



To
Joint Committee of
European Banking Authority
European Securities and Markets Authority
European Insurances and Occupational Pensions Authority

Submitted via EIOPA website

April 10th, 2015

Reference: ESA's joint Consultation Paper JC-CP-2015-001 Draft Implementing Technical Standards on the allocation of credit assessments of ECAs to an objective scale of credit quality steps.

Dear ESA's,

We first would like to thank the ESA's for the publication of the joint Consultation paper regarding the "allocation of credit assessments of ECAs to an objective scale of credit quality steps under the Solvency II Directive ("Solvency II mapping").

We hereby submit to your kind attention the position of 9 ESMA registered and 1 ESMA certified CRA (in alphabetical order): Assekurata, Axesor, Capital Intelligence, Cerved Rating Agency, Creditreform Rating, CRIF, Dagong Europe, Euler Hermes Rating, Kroll Bond Ratings and Scope Ratings.

We note that this Solvency II mapping makes a direct reference to the mapping of ECAI ratings under the CRD IV Regulation ("CRD IV mapping"), we therefore refer to our public response submitted on November 27th, 2014 to the ESA's on the CRD IV mapping via the EBA website. As mentioned therein, we think that the methodology used for the mapping of ECAI ratings includes a high number of policy choices, some of which we would like to recall here:

- Time horizon: while CRD IV and Solvency II use as primary reference the one-year probability of default, the mapping is based on a 3 years horizon.
- While neither CRD IV nor Solvency II define benchmarks for the Credit Quality Steps, the methodology for the mapping introduces such benchmarks.
- Long term view: the full quantitative approach requires at least 12 years of ratings history.
- Minimum number of ratings per credit quality step: the CRD IV mapping methodology defines a minimum of 496 ratings in the highest rating category in order to have the ratings mapped into CQS 1. While Solvency II uses also CQS 0, the present methodology is silent on how the split between AAA and AA ratings is being done.

Overall, the proposed methodology can be applied only to about 5 out of 27 currently registered or certified CRAs. Since this ITS is meant to cover all registered or certified CRAs, we hereby would like to cite key requirements of the CRA Regulation on CRAs.

Key requirements of the CRA Regulation

Article 1 of the CRA Regulation states the following: This Regulation introduces a common regulatory approach in order to enhance the integrity, transparency, responsibility, good governance and reliability of credit rating activities, contributing "to the quality of credit ratings

(...), thereby contributing to the smooth functioning of the internal market while achieving a high level of consumer and investor protection”. The CRA regulation mandates therefore substantial requirements on CRAs rating methodologies, processes and organisation in order to ensure that ratings correspond to the expected quality standards.

These material requirements apply equally to all CRAs (the scope of possible exemptions under Art 6.3 being rather limited – these exemptions may be granted by ESMA on the demand of a CRA but can be reserved any time if deemed not appropriate any more). CRA II and CRA III has introduced a wide range of sanctions and penalties on CRAs in case of breach of the regulation (up to the withdrawal of the registration). Given that the possible sanctions are stated as fixed amount ranges, any sanction on a smaller CRA will weigh more heavily than on a larger player. Small CRAs have therefore the highest interest to comply with all elements of the regulation.

On Rating scales and Rating methodologies as basis for rating assignments

Article 3 (1) a define a Credit rating as an “opinion regarding the creditworthiness of an entity (...) using an established and defined ranking system of rating categories; A “rating category” is defined in Article 3(1) h as “a rating symbol, such as a letter or numerical symbol which might be accompanied by appending identifying characters, used in a credit rating to provide a relative measure of risk to distinguish the different risk characteristics of the types of rated entities”

While the CRA Regulation does not standardize the rating scale, given the target to rank the relative measure of credit risk, rating scales are meant to cover the whole range of possible outcomes – from very low to high credit risk. Similarly, neither CRD IV nor Solvency II define in Level 1 legislation the different credit quality steps but uses these to assign different risk factors or risk weight to increased risk. Given this convergent approach of the CRA, CRD IV and Solvency II on the ranking of risk, it is objectively difficult to understand how some CRAs have no rating symbol mapped into the highest Credit Quality Steps.

Ratings issued according to the CRA regulation need to adhere to the following elements:

- They need to be based on rating methodologies
- They need to include analytical input from analysts
- They need to be assigned according to a process ensuring objectivity and eliminating possible conflict of interests
- They need to be formally issued (not being “private ratings”) and be monitored at least annually (or twice annually in case of Sovereign ratings).

While CRAs can define independently the content of their rating methodologies in order to reflect the specificities of the market segment under consideration, these methodologies include usually quantitative and qualitative elements. These rating methodologies are subject to a number of requirements, including the historical back-testing. The back-testing is done on the quantitative section of the rating methodologies using an extensive set of financial statements to demonstrate the robustness and the discriminatory power of the defined key ratios.

Therefore, it cannot be argued that smaller players have less quality – smaller players operate in very special markets and compete against the standards of larger CRAs – in order to have a selling proposition, these agencies need to excel in their specific market segments. Current market shares (measured on an European wide basis) are not an indicator for quality of the respective CRA: some CRAs benefit from their global activity and the coverage of all market segments. Quality of ratings cannot be measured upfront, it is the reputation of the

CRA and their acceptance in the market which counts. Reputation builds up only very slowly with track record (coverage) and time.

Last but not least, the CRA Regulation mandates prior registration with ESMA before the issuance of credit ratings. The currently proposed methodology for the mapping of ratings does not, in our opinion, reflect the material requirements imposed on the registration of a CRA. Instead, this mapping methodology acts as an additional regulatory filter on CRAs.

At the same time, in order to increase competition in the rating market, the CRD IV and Solvency II Regulation include the following key elements:

- All ESMA registered or certified CRA are automatically recognized “eligible ECAIs”. Potential users need to nominate those ECAIs they effectively use.
- Users of ratings should not rely mechanistically on ECAI ratings and should carry out their own assessments. In order to facilitate this own assessment by users of ratings, the CRA Regulation mandates mandatory disclosures by CRAs. Additionally, CRA III establishes the European Rating Platform, which should allow users of ratings to easily compare the ratings from several ECAIs.

We therefore think that the policy choices done in this “implementing technical standards” are not compatible with the requirements of Level 1 Legislation.

As an alternative approach, we would like to refer to the US National Association of Insurance Commissioners (“NAIC”) and the mapping of Credit Rating Providers ratings to the 6 steps used by the Securities Valuations Office (SVO). The US NAIC takes the information from the Credit Rating Providers and maps the symbols consistently into the same SVO categories. The US NAIC explicitly does not “endorse” or “verify” the accuracy of the information provided by CRP. The mapping is available following this link: http://www.naic.org/documents/svo_naic_aro.pdf

In order to ensure transparency to users and to support their own assessments, we recommend that the mapping reports should be based on the old template for CRD IV mappings, an Excel file, as available at the European Banking Authorities website until end 2013 and should be complemented with the following information:

- Include a reference to each ECAIs regulatory disclosures website. The CRA Regulation requires CRAs to publish every six months data on historical default rates. In addition, users of ratings may find the detailed definition of each ECAIs rating scales as well as the definition of default, rating transition and default studies.
- Map all rating scales and all rating symbols into the 7 Credit quality steps. While the mapping of all notches makes the pictures a little more complicated, it avoids any potential doubts for users.
- State whether the rating agency uses a Point in Time or Through-the-cycle approach. Rating scales not linked to credit risk should be properly identified.
- As Credit Rating Agencies may work under different time horizons, the mapping should include information on the time frame under consideration. This will allow users to map all ratings scales to their internal systems.
- Depending on how the annual review of ECAIs ratings will be done, the date of assessment of the ECAI mapping and the date of next scheduled review (which could be tied to publication of new rating statistics at CEREP) should be disclosed. This will allow user of ratings, in case of need, to review the impact of a revised mapping in a timely manner.

On Cross-sectorial consistency in terms of output

The Consultation Paper cites on page 21 the following: “among the objectives of this ITS there is the need to ensure a methodological cross-sectorial consistency in terms of output”.

We think that both Solvency II and CRD IV include several policy choices and that consistency between the two was not the primary target. We note that in the context of ECAI ratings, some fundamental differences between the two frameworks exist:

- While Solvency II differentiates between CQS 0 and CQS 1 (which are aggregated into CQS 1 under CRD IV), Solvency II does not differentiate for CQS 5 and CQS 6 (by assigning the same risk factors).
- Increases in risk factors/risk weights from one CQS to the next one are neither convergent.
- Unsolicited ratings are treated differently: while CRD IV is “cautious” towards these ratings, Solvency II states that these should be equally used.
- Unrated exposures are treated differently: under Solvency II, unrated exposures (under Art 176) have risk factors between CQS 3 and CQS 4. On the other hand, CRD IV usually assigns a Risk Weight of 100% (or the second highest RW). Additionally, in some cases, Solvency II proposes alternative risk measures.

While the CRA Regulation explicitly does not standardize the rating scales, most rating agencies use highly comparable rating categories (and several CRAs have adopted this standard in recent years) and thereby have a “universal” meaning. The currently proposed CRD IV mapping fundamentally undermines the original meaning, introduces complexity and requires substantial attention from users of ratings. Having a different Solvency II mapping would only add limited complexity.

With respect to consistency with prior ratings, the 2009 CEIOPS initial advice only uses the classical rating categories (without citing the name of a specific CRA) and does not state the respective CQS. The 2009 CEIOPS advice assumed therefore that the ratings of all ECAs would map into the same CQS.

In terms of consistency with other mappings, we again highlight that EBA has not disclosed how SF ratings will be mapped. Since the proposed Solvency II mapping also addresses securitisations, how will consistency with the EBA SF Ratings be reached?

In terms of global consistency of the mapping, we note that this Solvency II mapping is not consistent with the mapping of US Credit Rating Providers by the US National Association of Insurance Commissioners.

Last but not least, we note that Article 111 (1) (n) of Directive 138/2009 explicitly requests that the Solvency II mappings are consistent with the CRD IV mappings. Since this requirement is included in a Directive, we think that this target is subordinated to the requirements embedded in the Regulations.

On Structured Finance ratings

While we appreciate the ESA’s special interest towards smaller ECAs, we think that equal attention should be given to the mapping of ECAs Structured Finance Ratings. We highly regret that EBA has yet not published any specific consultation on the topic as an important point of comparison is missing:

- Will these SF ratings be mapped according to their performance and potentially differentiate for the different asset classes and geographies? If so, we would expect that the mapping of SF ratings will be highly complex and that in some market segments AAA ratings would only map into CQS 3.
- Given the wish to revitalize the securitisation market, another option is to disregard the historic performance and take a pragmatic forward looking approach and map the



SF ratings into the same CQS. If this option is retained and at the same time the mapping of “smaller” ECAIs is not adapted with the same degree of pragmatism, it would be evident that this draft ITS is discriminatory towards these new, focused players.

We note that most “smaller ECAIs” have no rating symbols mapped into CQS 0 or CQS 1 thereby shouting out these agencies from the highest asset class. These new ECAIs will for example never be able to compete in the covered bond market (since 83% of all ratings outstanding in this segment mapped into CQS 1).

On Entry into force and annual review of ratings

In view of the potential effect of the mappings (and in future in case of the revision of the mapping) on users of ratings, we propose that the effective entry into force shall take place within 2 months of the publication in the Official Journal of the European Union. In addition, in order not to collide with Quarterly reporting dates, the entry into force should occur in the middle of each quarter of the year.

We note that the CRD IV mapping (and thereby the Solvency II mapping) is yet silent on the annual review of the mappings and how this will be effectively implemented. In case of a revision of the mappings, which translate in changing risk factors/risk weights, the economics of an insurer or bank is affected. Since the Civil liability regime applicable on CRA refers to credit ratings (and NOT to the mapped ratings), we assume that CRAs can't be made liable for a changed mapping of ratings.

Given the long term view used to derive the mappings (12 years of rating history are required to allow for the full quantitative approach), the annual review of ratings will impact more heavily on those agencies having a shorter track record/a lower number of ratings outstanding – given this risk, potential users of ECAI ratings will be reluctant to effectively nominate these newer ECAIs for the calculation of risk factors/risk weights.

We once again would like to thank the ESA's for launching this important consultation and we hope that our contribution will help to finalize an Implementing Technical Standard consistent with the objectives of Solvency II, CRD IV and CRA III Regulations.

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 owned by Dagong Global Credit Rating and 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.

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

Scope Ratings 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).