

JC/CP/2015/001

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# Joint Consultation Paper

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Draft Implementing Technical Standards on the allocation of credit assessments of ECAs to an objective scale of credit quality steps under Article 109 (a) of Directive 2009/138/EC

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# Contents

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<b>1. Responding to this Consultation</b>	<b>3</b>
<b>2. Consultation Paper Overview &amp; Next Steps</b>	<b>4</b>
<b>3. Draft Technical Standard</b>	<b>5</b>
<b>4. Accompanying documents</b>	<b>11</b>
<b>4.1 Impact Assessment</b>	<b>11</b>

# 1. Responding to this Consultation

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The ESAs welcome comments on the Implementing Technical Standards on the allocation of credit assessments of ECAs to an objective scale of credit quality steps.

The consultation package includes:

- The Consultation Paper Template for comments

The ESAs invite comments on any aspect of this paper. Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives the ESAs should consider.

## Submission of responses

Please send your comments in the provided Template for Comments, by email to [JointCommitteeConsultation@eiopa.europa.eu](mailto:JointCommitteeConsultation@eiopa.europa.eu), by 10 April 2015. Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

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## Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESAs rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESAs Board of Appeal and the European Ombudsman.

## Data protection

Information on protection of individuals with regard to the processing of personal data can be found under the heading 'Legal framework' of the EIOPA, and under the heading 'Legal notice' of the EBA and ESMA website (<https://eiopa.europa.eu/About-EIOPA/Legal-framework>, <http://www.eba.europa.eu/legal-notice>, <http://www.esma.europa.eu/legal-notice>).

## 2. Consultation Paper Overview & Next Steps

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ESAs carry out consultations in the case of drafting Implementing Technical Standards in accordance to Article 15 of the EIOPA Regulation, Article 15 of the ESMA Regulation and Article 15 of the EBA Regulation.

This Consultation Paper is being issued on the allocation of credit assessments of ECAs to an objective scale of credit quality steps.

This Consultation Paper presents the draft Implementing Technical Standard.

The analysis of the expected impact from the proposed policy is covered under the Impact Assessment section.

### **Next steps**

ESAs will consider the feedback received and expects to publish a final report on the consultation and to submit the Implementing Technical Standards for endorsement by the European Commission by 30 June 2015.

## 3. Draft Technical Standard

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EUROPEAN COMMISSION

Brussels, XXX  
[...] (2011) XXX draft

**COMMISSION IMPLEMENTING REGULATION (EU) No .../..**

**of [ ]**

**COMMISSION IMPLEMENTING REGULATION (EU) No .../.. of [date] laying down  
implementing technical standards with regard to the allocation of credit  
assessments of external credit assessment institutions in accordance with  
Directive 2009/138/EC of the European Parliament and of the Council**

**of XXX**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) and in particular Article 109a(1) thereof.

Whereas:

- (1) In order to accomplish the allocation of ECAI credit assessments, the mapping methodology laid down in the [Draft implementing technical standards on the mapping of ECAI's credit assessments under Articles 136(1) and 136(3) of Regulation (EU) No 575/2013 of the European Parliament and the Council on prudential requirements for credit institutions and investment firms] has been applied *mutatis mutandis*. In particular, this methodology has been used to specify the quantitative and qualitative factors, default benchmarks and to define the reference meaning of the allocation of ECAI credit assessments to the credit quality steps laid down in Article 3 of Commission Delegated Regulation (EU) 2015/35.
- (2) This Regulation is based on the draft implementing technical standards submitted by the European Supervisory Authorities (European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority) to the Commission.
- (3) The European Supervisory Authorities have conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group, the Insurance and Reinsurance Stakeholder Group and the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 respectively,

HAS ADOPTED THIS REGULATION:

## Article 1

### **Allocation of ECAI credit assessments to an objective scale of credit quality steps**

For the purpose of the allocation of ECAI credit assessments to an objective scale of credit quality steps, the following table shall apply:

N.	ECAI	0*	1*	2*	3*	4*	5*	6*
1.	<b>AMBEST</b>	aaa	aa	a	bbb	bb	b	<b
2.	<b>ARC</b>	-	-	AAA, AA, A	-	BBB	BB	B, <B
3.	<b>Assekurata</b>	-	-	AAA, AA	A	BBB	BB	B, <B
4.	<b>Axesor</b>	-	-	AAA, AA, A	BBB	BB	B	<B
5.	<b>BCRA</b>	-	-	AAA, AA, A	BBB	BB	-	B, <B
6.	<b>BdF</b>	-	3++	3+	3,4+	4,5+	5,6	<=7
7.	<b>CapInt</b>	-	-	AAA, AA, A	BBB	BB	B	<B
8.	<b>CERVED</b>	-	-	A1.1, A1.2, A1.3, A2.1, A2.2	A3.1, B1.1, B1.2	B2.1, B2.2	C1.1,	C1.2, C2.1
9.	<b>Creditreform</b>	-	-	AAA, AA, A	BBB	BB	B	<B
10.	<b>Crif</b>	-	-	AAA, AA, A	BBB	BB	B	<B
11.	<b>Dagong</b>	-	-	AAA, AA, A	BBB	BB	B	<B
12.	<b>DBRS</b>	AAA	AA	A	BBB	BB	B	<B
13.	<b>EIU</b>	AAA	AA	A	BBB	BB	B	<B
14.	<b>ERA</b>	-	-	AAA, AA	A	BBB	BB	B, <B
15.	<b>Euler Hermes</b>	-	-	AAA, AA, A	-	BBB, BB	B	<B
16.	<b>EuroRating **</b>	-	-	AAA, AA, A	BBB	-	BB	B, <B
17.	<b>Feri</b>	AAA	AA	A	-	BBB, BB	B	<B
18.	<b>Fitch</b>	AAA	AA	A	BBB	BB	B	<B
19.	<b>GBB</b>	-	-	AAA, AA	A, BBB	BB	B	<B
20.	<b>ICAP</b>	-	-	AA,A	BB, B	C, D	E, F	<F
21.	<b>JCRA</b>	AAA	AA	A	BBB	BB	B	<B
22.	<b>Kroll **</b>	-	-	AAA, AA, A	BBB	-	BB	B, <B
23.	<b>Moody's</b>	Aaa	Aa	A	Baa	Ba	B	<B
24.	<b>S&amp;P's</b>	AAA	AA	A	BBB	BB	B	<B
25.	<b>Scope</b>	-	-	AAA, AA, A	BBB	BB	B	<B
26.	<b>Spread Research</b>	-	-	AAA, AA	A	BBB	BB	B, <B

\* **Note:** The reference meaning of the allocation of ECAI credit assessments to credit quality steps is shown in Annex 1 to this Regulation. A list of abbreviations of the external credit assessment institutions is set out in Annex 2 to this Regulation.

\*\* **Note:** For ECAs Kroll and EuroRating, the associated mapping report developed as part of the mandate given by Article 136 CRR has not yet been published. Following the input received during this consultation and as part of the similar work undertaken by the Joint Committee under the equivalent CRR mandate, the mapping report will subsequently be made available for this ECAI. The mapping in this consultation paper may change as a consequence of this work.

*Article 2*

**Final provisions**

1. This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.
2. This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, [ ]

*[For the Commission*

*The President]*

*[On behalf of the President]*

*[Position]*

## ANNEX 1

### REFERENCE MEANING OF THE ALLOCATION OF ECAI CREDIT ASSESSMENTS TO CREDIT QUALITY STEPS

<b>Credit Quality Step</b>	<b>Reference meaning of the allocation of ECAI credit assessments</b>
0	The rated entity has extremely strong capacity to meet its financial commitments and is subject to minimal credit risk.
1	The rated entity has very strong capacity to meet its financial commitments and is subject to very low credit risk.
2	The rated entity has strong capacity to meet its financial commitments and is subject to low credit risk but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than rated entities in credit quality step 1.
3	The rated entity has adequate capacity to meet its financial commitments and is subject to moderate credit risk. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the rated entity to meet its financial commitments.
4	The rated entity has the capacity to meet its financial commitments but is subject to substantial credit risk. It faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions, which could lead to the rated entity's inadequate capacity to meet its financial commitments.
5	The rated entity has the capacity to meet its financial commitments but is subject to high credit risk. Adverse business, financial, or economic conditions will likely impair the rated entity's capacity or willingness to meet its financial commitments
6	The rated entity is currently vulnerable or highly vulnerable and is subject to very high credit risk, including in or very near to default. It is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.

## ANNEX 2

**LIST OF ABBREVIATIONS OF THE EXTERNAL CREDIT ASSESSMENT INSTITUTIONS**

AMBEST	- AM Best Europe-Rating Services Ltd. (AMBERS)
ARC	- ARC Ratings, S.A.
Assekurata	- ASSEKURATA Assekuranz Rating-Agentur GmbH
Axesor	- Axesor SA
BCRA	- BCRA – Credit Rating Agency AD
BdF	- Banque de France
CapInt	- Capital Intelligence (Cyprus) Ltd
CERVED	- Cerved Rating Agency S.p.A.
Creditreform	- Creditreform Rating AG
Crif	- CRIF S.p.A.
Dagong	- Dagong Europe Credit Rating Srl (Dagong Europe)
DBRS	- DBRS Ratings Limited
EIU	- The Economist Intelligence Unit Ltd
ERA	- European Rating Agency, a.s.
Euler Hermes	- Euler Hermes Rating GmbH
EuroRating	- EuroRating Sp. z o.o.
Feri	- FERI EuroRating Services AG
Fitch	- Fitch Ratings
GBR	- GBR-Rating Gesellschaft für Bonitätsbeurteilung GmbH
ICAP	- ICAP Group SA
JCRA	- Japan Credit Rating Agency Ltd
Kroll	- Kroll Bond Rating Agency
Moody's	- Moody's Investors Service
S&P's	- Standard & Poor's Ratings Services
Scope	- Scope Ratings AG
Spread Research	- Spread Research

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## 4. Accompanying documents

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### 4.1 Impact Assessment

#### 1. Procedural issues and consultation of interested parties

According to ESAs' Regulation, the ESAs conduct analysis of costs and benefits when drafting implementing technical standards. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

The draft ITS and its impact assessment are envisaged to be subject to public consultation.

#### 2. Problem definition

Article 109a of Directive 2009/138/EC requires the ESAs through the Joint Committee (JC) to develop draft implementing technical standards on the association of the credit assessments of ECAIs to an objective scale of credit quality steps (CQS) applying the steps specified in accordance with Article 111(1)(n) of Directive 2009/138/EC.

In Solvency II this association (i.e. mapping) serves the purpose of assigning the appropriate risk factors which depend on the CQS of the exposure as set out in article 176, 178, 179, 180, 181, 185, 186, 187, 193, 199 of [Implementing Measures] to the rating categories of nominated ECAIs.

It is generally agreed that the methodology to be used in Solvency II by EIOPA for the mapping shall follow as closely as possible the EBA's approach currently proposed for banking in order to ensure a global consistency. This aspect is covered by the legal mandate (art. 109 of Omnibus II) which requires an *“allocation of external credit assessments to a scale of credit quality steps referred to in Article 109a(1) which shall be consistent with the use of external credit assessments from ECAIs in the calculation of the capital requirements for credit institutions as defined in Article 4(1)(1) of Regulation (EU) No 575/2013 and financial institutions as defined in Article 4(1)(26) thereof”*.

The following main aspects have been considered for the development of a methodology for the mapping of ECAIs in Solvency II:

- the mandate for the JC: the mapping in the insurance framework should be consistent with the mapping in the banking framework;
- the differences between the banking and insurance framework;
- the pros and cons for each methodology option considered in the policy decision, taking into account the differences between the two frameworks;

- the mapping outcomes of the proposed options.

There are two fundamental differences between the banking and the insurance framework:

- (i) the number of CQS: 6 in the banking regulation, 7 in insurance regulation;

(ii) the long run benchmarks: long term average of 3-years default rates have been adopted by the EBA basing on Basel Committee data, while probabilities of default given in the counterparty default risk of the standard formula are based on the 1-year time horizon.

It should be mentioned that:

- both in CRR and in Solvency II there is no definition of which shall be the “legally binding” benchmarks for mapping purposes. Among the policy options there will be the choice of such benchmarks.
- The mapping will be provided on the basis of long run (benchmark) probabilities of defaults, calculated as long term average of short run probabilities.

In order to reduce the foreclosure of a market already dominated by three undertakings, Article 13(40) of Directive 2009/138/EC automatically recognizes as external credit assessment institution (ECAI) credit rating agencies registered or certified in accordance with Regulation (EC) No 1060/2009. This means that ‘mappings’ should be made available for all existing credit rating agencies that conduct their activities in accordance with the principles of integrity, transparency, responsibility and good governance set out in that Regulation. As an exception, ‘mappings’ should also be made available for central banks producing ratings that are not subject to that Regulation.

### ***Baseline scenario***

When analysing the impact from proposed policies, the impact assessment methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

The baseline scenario is based on the current situation of EU insurance and reinsurance markets, taking account of the progress towards the implementation of the Solvency II framework achieved at this stage by insurance and reinsurance undertakings and supervisory authorities.

In particular the baseline scenario includes:

- The relevant content of Directive 2009/138/EC as amended by Directive 2014/51/EU.

- The relevant Implementing Measures.

It has to be noted that according to the first paragraph of Article 109a of the Directive, the ESAs through the Joint Committee shall develop draft implementing technical standards on the association of the credit assessments of ECAs to an objective scale of credit quality steps (CQS) applying the steps specified in accordance with Article 111(1)(n) of the Directive.

### 3. Objectives

The objective of this ITS is assigning the appropriate CQS to the rating categories of ECAs for the purpose of calculating the capital requirements under the Standard Formula. This is notably the case for risks where the capital charge is determined according to the rating of exposures, in particular market and counterparty risk exposures.

To promote consistency in the way the ‘mappings’ are determined, the Joint Committee has been mandated to draft the quantitative and qualitative factors that should be considered to differentiate between the relative degrees of risk expressed by each credit assessment of a particular ECA as well as the benchmarks against which these factors should be compared. Additionally, the Joint Committee has been requested to specify the ‘mappings’ for all ECAs in accordance with Article 109a of Directive 2009/138/EC.

This ITS will contribute to a common understanding among institutions and the EU’s national competent authorities about the methodology that the Joint Committee should use to specify the ‘mappings’. Given that the mappings of any ECA will be equally applicable in all EU Member States, this ITS will also contribute to ensure a high level of harmonisation and consistent practice in this area.

These objectives correspond to the specific Solvency II objectives “Advance supervisory convergence”, “Encourage cross-sectorial consistency”, “Improved risk management of EU insurers” and “Better allocation of capital” as well as to the Solvency II general objectives “Enhanced policy holder protection” and “Deeper integration of EU insurance market”.

### 4. Policy options

This section explains the rationale behind the most relevant alternative solutions that the Joint Committee has made when designing the ITS proposals.

#### **Policy issue 1: measure of the degree of risk underlying the credit assessment of an ECA**

**Option 1.1:** traditional risk metrics: probabilities of default based on defaulted entities recorded by ECAs.

**Option 1.2:** alternative instruments or probabilities of default based on different data.

Among the factors considered to measure the degree of risk underlying the credit assessment of an ECAI, traditional risk metrics (option 1.1) such as the default rate and the loss upon default rate have been considered.

In order to decide between the two options, factors such as the availability of information, the consistency with the definition of the credit assessment and the consistency with the banking regulatory framework have been considered. Regarding the availability of information, the default rates are the best option (Option 1.1). Whereas all ECAs record information about their defaulted rated entities (for back testing purposes, mainly), they usually do not database the effective losses borne by investors in defaulted instruments. Regarding the definition of the credit assessments, most ECAs provide opinions on the ability of the rated entity to meet the financial obligations derived from the instrument. Losses upon default are usually excluded from such credit opinion.

**Policy Option 1.1:**

No.	Pros	Cons
1	Consistency with EBA's approach used for the mapping of ECAs in the banking sector.	Reliance on data on defaults recorded by ECAs.
2	Wide and reliable information is available.	-

**Policy Option 1.2:**

No.	Pros	Cons
1	Reduced reliance on data on defaults recorded by ECAs.	Inconsistency with EBA's approach used for the mapping of ECAs in the banking sector.

**Policy issue 2: Characterization of the level of risk underlying each credit assessment**

**Option 2.1:** Long run default rates: probabilities of default calculated over a long time horizon;

**Option 2.2:** Short run default rates: probabilities of default calculated over a short time horizon;

Both short run and long run default rates have been considered to characterize the level of risk underlying each credit assessment. Each one has a specific role and therefore both of them are equally necessary. But the long run default rate of a credit assessment should provide the basis of the mapping proposal under the quantitative framework (option 2.1). Such role cannot be played by the short run default rate because it may be affected by temporary shocks that do not reflect the true underlying level of risk of the credit assessment and/or induce cyclical in the capital requirement.

The role of the short run default rate of a credit assessment may be instead used to provide an early warning of a weakening of the assessment standards of the ECAI that might be affecting the level of risk of the items currently assigned to that credit assessment.

## Policy Option 2.1:

No.	Pros	Cons
1	Consistency with EBA's approach used for the mapping of ECAIs in the banking sector.	The use of log run rates, if not accompanied by short run analysis, might not capture any sudden weakening of the assessment standard of an ECAI that might be affect the level of risk of the items currently assigned to that credit assessment.
2	Long run default rates are not affected by temporary shocks that cannot reflect the true underlying level of risk of the credit assessment.	

## Policy Option 2.2:

No.	Pros	Cons
1	The role of the short run default rate of a credit assessment may be used to provide an early warning of a weakening of the assessment standards rather than the basis for producing the mapping.	Inconsistency with EBA's approach used for the mapping of ECAIs in the banking sector.

## Policy issue 3: Use of all available default data to calculate the default rate.

**Option 3.1:** use of quantitative information on default only;

**Option 3.2:** use of alternative qualitative information and of qualitative information.

The calculation of default rates is considered a key step of the mapping process. When sufficient default data are available, a set of requirements has been established in this mapping framework. When default data are not sufficient, the ECAI should be consulted on the long run default rate associated with a credit assessment. In order to promote objectivity and consistency in this process, the mapping framework specifies what information should be used by the Joint Committee to conclude on the final level of the long run default rate.

As a first choice, the level of risk of a credit assessment can be inferred from the long run default rate associated with a (sufficiently correlated) alternative measure of creditworthiness, such as the rating provided by another ECAI or a score provided by the

ECAI itself. Under this option, the alternative measure of creditworthiness can be considered as a proxy for the default rate of the credit assessment. Although this implies that expert judgement still needs to be exercised, the degree of uncertainty regarding the default rate estimate should be significantly smaller compared to a situation where the default rate is purely based on a qualitative statement. Therefore, the use of the default rates associated with an alternative measure of creditworthiness and qualitative information about the relevant ECAI should be considered for the mapping of a credit assessment (Option 3.2).

When the long run default rate of a valid alternative measure of creditworthiness is not available, the estimate of the default rate provided by the ECAI should be addressed with an appropriate degree of careful consideration in order to reflect the implicit uncertainty. Failure to do this would make it very difficult to impose a conservative mapping of credit assessments where the default data showed a bad performance by the ECAI. In any case, it should be made clear that qualitative factors may challenge the mapping stemming from this conservative estimate of the long run default rate.

### Policy Option 3.1:

No.	Pros	Cons
1	Full reliance on data regarding defaulted entities, without using expert judgment.	Inconsistency with EBA's approach used for the mapping of ECAs in the banking sector.
2		Only a few ECAs have sufficient data.

### Policy Option 3.2:

No.	Pros	Cons
1	Consistency with EBA's approach used for the mapping of ECAs in the banking sector.	Use of expert judgment when there are no sufficient data on defaults available.
2	Alternative measures regarding the creditworthiness and qualitative criteria can provide added value when the default rate provided by the ECAI contains a level of uncertainty.	

## Policy issue 4: Definition of default.

**Option 4.1:** use of each ECAI's default definition;

**Option 4.2:** use of a common default definition;

The definition of default is a key element of the mapping process, especially where sufficiently numerous default data are available. Any difference in the level of strictness of an ECAI's default definition with respect to other ECAs has a large potential of affecting the level playing field since the respective mappings would not have been done under similar terms. Therefore the comparability of an ECAI's definition of default should be assessed.

The mapping framework proposes to use the definition of each ECAI's default definition (Option 4.1) and to base the comparison on the bankruptcy (and similar legal proceedings) rate. This information is generally available to all ECAs and can be used to characterize the degree of strictness of a default definition as the increase in the number of default events with respect to the number of observed bankruptcies. Any other comparison based on a set of default events that are not generally observed for most ECAs would be very difficult to implement and the degree of uncertainty implied in the comparison would be very large.

### Policy Option 4.1:

No.	Pros	Cons
1	Consistency with EBA's approach used for the mapping of ECAs in the banking sector.	Any difference in the level of strictness of an ECAI's default definition with respect to other ECAs has a potential of affecting the level playing field.
2	This definition of default is generally available to all ECAs and follows similar criteria. The impact of using different default definitions coming from different ECAs is supposed to be low since the comparability of the default definitions will be assessed.	

## Policy Option 4.2:

No.	Pros	Cons
1	Common criteria for setting a “default event” ensure full comparability among ECAs.	Inconsistency with EBA’s approach used for the mapping of ECAs in the banking sector. Imposing a common default definition may result that ad hoc data from ECAs is not being available.

## Policy issue 5. Methodology for the mapping in Solvency II

The method for deriving the mapping for Solvency II is the most crucial policy decision to be taken as lots of elements are closely connected with each other.

Given the identified differences between the insurance and the banking framework, some adaptations to the current method developed by EBA for the banking sector have been investigated by EIOPA in order to seek for consistency with the Solvency II principles and with the criteria used for the calibration of the Standard Formula, without losing connection with the credit assessment mapping principles developed by EBA.

In light of these aspects, any methodology considered in the policy decision has been fully tested in terms of final results (mapping tables): the output of all policy options has been derived for some representative ECAs in order to get an idea of the dimension of any preliminary difference between the results produced by EBA for the banking sector and those coming from any alternative method.

Given the misalignment between banking and insurance framework, and required consistency in these technical standards, the following options have been considered:

**Option 5.1:** 1-year benchmarks of Article 199(2) of Delegated Act;

**Option 5.2:** 3-years benchmarks as described in EBA draft ITS;

**Option 5.3:** recalibration of 1-year benchmarks of Article 199(2) of Delegated Act into 3 years probabilities of default.

All possible options have been presented in detail to the JC, accompanied by preliminary results and impact assessments.

The default rate can be defined in multiple ways. All options proposed reflect the criteria which are of interest from a prudential perspective and at the same time guarantee a

consistency with Solvency II principles. An analysis of pros and cons of each policy option is presented at the end of this section.

From a practical perspective, a 3-year time horizon would allow the observation of a sufficient number of defaults in low risk credit assessments. A three-year time horizon would guarantee a sufficient level of reliable and stable data on default. Therefore a 3-year time horizon can be anyway relevant for the purpose of the mapping.

In addition a requirement that the size of the pool of rated items is sufficiently numerous is proposed. More concretely, it is proposed that the size of a pool is considered as sufficiently large if it is at least equal to the inverse of the 'expected' long run default rate. For example, where the 'expected' long run default rate is 1%, each historical pool should contain, at least, 100 rated items. This requirement should provide the necessary degree of comfort regarding the certainty surrounding the default rates used for the mapping.

The contribution of withdrawn ratings is also addressed in the mapping framework. It is acknowledged that they provide some evidence of the default behaviour of a credit assessment. However, such evidence should be less conclusive than the case of credit assessment that have been observed for the whole 1-year period because it cannot be guaranteed that a default has not taken place after withdrawal. In order not to affect those rating businesses where withdrawals are more frequently observed, no weighting is applied as long as the default behaviour has been observed after the credit assessment has been withdrawn.

A quantitative impact study has been performed for 3 large, 2 medium and 2 small ECAs. In terms of mapping outcomes, the results are as follows:

In case of **Option 5.1:**

the mappings have a good consistency with the EBA mapping for large ECAs. The mappings are similar to the EBA mapping except AAA rating category which is allocated consistently to a different CQS (CQS 0 instead of CQS 1). However, this is a result of the different total credit quality steps between the insurance and banking regulation frameworks, i.e. the highest CQ for insurance is 0 while the highest CQ for banking is 1.

the mappings are partially consistent with the EBA mappings for medium and small size ECAs.

In case of **Option 5.2:**

the mappings are identical to the EBA mapping for all ECAs, except AAA rating category which is allocated consistently to a different CQS (e.g. CQS 0 instead of CQS 1 for large ECAs). As explained, this is a result of the fundamental difference between the insurance and the banking framework.

### In case of **Option 5.3**:

the mappings are partially similar to the EBA mappings. One difference is the AAA rating category which is allocated consistently to a different CQS (CQS 0 instead of CQS 1). This is a result of the fundamental difference between the insurance and banking frameworks. Other differences refer to rating categories AA, A, BBB, BB and B and are observed in large, medium and small ECAIs. This may be a result of the calibration of the 3-year default rates based on a flat factor applied to the 1-year default rates.

For the purpose of ensuring:

- coherence with the mapping tables provided for previous EIOPA Impact Studies and
- consistency with the mapping framework and output of EBA,

the best choice is **Option 5.2**. The JC also showed the preference for **Option 5.2**, because it was considered within legal boundaries of SII and to provide the best output compared to the past recommendation provided by CEIOPS/EIOPA.

Furthermore such option does not lead to breach of the fundamentals of SII or wide-ranging reassessment of previous work.

Finally among the objectives of this ITS there is the need to ensure a methodological cross-sectorial consistency in terms of output.

The initial CEIOPS advice (<https://eiopa.europa.eu/CEIOPS-Archive/Documents/Advices/CEIOPS-L2-Final-Advice-SCR-SF-Counterparty-default-risk.pdf>) also supported the policy option used for the banking sector:

“

*3.136. In order to make use of credit ratings for the determination of the probability of default, two elements need to be specified:*

- *A recognition of the CRAs whose credit ratings can be used in the standard formula.*
- *For each recognised CRA, an assignment of probabilities of default to the rating classes used by the CRA. This assignment should distinguish between different kind of rated instruments and counterparties.*

*3.137. The credit ratings used in the standard formula should meet highest standards. Only credit ratings of CRAs which are registered according to the Regulation on Credit Rating Agencies and which meet the requirements specified in this Regulation should be recognised. Moreover, they should meet requirements which are consistent with those for external credit assessment institutions included in the Capital Requirements Directive 2006/48/EC”.*

## Policy Option 5.1:

No.	Pros	Cons
1	Long run benchmark probabilities are taken from the Standard Formula (1 year Probability of Defaults (PD) under counterparty default risk).	Long run benchmarks will be different from the banking regulation, as in CRR they are derived basing on 3-years PDs of Basel proposal.
2	The allocation process is based on seven benchmarks for the corresponding seven CQS envisaged in Solvency II regulations.	Resulting Mapping tables in Solvency II can be different from banking tables, so for some small ECAs the usage of different benchmarks can produce different results, and this is less advisable.
3	The methodology used by EBA is adapted to Solvency II.	Application of 1-year default rates, compared to 3 year default rates could introduce higher migration into the ratings. In the banking framework, the migration of ratings was a particular concern, as it induces cyclicity in own funds requirements. Therefore, this was the driving factor behind choosing the 3-year short-run default rate for the mapping in the banking framework.
4		1 year default rate is approximately 3 times lower than 3 years default rates, leading to a proportional increase of the minimum required data sample, which makes it unrealistic for small and medium-sized ECAs to have sufficient data, as well as for large CRAs in the lower risk CQs. However, adjustments could be applied to compensate this, e.g. a cap on the minimum number of require items.

## Policy Option 5.2:

No.	Pros	Cons
1	<p>The outcomes of this option are mostly the same as the EBA's results, because benchmarks and criteria used are the same. Resulting Mapping tables for insurance sector will be, to a large extent, the same as the Mapping tables produced by EBA for banking sector.</p>	<p>The allocation process is based on six benchmarks for the corresponding seven CQS envisaged in Solvency II regulations. Expert judgment is used to accommodate such difference (i.e. through association of the best rating assessments to the first (best) CQS).</p>
2	<p>The methodology used for banking and insurance is the same (except of number of CQS). It will be easier to set up a joint process, as separate mappings need not be calculated. In the light of continuous revisions, the workload in the continued is assessed to be lower. The allocation process is based on seven benchmarks for the corresponding seven CQS envisaged in Solvency II regulations.</p>	<p>Standard Formula's PDs are not used.</p>
3	<p>The methodology used for banking and insurance is unique (except of number of CQS).</p>	<p>Providing benchmarks which are different from PDs of SII Standard Formula would give an impression to external parties that capital requirements are derived with a different risk assessment used for the Mapping exercise.</p>
4	<p>Application of 3-year default rates, compared to 1 year default rates could introduce lower migration into the ratings. In the banking framework, the migration of ratings was a particular concern, as it induces cyclicity in own funds requirements.</p>	<p>The allocation process is based on six benchmarks for the corresponding seven CQS envisaged in Solvency II regulations. Expert judgment is used to accommodate such difference, i.e. through an expert association of the best rating assessments to the first (best) CQS.</p>
5	<p>It will be easier to set up a joint process, as separate mappings need not be calculated. In the light of continuous revisions, the workload in the continued is assessed to be lower.</p>	

### Policy Option 5.3:

No.	Pros	Cons
1	Consistency with the 3 years probability of defaults provided by EBA, because benchmarks are defined on a 3-year time horizon.	The three year PDs used are based on the one year PDs provided in the Solvency 2 regulation, which have been approximately scaled up, with expert judgments.
2	The allocation has seven benchmarks for the corresponding seven CQS envisaged in Solvency II regulations.	Resulting Mapping tables in Solvency II can be slightly different from banking tables, so for some ECAIs the usage of different benchmarks can produce different results.
3	Application of 3-year default rates, compared to 1 year default rates could introduce lower migration into the ratings. In the banking framework, the migration of ratings was a particular concern, as it induces cyclical in own funds requirements.	The derivation of benchmarks followed a rough approach. The use of a proxy for this purpose can generate less advisable and unexpected results.

## 5. Analysis of impacts

The use of external ratings for capital requirements under the Standard Formula is new in the prudential regulation of insurance undertakings.

On the one hand, insurance undertakings subject to the Solvency II will be affected by the mappings established according to these draft ITS. Since the mappings constitute an element for the calculation of Solvency Capital Requirement under the Standard Formula, the main impact of this Regulation on insurance and reinsurance undertakings will be regarding the actual level of capital that they are required to hold for externally rated exposures.

On the other hand, ECAIs, as defined in Article 4(98) of CRR, will also be impacted by these proposals given that they will have to provide all necessary information for the mappings to be completed. In this case, the indirect costs derived from this situation will represent the main impact of these draft ITS for them.

### ***Direct compliance costs***

The costs derived from the compliance with this Regulation basically affect credit rating agencies for which a mapping has to be provided. In order to assess the level of risk behind each credit assessment, the corresponding ECAI is in the best place to provide all necessary relevant information and therefore they support the main cost of compliance with this Regulation. For this reason, the Joint Committee has made all efforts to keep burden on the ECAIs to the minimum extent possible. For example, the calculation of the quantitative factors for those ECAIs that have sufficient default data in CEREP (ESMA's central repository of credit ratings) has been done in a centralised manner by the Joint Committee.

However, it is acknowledged that in the case of smaller ECAIs, where the amount of default information is scarce, an additional effort has been requested to them in order to make use of any type of default evidence that could help quantifying the level of risk behind their rating categories. In this case the Joint Committee has also tried to keep the burden to the smallest extent possible. For example, CEREP has been used whenever possible to capture any default evidence that could be used for the purpose of the mapping (as it is the case, for example, of items rated both by the smaller ECAI and an ECAI with larger amounts of default data).

The compliance costs of insurance institutions with this Regulation are negligible since the individual mapping tables for each ECAI will be made publicly available and should be easily incorporated in the calculation process of solvency capital requirements.

### ***Indirect capital costs***

The costs, defined in terms of capital requirements under the Standard Formula, derived from the specification of the new mapping tables will be entirely faced by the insurance and reinsurance undertakings.

### ***Benefits***

The methodology applied to map the ECAs' credit assessments for the purpose of the draft ITS will ensure that a complete harmonisation of the mapping of credit assessments to the corresponding credit quality steps is applied across Member States. This will allow the calculation of the capital requirements for externally rated exposures under the Standardised Approach to be the same across all institutions within the EU, what should be the main feature of that Approach.

Also, the analysis performed to arrive at each individual mapping and its regular monitoring over time should mitigate any mechanistic overreliance of the credit risk rules on external ratings, which is one of the objectives of the CRD derived from the G-20 conclusions and the FSB principles for Reducing Reliance on external credit ratings.