provided it meets certain requirements,</p> | <p>http://www.occ.gov/fr/cfr.htm</p> | <p>Interagency Regulation</p> |
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⁴⁹ OCC regulations are included as an example; capital regulations for the other banking agencies are analogous. See 12 CFR 208, Appendix A (for state member banks), 12 CFR 225, Appendix A (for bank holding companies), 12 CFR 325 (for state nonmember banks), and 12 CFR Part 567 (for savings associations).

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| | | <p>including the requirement that if the assets that an asset-backed commercial paper liquidity facility is required to fund are externally rated securities at the time they are transferred into the program, the asset-backed commercial paper liquidity facility must be used to fund only securities that are externally rated investment grade at the time of funding.</p> <p>§ 4(a)(16) - Definition of traded position references an external rating – to be considered a “traded position” the position must be externally rated and there must be a reasonable expectation that the rating will be relied upon by an unaffiliated investor or third party.</p> <p>§ 4(d) - A recourse obligation, direct credit substitute, residual interest (other than a credit-enhancing interest-only strip) or asset- or mortgage-backed security that is a “traded position” and that has received an external rating on a long-term position that is one grade below investment grade or better or a short-term position that is investment grade may receive a risk weight of either 20, 50, 100, or 200 percent, depending on the NRSRO rating.</p> <p>§ 4(e) - applies to senior positions that are not externally rated – unrated positions that are senior in all respects to externally rated positions may receive a risk weight according to the risk weight applicable to the externally rated position.</p> <p>§ 4(g)(1-3) - Certain assets not rated by an NRSRO may be risk weighted as if the assets were so rated if a bank’s internal systems meet certain requirements. For example, the bank must use an acceptable credit assessment computer program developed by an NRSRO to determine the rating of a direct credit substitute or recourse obligation (but not a residual interest) extended in connection with a structured finance program.</p> | | |
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| Risk-Based Capital Guidelines; Market Risk Adjustment ⁵⁰ 12 CFR 3, Appendix B | Market risk capital guidelines applicable to national banks with significant exposure to market risk. Capital | § 5(c)(1)(B)(fn2) - debt instruments that are rated investment grade by one or more NRSROs are considered “qualifying” and receive a lower specific risk add-on under the standard option. | http://www.occ.gov/fr/cfr.htm | Interagency Regulation |
| Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches ⁵¹ 12 CFR 3 Appendix C | Risk-based capital adequacy guidelines for Basel II advanced approaches applicable to national banks. Capital | § 2: - definition of an NRSRO – this definition is substantially the same as the definitions in Appendix A, §§ 1 and 4. - definition of external rating – for the purposes of the Basel II rule, an external rating is a rating from an NRSRO that reflects the entire amount of credit risk with regard to all payments owed, is published in an accessible form, and is or will be included in the NRSRO’s publicly available transition matrices. - definition of applicable inferred rating references an external rating. - definition of asset-backed commercial paper program (“ABCP”) references external ratings – for the purposes of the Basel II rule, an ABCP program must have an external rating. - definition of eligible double default guarantor – in some cases to recognize a double default guarantor, the bank must assign a probability of default (PD) to the guarantor’s rating grade that is equal to or lower than the PD associated with a long-term external rating of at least investment grade. - definition of eligible securitization guarantor includes entities that must have an external rating in one of the three highest investment-grade categories. - definition of financial collateral includes various types of securities that have applicable external ratings of at least investment grade. § 32(b)(2) - section on supervisory market price volatility haircuts references applicable external rating | http://www.occ.gov/fr/cfr.htm | Interagency Regulation |

⁵⁰ OCC regulations are included as an example; capital regulations for the other banking agencies are analogous. See 12 CFR part 208, Appendix E (for state member banks), 12 CFR part 225, Appendix E (for bank holding companies), and 12 CFR part 325, Appendix C (for state nonmember banks).

⁵¹ OCC regulations are included as an example; capital regulations for the other banking agencies are analogous. See 12 CFR 208 Appendix F (for state member banks), 12 CFR 225, Appendix G (for bank holding companies), 12 CFR 325, Appendix D (for state nonmember banks), and 12 CFR 567, Appendix C (for savings associations).

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| | | <p>grade categories for debt securities.</p> <p>§ 32(c)(5)(fn3) - table on the conversion factor matrix for OTC derivative contracts references external ratings for certain credit derivatives.</p> <p>§ 35(e)(2)(i) - bank may assign an obligor rating, under this section, to a counterparty dependant on the applicable external rating of certain debt issued by the counterparty.</p> <p>§ 43(a) - eligibility requirements for the use of the ratings-based approach requires an originating bank to use the ratings-based approach for a securitization exposure that has at least two external ratings, while an investing banks must use the approach for a securitization exposure that has at least one external rating – national banks may not use the ratings-based approach for exposures that do not meet the eligibility requirements.</p> <p>§ 43(b) - the ratings-based approach references applicable external or inferred ratings of certain securitization exposures in order to determine the appropriate risk weights, as shown in Tables 6 and 7; risk weights rage from 7 percent for AAA-rated securities that are both senior and granular, to deduction for securities that are rated more than one category below investment grade.</p> <p>§ 44 - bank's eligibility to use the internal assessment approach ("IAA") dependant, in part, on referring to the rating criteria of NRSROs and the actual external ratings of NRSROs.</p> <p>§ 46 - limits the recognition of a credit risk mitigant where a bank is applying the ratings-based approach and the external rating used to determine the appropriate risk weight already reflects the benefits of the credit risk mitigant.</p> <p>§ 54(c) - modified look-through approach for equity exposures to investment funds references applicable external ratings.</p> <p>§ 54(e) - money market fund approach references applicable external ratings.</p> <p>§ 61(b)(1)(i) - in order to qualify as an operational risk</p> | | |
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| | | mitigant, insurance must be provided by an insurer with a claims payment ability rated in one of the three highest ratings categories by an NRSRO. | | |
| SR 05-13: Interagency Guidance on the Eligibility of Asset-Backed Commercial Paper Program Liquidity Facilities and the Resulting Risk-Based Capital Treatment | Clarifies how to determine the eligibility or ineligibility of an ABCP liquidity facility and the resulting risk-based capital treatment Capital | Credit ratings are used as part of an asset quality test to determine whether a liquidity facility is eligible, and thus serving its primary purpose of providing liquidity (not credit enhancement). "To be an eligible liquidity facility and qualify for a more favorable risk-based capital treatment, the liquidity provider may not fund against assets that are 90 days or more past due, in default, or below investment grade (p. 2)." | | Interagency Guidance |
| SR 05-6: Risk-Based Capital Treatment for Unrated Direct Credit Substitutes Extended to Asset-Backed Commercial Paper Programs | Clarifies how banks use internal ratings assigned to asset pools purchased by ABCP programs in order to risk weight direct credit substitutes to such programs Capital | Credit rating agency's rating methodologies are cited as being similar to the factors used in the guidance to assess the credit quality of risk exposures to ABCP programs (p. 4-5). One of the requirements for using the internal assessment approach is that the commercial paper issued by the ABCP program be externally rated (p. 12-13). One factor for supervisors to consider when assessing a bank's internal risk rating system is whether the rating system corresponds to external rating categories of investment grade, high non-investment grade and low non-investment grade (p. 2, 12). "The Securitization Capital Rule permits banking organizations with qualifying internal risk rating systems to use those systems to apply the internal ratings approach to their unrated direct credit substitutes extended to ABCP programs that they sponsor by mapping internal risk ratings to external ratings | | Interagency Guidance |

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| | | <p>equivalents. These external credit rating equivalents are organized into three ratings categories: investment grade credit risk, high non-investment grade (BB+ through BB-) credit risk, and low non-investment grade (below BB-) credit risk. . . . the minimum risk weight available under the internal risk ratings approach is 100 percent, regardless of the internal rating [Exposures externally rated by a nationally recognized statistical rating organization (NRSRO) above BBB+ are eligible for lower risk weights].”</p> <p>Another factor for supervisors to consider when assessing a bank’s internal rating system is whether the internal ratings of ABCP program exposures are consistent with ratings issued by the rating agencies (p. 19).</p> | | |
| SR 04-9: Revised Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts | <p>Describes the supervisory classification of bank assets</p> <p>Asset Identification /Categorisation</p> | <p>Credit ratings are used by agency examiners as a proxy for the supervisory classification of securities. “Examiners may, however, assign a more or less severe classification for an individual security upon review. Where there are multiple NRSRO ratings for a security, the lowest rating is usually used (p. 1).”</p> | | Interagency Guidance |
| SR 03-2: Adoption of Regulation W Implementing Sections 23A and 23B of the Federal Reserve Act | <p>Adoption of Regulation W Implementing Sections 23A and 23B of the Federal Reserve Act</p> <p>Asset Identification /Categorisation</p> | <p>Comprehensive Review of Regulation W Attachment (p. 1) - "Section 23A prohibits a bank from purchasing a low-quality asset from an affiliate. Section 223.3(u) of Regulation W defines a low quality asset to include an asset that is classified or treated as 'special mention' . . . in an examination report Securities issued by an affiliate and low-quality assets are not acceptable collateral for any credit transaction with an affiliate."</p> <p>P. 16 - “Exemption for Purchases of Municipal Securities from a Securities</p> | | Interagency Guidance |

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| | | Affiliate. . . . The security is rated by a nationally recognized statistical rating organization” | | |
| SR 02-16: Questions and Answers on the Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations | Questions and Answers on the Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations Capital | Attached interagency Q&A document (p. 2) - “The ratings-based approach provides a way for the agencies to use determinations of credit quality . . . to differentiate the regulatory capital treatment for loss positions representing different gradations of risk.” | | Interagency Guidance |
| SR 02-15: Implicit Recourse Provided to Asset Securitizations | Implicit Recourse Provided to Asset Securitizations Capital | Attached interagency guidance (p. 2) - "For a residual interest . . . which qualifies for the ratings-based approach, the required amount of risk-based capital is determined based on its relative risk of loss . . . depending upon the ratings assigned by one or more nationally recognized statistical rating organizations and whether the position is traded." | | Interagency Guidance |
| SR 01-6: Enhancements to Public Disclosure | Enhancements to Public Disclosure Disclosure | Credit disclosure by internal rating . . . (f)irms should provide explanatory information on their ratings, including, if appropriate, how they compare to external ratings (p. 2). Note: The guidance is not an interagency guidance document; it was developed by the private sector Working Group on Public Disclosure sponsored by the Board, OCC, and SEC. | | Interagency Guidance |
| SR 98-12: FFIEC Policy Statement on Investment Securities and End-User Derivatives Activities | FFIEC Policy Statement on Investment Securities and End-User Derivatives Activities Asset Identification /Categorisation | Attached FFIEC policy statement (p. 12) - “Institutions are legally required to meet certain quality standards (i.e., investment grade) for security purchases. Many institutions maintain and update ratings reports from one of the major rating services. | | Interagency Guidance |

U.S. Insurance Credit Rating Usage

| In which LRSPs does your authority use credit ratings (or related terms) and/or refer to credit rating agencies (or related terms)? | For each applicable LRSP, what is the LRSP designed to accomplish (<u>i.e.</u> , what is the purpose of the LRSP, independent of any use of credit ratings or related terms or reference to credit rating agencies or related terms)? | For each applicable LRSP, what is the purpose of using credit ratings (or related terms) and/or referring to credit rating agencies (or related terms) (<u>i.e.</u> , why does your authority use credit ratings or related terms and/or refer to credit rating agencies or related terms in such regulation)? | Please include an Internet web link to each such LRSP or otherwise indicate where each such LRSP is publicly available. | Legislation/Regulation/Guidance? |
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| | <p>Disclosure and Capital</p> | <p>Insurance regulators require bonds and preferred stocks to be reported in statutory financial statements in one of six NAIC designation categories that denote credit quality. If an accepted rating organization (ARO) has rated the security, the security is not required to be filed with the NAIC's Securities Valuation Office. Rather, the ARO rating is used to map the security to one of the six the NAIC designation categories. (Government bonds are an exception.)</p> <p>The NAIC designations are primarily designed to assist regulators (as opposed to investors) to monitor the financial condition of their insurers. These designations (along with the particular asset class to which the security belongs) drive the risk-based capital charge. In addition, these designations have implications for statutory reporting of the asset. For example, for Property and Casualty companies ("P&C" or "non-life insurance companies"), bonds reported in categories 4 through 6 (<u>i.e.</u>, below investment</p> | | Legislation |

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| | | grade) must be reported at market values where as those in categories 1 through 3 are reported at amortized value | | |
| Article 14, Section 1404 a (2) (A). (Note, the two criteria highlighted are only a portion of a longer list.) | Asset classification / permissible investments | Some state insurance laws describe permissible investments in terms of ratings. For example, New York State Insurance Law delineates permissible investments for the portion of assets corresponding to insurance liabilities. In describing permissible investments in the obligations of American institutions (other than an insurance company), the law indicates that such investments are permitted as long as they meet one of several criteria. The list of criteria makes at least two references to rating agency ratings. First, investment in the obligations of American institutions are permitted if they are rated A or higher (or the equivalent thereto) by a securities rating agency recognized by the Superintendent. Second, such investments are permitted if such obligations are insured and, after considering such insurance, are rated Aaa (or the equivalent thereto) by a securities rating agency recognized by the Superintendent | | Legislation |
| Article 69, Section 6904 (b)(2) | Asset classification / permissibility | Some state insurance laws provide limitations on the types of obligations that financial guarantee insurance companies can insure. For example, New York State Insurance Law provides that an insurer may insure municipal obligation bonds that are not investment grade so long as at least 95% of the insurer's aggregate net liability is investment grade. | | Legislation |
| | Capital | A new <i>Reinsurance Regulatory Modernisation Framework</i> has been adopted by the NAIC's Reinsurance Task Force. This framework, which is subject to ratification by the NAIC, would change the manner and extent to which US ceding companies can reflect offsets in their statutory financial statements for reinsurance ceded. Under the current rules, US cedants must obtain collateral from non US licensed reinsurers in order to reflect the reinsurance, but no collateral | | Proposal |

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| | | <p>is required when ceding to US licensed reinsurers. Under the proposed framework, reinsurers (both US and non-US) will be assigned to one of five rating categories determined by US insurance regulators based on a number of factors, similar to the New York and Florida frameworks.</p> <p>Importantly, one of those factors is the reinsurer's financial strength rating provided from a recognized credit rating agency. In particular, the lowest rating received by the rating agencies will be used by the regulators to establish the maximum rating of a reinsurer (eg, the maximum amount of collateral reduction). The assigned rating category determines the extent to which the reinsurer is required to collateralise its obligations in order for US cedants to take credit for that reinsurance.</p> | | |
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Appendix 6

List of members of the Joint Forum Working Group on Risk Assessment and Capital

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|---------------------|---|--|
| Co-Chairs | Lance Auer Tom Crossland | Federal Reserve Bank of New York Financial Services Authority |
| Australia | Denis Wilkinson | Australian Prudential Regulation Authority |
| Belgium | Jeroen Lamoot | Banking, Finance & Insurance Commission |
| Canada | Daniel Mayost Marriane Bridge | OSFI Ontario Securities Commission |
| France | Catherine Dias Sylvain Cuenot Emmanuel Dupouy | Autorité des marchés financiers Commission Bancaire ACAM |
| Germany | Christian Buck Jorg Schmidt-Ebeling | BaFin BaFin |
| Italy | Emanuela Piani Neomisio Susi | Bank of Italy CONSOB |
| Japan | Takashi Isogai Shoko Moriya | Bank of Japan Financial Services Agency |
| Spain | Marta Estavillo José Manuel Portero | Banco de España Comisión Nacional de Mercado de Valores |
| Switzerland | Andreas Achermann | Swiss Federal Banking Commission |
| United Kingdom | Tamiko Bayliss | Financial Services Authority |
| United States | Elizabeth Ling Suzanne Claire Michael Drennan Joseph Levinson George Lavdas | Federal Reserve Bank of New York Federal Deposit Insurance Corporation Office of the Comptroller of the Currency Securities and Exchange Commission Securities and Exchange Commission |
| European Commission | Martin Spolc | |
| BCBS Secretariat | Tom Boemio Brad Shinn | |