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European Banking Authority
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Online Submission

DRAFT ITS ON THE MAPPING OF ECAI'S CREDIT ASSESSMENTS FOR SECURITISATION POSITIONS

Moody's Investors Service ("MIS") appreciates the opportunity to provide comments to the European Banking Authority ("EBA") on the consultation paper: *Draft Implementing Technical Standards: On the mapping of ECAI's credit assessments for securitisation positions under Article 270 of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)*. These relate to:

1. Observations on the methodology used by the EBA in its proposed quantitative approach set out in the Draft Impact Assessment.
2. The Impact of the current qualitative approach and the risk of commoditisation of ratings.

1. The methodology used by the EBA in proposed quantitative approach

In the Draft Impact Assessment accompanying the Paper, an EBA study compares 3-year structured finance (SF) transition rates to the lowest rating category for each of the mapped CRAs¹ as follows:

- S&P, Fitch and DBRS - transition to "D"
- MIS - transition to "C"

The study concludes that within a 3 year horizon, MIS ratings were more likely to transition to "C" than were other agency ratings likely to transition to "D".² By equating an MIS "C" rating with other agencies

¹ Section 5 of the Paper (Draft Impact Assessment), Option 1 (Systematic and quantitative mapping methodology based on ratings' historical default performance (where available)), Table 2 (page 26).

² See Tables 2, 11, 12 and 13 in the Impact Assessment.

“D” rating, the EBA concluded that the risk profile of MIS ratings were, in some cases, greater than the equivalent rating of the other agencies.

Such a study should compare ratings that rate to the same event or are intended to measure the same risk. This is not the case with the EBA study. An MIS “C” rating is not equivalent to a “D” rating of other CRAs. An MIS “C” rating indicates “significant expected loss” and may be assigned well in advance (perhaps years in advance) of actual default. From the definitions provided in the Paper,³ the “D” rating of other CRAs indicates that the security is (already) in default. An MIS “C” rating is not a default rating and there may be many securities rated “C” which are not in default. These characteristics of an MIS “C” rating illustrate that it is not a proxy for default (nor is it intended to be).⁴ Consequently, we would fully expect to see that transition rates to MIS “C” rating often exceed transition rates to other CRAs “D” rating. This is not a question of which rating is “correct,” but a natural result of their different explicit meanings.

Although the Paper refers to the different transition rates between MIS (transition to “C”) and other CRAs (transition to “D”), we believe that due to the fundamental incomparability of the ratings themselves, it is not appropriate to compare their transition rates and such an analysis supports no meaningful conclusions. Instead, we would suggest that a new methodology be found to support the upcoming proposed quantitative approach. In addition, the Impact Assessment should more clearly reflect the differences between an MIS “C” rating and other CRAs “D” either through revised tables indicating the differentiation or by removing the MIS content from the respective tables and replacing it with an explanatory paragraph.

2. Current qualitative approach

In the proposed qualitative approach, there are no criteria used to either assess the performance of credit ratings or to differentiate between them. The resulting outcome is that all CRAs are treated the same with an assumption that ratings from different CRAs are as predictive as each other. As all ratings are to be regarded as equivalent (for regulatory purposes), this risks credit ratings becoming viewed as commodities. Such a commoditisation of credit ratings can affect the traditional incentives to differentiate among CRAs based on the performance of a CRA’s credit ratings. This, in turn, can encourage rating shopping.

Credit ratings from different rating agencies, while often expressed with similar symbols, may nevertheless have very different meanings. Some CRA’s ratings are intended to address only the

³ See Section 5.1.3 in Annex to the Impact Assessment.

⁴ MIS’s credit ratings are forward-looking opinions about credit risk. They address the probability that a financial obligation will not be honored as promised (*i.e.*, probability of default, or “PD”), and any financial loss suffered in the event of default. Our analysis of these two factors together forms the basis of MIS’s expected loss (“EI”) approach to credit risk. Obligations rated on MIS’s global rating scale measure long-term credit risk, and our analytical focus is on the key factors that drive each issuer’s ability over the long term to meet its obligations as they come due

probability of default while some address expected loss (i.e., placing weight on both default probability and expected loss given default).

We believe the EBA's analysis should focus on the expected future performance of ratings of different CRAs taking into account both quantitative and qualitative considerations⁵. Although we understand the need for the proposed qualitative approach at this time, we support the intention of the EBA to move to a more quantitative approach based on an CRA's performance data in the near future (taking into account the differentiation amongst credit ratings).

We appreciate the opportunity to comment and would be pleased to discuss our comments further with the EBA or their staff.

Yours sincerely

/s

Olivier Beroud
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⁵ Where possible, this may include (1) realised loss rates by rating category on securities jointly rated by CRAs; (2) realised loss rates on ratings that are singly rated by CRAs, (3) observed rating differences/gaps on jointly rated issues and issuers.