To

Joint Committee of EBA, ESMA and EIOPA

Submitted via EBA website

Date: November 27th, 2014

Reference: Consultation Paper JC/CP/2014/01 Draft Implementing Technical Standard on the mapping of ECAIs' credit assessments under Article 136 (1) and (3) of Regulation (EU) N° 575/2013 (Capital Requirements Regulation – CRR) dated February 5th, 2014 and Addendum to Consultation Paper dated October 30th, 2014

Dear Sir,

With reference to the publication of the above consultation on February 5th, 2014 and the Addendum to the consultation (which includes the draft mapping reports for 25 ECAIs), we are pleased to submit the views of 8 ESMA registered CRAs and 1 ESMA certified CRA[1], representing about a third of all ECAIs in Europe.

We would like to first thank the Joint Committee of European Supervisory Authorities ("ESAs") for outlining the detailed methodology for the mapping of ECAI ratings, as this alone represents a substantial improvement. We further congratulate the ESA's for the extensive work carried out, the willingness to interact with the ECAIs and the detailed analysis of each specific ECAI. The analysis clearly shows that there is a big variety of business models as well as sizes of CRAs in Europe.

In this response, we are taking an industry perspective and we are not commenting on the individual mapping of a specific ECAI. Given the outcome of the mappings, we are not responding to the specific questions raised in the consultation but rather propose two amendments. Overall, we think that the resulting picture is extremely complex, corresponds to an additional regulatory filter on ECAIs and will negatively impact on the competition in the rating market. In order to make this Draft ITS consistent with the political choices in level 1 legislation, we propose two amendments: 1) delete requirement on minimum number of ratings on CQS 1 and 2) create a special framework for newly established/focused CRAs. Without modifying the methodology used in this ECAI mapping, these 2 amendments are objectively required to cope with the current situation in the rating market.

Background

While the EU Regulation on CRAs was adopted in 2009, most CRAs had to wait 5 years to get their ratings mapped into the 6 Credit Quality Steps ("CQS") under the CRR Regulation. This mapping is highly important as it translates CRA ratings into the relevant CQS – these may then be used to determine Risk Weighted Assets under the Standardized Approach and

[1] The views expressed represent the position of the following agencies (in Alphabetical order): Assekurata, Axesor, Cerved, Capital Intelligence, Creditreform Rating, CRIF, Dagong Europe, Kroll Bond Rating Agency and Scope.

may act as a reference point in several other regulations. In addition, the mapping is "also important from a customer perspective as, in a wider context, there is generally a link between the rating of a bank's customer by an ECAI and the pricing of products to that specific customer"[2]

This mapping precedes the ESMA report foreseen under Article 21 (4b) of the CRA Regulation on the "possibility of establishing one or more mappings submitted in accordance with Article 11a(1)" (on European Rating platform). The methodology used for the ECAI mapping may therefore spill-over onto the potential ESMA mapping.

As opposed to the US, which requires at least 3 years of rating activity to apply with the SEC as NRSRO, the CRA Regulation in Europe requires CRAs to register prior to the issuance of ratings. It is therefore expected that newly established CRAs will have a limited number of ratings outstanding.

The CRR Regulation modified the definition of ECAI by granting automatic recognition as "Eligible ECAI" to all ESMA registered and certified CRAs[3] on an EU wide basis. This is a substantial change from the previous approach where ECAI status was granted on a Member States level by national competent authorities and only 2 ECAIs were recognized in all EU Member States. We much appreciate this change as it increases choices to users of ratings, reduces complexity and contributes to a better functioning of the internal market on a European level.

With the adoption of the CRA III Regulation, European policy makers have opted to increase competition in the rating market by introducing amongst others the following requirements:

- Rotation of rating agencies in the re-securitization market
- Minimum of 2 ratings in SF otherwise considered unrated
- Article 8d on the use of multiple rating agencies
- Revision clauses in Article 39 focusing on the situation in the rating market.

While limited in scope, the CRA III regulation also takes into account proportionality principle by granting a limited number of exemptions to organizational requirements on CRAs and in the calculation of supervisory fees.

We view competition in the ratings market as positive as:

- It drives innovation: as each CRA needs to be registered on its own, each has to develop specific rating methodologies. All CRAs have made substantial investments in establishing or upgrading their methodologies.
- Increases choices to issuers and impacts on pricing: the more CRAs participate in the market, the higher the choice for issuers. Ultimately, this results in higher competition and has a direct impact on the pricing of rating services.

[2] See EBA Banking Stakeholder Group's response to the above Consultation dated June 10th, 2014 available at the EBA website (the "EBA BSG response")

[3] Article 4 (1) 98 of the CRD IV Regulation defines an 'external credit assessment institution' or 'ECAI' as a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009;

- Increases information available to investors/users: as each CRA has its own methodologies, additional ratings will result in a greater availability of information to users of ratings.
- Reduces reliance and dependence on single CRAs: the more CRAs are taken into account, the less a user of ratings relies on the ratings of a single CRA
- Contributes to financial stability: in view of specific rules on the uses of several ECAI ratings embedded in the CRR Regulation, using 3 or even more CRAs to derive risk weights substantially increases stability of the outcome over time.

On the methodology used

Similar to the CRR Regulation being based on the international Basel III standards, the ESA's mapping methodology also follows the respective international standards. The methodology takes into account a very long time series and is based on the historic performance of one Benchmark ECAI[4]. This long term approach, which requires at least 12 years of rating activity on a high number of ratings outstanding in order to allow for a full mapping, smooth out short term changes, ensures that the mapping of ratings is relatively stable, provides for stability of risk weighted assets and contributes to financial stability.

As legislation on CRAs in Europe exists only since 2009 and that effective registration and supervision started only in 2011, only a small share of the historic performance falls under the scope of the regulation - the majority of the ratings data used by the ESA's is based on ratings that have been issued prior to the CRA Regulation and may not have been subject to the same stringent requirements with are now in place. On the other hand, ratings issued by any registered or certified CRAs are now subject to the supervision by ESMA. In view of the Annex III of the CRA Regulation, ESMA has substantial powers to ensure compliance with the high quality standards required by the regulation[5].

While the CRR Regulation defines 'probability of default' or 'PD' as "the probability of default of a counterparty over a one year period"[6]; this Draft ITS bases the analysis on Short Run Default rates over a 3 years period and treats withdrawn ratings as 50% defaulted (which corresponds to the lowest CQS) – we agree with the EBA Stakeholder's Group that this approach is "too conservative"[7].

Overview on the proposed mapping

With reference to the Mapping tables, as included in the Addendum to the Consultation Paper, only 3 of the 25 ECAIs use a different long term rating scale from the standard AAA, AA…C, D to rank their assessments. For these 22 ECAIs, overall there are 8 different ways

[4] See Basel Committee on Banking Supervision Working paper N° 22: "Foundations of the proposed Modified Supervisory Formula Approach", January 2013 – Annex 1 "Estimating Term Structure of Default probabilities"
[5] The fines defined in Annex 3 are set in ranges of EUR and not as a percentage of rating revenues. Small CRAs would be hit much harder by such a fine than large CRAs, small CRAs therefore devote substantial resources to ensure compliance with all requirements. As ultima ratio, ESMA may also withdraw the registration of an CRA.
[6] See Article 4 (1) 54 of the CRR Regulation. We further understand that under the IRB approach, the long-run average of one-year default rates should be used. (see EBA consultation on "assessment methodology for IRB approach" dated November 12th, 2014 page 14).
[7] See EBA BSG response, page 4.

of mapping the whole rating scale into the 6 CQS. In addition, for one agency, the mapping depends on the different market segment.

We further note that 15 ECAIs (out of the 25) had no rating symbol mapped to the highest credit quality 'CQS 1'., This "down-mapping" of ratings from CQS 1 to CQS2 means that capital requirements are increased by 2 to 2,5x depending on the market segment (in case of Sovereigns outside of the EU Risk Weight increase from 0% to 20%).

Finally, some ECAIs have no rating symbol in CQS 3 (or CQS 5). A downgrade from A- to BBB+ can therefore trigger a substantial increase in risk weights and thereby amplify cliff effects. While rating scales[8] are meant to cover the whole range of probabilities of default (and should therefore also include CQS 1), having a gap in the CQS is a highly surprising outcome.

The overall picture across all ECAIs is therefore highly complex and requires substantial attention from rating users, thereby increasing transaction costs linked to the use of external ratings. The likely result is that users will turn only to those CRAs having the traditional mapping and will disregard the others.

Underlying quantitative data

In order to implement the mapping, the ESA's used the rating data provided by the CRAs to the Central Repository of Ratings ("CEREP") which is maintained by ESMA. When accessing the public CEREP website, a user finds currently the following information:

ECAI	Date of ESMA registration	Cerep Data	Cerep start date	Nb of 3y SR sets	Full historic view	Nb of Corporate Ratings	Full quantitative approach possible
AM Best	08.09.2011	Yes	01.01.2002	20	Yes	3.741	Yes
Assekurata	18.08.2011	Yes	01.01.2001	22	Yes	42 *	No
Axesor	01.10.2012	Yes	01.01.2013	N/A	No	60	No
BCRBG	06.04.2011	Yes	01.01.2005	14	No	18	No
BdF	Exempted	No					
Cerved	20.10.2012	Yes	01.01.2009	6	No	29.142	No
CI	08.05.2012	Yes	01.01.2001	22	Yes	278	No
ARC Rating	26.08.2011	Yes	01.01.1999	26	Yes	5	No
CRAG	18.05.2011	Yes	01.01.2001	22	yes	80	No
CRIF	22.12.2011	Yes	01.07.2010	3	No	62	No
Dagong	13.06.2013	Yes	01.01.2014	N/A	no		No
DBRS	31.10.2011	Yes	01.01.2000	24	yes	358	*Yes*

[8] While some jurisdictions have standardized the rating scales (eg Chile and India), the US and the EU have not taken such a step and allow the use of an "established ranking system or rating categories".

EHRG	16.10.2010	Yes	01.01.2002	20	Yes	26	No
EIU	03.06.2013	Yes	01.01.2014	N/A	no	0	No
ERA	30.07.2012	Yes	01.01.2002	20	No	0	No
EuroRating		No		N/A	no		No
Feri	14.04.2011	Yes	01.01.2000	24	yes	0	No
Fitch	31.10.2011	Yes	01.07.2001	21	Yes	3.350	Yes
GBB	28.07.2011	Yes	01.01.2008	8	No	193	No
HR Ratings	07.11.2014	No		N/A	No		
ICAP	07.07.2011	Yes	01.01.2005	14	No	1.896	No
JCRA	06.01.2011	Yes	01.01.2001	22	No *	593	
KBRA	20.03.2013	Yes	01.01.2012	N/A	no	31	No
Moody's	31.10.2011	Yes	01.01.2000	24	Yes	4.307	Yes
S&P	31.10.2011	Yes	01.01.2000	24	Yes	6.961	Yes
Scope	24.05.2011	Yes	01.01.2007	10	No	162 *	No
Spread	01.07.2013	Yes	01.01.2014	N/A	no		No
	Yes	**24**		**Yes**	**10**		**5**
	No	**3**		**No**	**16**		**21**

Source: ESMA list of registered and certified CRAs, CEREP and own research.
Explanations:

- “CEREP DATA” indicates whether rating activity data are available at CEREP
- “CEREP Start Date” indicates since when rating activity of a CRA is available.
- “Number (Nb) of 3y SR sets”: Based on the CEREP Start Date we calculate the number of Short Run benchmark sets available. SR default rates are calculated each January and July and cover a period of 3 years.
- “Full historic view”: in order to run the full quantitative approach under this mapping methodology, at least 20 SR sets are required. As JCRA has changed its rating scale during 2012, CEREP does not display 3 year rating transition for January 2010 onwards.
- “Number of Corporate Ratings” refers to all long term corporate ratings (financials and non-financials) outstanding as of December 2013 without geographic limitation (only 21% of the benchmark ECAIs relate to the EU). For Assekurata and Scope, short term ratings are stated.
- “Full quantitative approach possible”: the mapping methodology takes into account a minimum number of ratings for each CQS. A full approach is only possible if enough ratings are available in all CQS.

The above table clearly shows that the mapping of ECAI ratings based only on a quantitative approach is feasible and appropriate for a very limited number of CRAs.

An outsider will not be able to challenge/review the mapping

CEREP displays a different default rate than the one used by the ESA’s for the mapping (which treats withdrawals of ratings differently). As long time series are used to derive the mapping, users will face difficulties in the multiple download of data. Finally, rating scales may have changed over time and therefore no rating activity may be displayed at CEREP.

During the mapping process, the ESA’s invited ECAIs to provide additional information to support the process. According to the draft mapping reports, several ECAIs used the opportunity to provide information on private ratings (which are not available at CEREP), on their credit scoring activities or indicative ratings on a larger sample of issuers. While we appreciate that the ESA's accepted this information, an external user would not have access to this confidential information and therefore would not be able to track the ESA's qualitative assessment.

Users of ratings will therefore rely heavily on the proposed mapping and will not carry out their own assessment[9]. While we appreciate the ESA's transparency effort by providing extensive mapping reports, these reports further increase reliance on the ESA's assessment.

Mapping impedes competition

In our view, the proposed mappings negatively impacts competition and is expected to have the following consequences.

- High quality issuers (those who are likely to have ratings of AA- or higher) will not engage a CRA that has no rating symbols mapped in CQS1 as these can only increase funding costs.
- CRAs whose focus had been in emerging markets (higher risk countries) lack sufficient rating history in the highest rating categories and despite their long history will find it extremely difficult to do business in developed markets.
- CRAs will not enter the Covered Bond market as 83% of all ratings by the Benchmark ECAIs fall into CQS 1[10].
- The rules regarding the use of several ECAI assessments implies that CRAs having their ratings mapped into lower categories will not be considered as these can only drive up risk weighted assets.
- While this mapping relates to the 6 CQS, we understand that the Solvency II Framework uses 7 steps (by splitting the CQS 1 level into two categories). Excluding the CQS 1 category for some ECAIs means that these will not be used by insurance.
- No new CRAs will enter the market as they shall equally face the regulatory filter.
- Non EU CRAs may get discouraged to apply for certification in the EU for fear that the European mapping will differ from the traditional standard and may result in negative repercussions in their domestic market. Similarly EU CRAs may face challenges in other jurisdictions where ECAI status has been granted.

In our view, the proposed methodology goes against the objectives and spirit of the CRA/CRR regulation and we therefore propose two amendments for your consideration.

Proposed amendments

With reference to the draft mapping reports of the Benchmark ECAIs[11,] we note that these have breached the (high requirements) benchmark for CQS1 during 2006-2011 and that the quantitative approach would therefore map into CQS 2. The proposed mappings of ratings for these ECAIs were nonetheless not adapted. We note that the ESA have therefore used a certain degree of pragmatism by not making the modification.

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[9] As an example, Banks using the Internal Ratings Based approach will not be able to carry out a separate mapping of ECAIs ratings to their own scales according to Article 180 (1) f.

[10] Based on CEREP data as of January 2014 and own calculations.

[11] See Draft mapping report on Fitch Page 33, Moody's page 23 and Standard and Poor's page 33

Why should the benchmark for CQS 1 be applied as a hard fact to the other CRAs then? We are of the opinion that setting a minimum requirement of 496 ratings for CQS1 implies a very wide coverage in the highest rating class, which implies a very large organization. In addition, we are of the opinion that setting a minimum number of default occurrences and equivalent rating category is not consistent with Level 1 legislation, which focuses on "default rates experienced". We therefore propose that these requirements on minimum number of ratings be removed.

We further propose to amend the draft ITS by creating a special framework for smaller and new CRAs. We think that this amendment is required in order to make this draft ITS consistent with Level 1 legislation:

- This proposal corresponds to the political choice of automatic recognition of CRAs as ECAIs and of prior registration with ESMA before issuance of credit ratings.
- Article 136 (2) a makes a clear reference to "recently established ECAIs and for those that have compiled only a short track record of default data"

From a prudential perspective, such an approach would have only a limited impact on financial stability as the reach of these ECAIs in terms of debt volume rated is still highly limited given the oligopolistic market structure. In addition, the CRR Regulation includes an important additional layer of prudence as users of ratings need to nominate specific ECAIs for the calculation of risk weighted assets.

Furthermore this proposal corresponds to the current market, where 21 out of 26 registered or certified CRAs do not have the required data to support the full quantitative process. This regime should not be temporary as reaching the required number of ratings is not proportionate and may (potentially) never be reached by highly focused CRAs. As mentioned, we think that ESMA has substantial powers to ensure the quality of the ratings and that may withdraw in ulitma ratio a registration before any mapping would be adapted.

On Structure Finance ratings mapping

This draft ITS relates to Article 136 CRR and relates only to Corporate, Sovereign and Covered Bond ratings. While the mapping according to Article 270 for Structured Finance has the same deadlines, no consultation or mapping of SF ratings has been released to date. While the legal requirements in level 1 legislation are slightly different for these two mappings, it is highly regrettable that the SF mapping is yet lacking as an important point of comparison is missing. Given the high number of SF ratings, we think that this segment is particularly suited for a quantitative approach. In view of the performance of SF Finance ratings[12], when using the same methodology than under Article 136, AAA and AA ratings assigned by Benchmark ECAIs would probably map only into CQS3. An alternative approach, which would be consistent with the differences observed in default rates in different asset classes and regions, would generate a highly complex picture again.

[12] As a good reference for the performance of SF ratings, please consult the "EBA Discussion Paper on simple standard and transparent securitizations" dated October 14th, 2014 page 12 available following this link: http://www.eba.europa.eu/documents/10180/846157/EBA-DP-2014-02+Discussion+Paper+on+simple+standard+and+transparent+securitisations.pdf

To conclude, we refer to EBA's Banking Stakeholder Group response to the initial consultation (where the mapping of ratings were yet not available": "This draft ITS raises complex issues. From time to time the BSG becomes concerned that excess complexity is being introduced into some aspects of regulation. Whilst it recognizes that complex issues sometimes need to be addressed by complex regulation, this is not always the case. The BSG strongly sympathizes with EBA's efforts to avoid unnecessary complexity and strongly encourages such efforts as part of its proportionality commitment"[13].

Sincerely yours

Thomas Missong
EACRA President

Adolfo Estevez Beneyto
EACRA Secretary General

About EACRA Members contributing to this letter

ESMA registered Credit Rating Agencies

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

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

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

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

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

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

Dagong Europe Credit Rating, headquartered in Milan, was registered by ESMA in June 2013. It is a joint venture between Dagong Global Credit Rating (60% ownership) and Mandarin Capital Partners (40%), led by Ulrich Bierbaum as General Manager. Dagong Europe provides European and Asian investors with credit opinions on financial institutions (including insurance companies) and non-financial corporate.

Scope was founded as an independent rating agency in Berlin, Germany, in 2002. The company is specialized in ratings and analysis of SMEs, bonds, certificates and funds across Europe.

ESMA certified Credit Rating Agencies

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

[13] See EBA BSG Response, page 3.