

Spread Research's credit assessments under the Standardised Approach

1. Executive summary¹

1. The methodology applied to produce the mapping is the one specified in the Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 (the Implementing Regulation)² laying down implementing technical standards with regard to the mapping of credit assessments of external credit assessment institutions for credit risk in accordance with Articles 136(1) and 136(3) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (Capital Requirements Regulation – CRR). This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) of the CRR.
2. The information base used to produce this mapping report reflects additional quantitative and qualitative information collected after the submission of the draft Implementing Technical Standards by the JC to the European Commission.
3. The mapping neither constitutes the one which ESMA shall report on in accordance with Article 21(4b) of Regulation (EC) No 1060/2009 (Credit Rating Agencies Regulation - CRA) with the objective of allowing investors to easily compare all credit ratings that exist with regard to a specific rated entity³ nor should be understood as a comparison of the rating methodologies of SR with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of SR with a regulatory scale which has been defined for prudential purposes.
4. As described in Recital 12 of the Implementing Regulation, it is necessary to avoid causing undue material disadvantage on those ECAIs which, due to their more recent entrance in the market, present limited quantitative information, with the view to balancing prudential with market concerns. Updates to the mapping should be made wherever this becomes necessary to reflect quantitative information collected after the entry into force of the Implementing Regulation

¹ The Joint Committee (JC) of the European Supervisory Authorities (ESAs) produces mapping reports illustrating how the outcome of the mapping assessment has been reached, based on the methodology set out in the Implementing Regulation (EU) 2016/1799 of 7 October 2016. While mapping reports are not mandated by the Capital Requirements Regulation, they are produced by own initiative to enhance transparency.

The JC of the ESAs has not received the consent from Spread Research to publish the information transmitted by the ECAI for the purposes of assessing the mapping. Therefore,, the JC of the ESAs is not in a position to provide similar information for Spread Research as for other ECAIs having consented to the publication of their mapping reports.

² OJ L 275, 12.10.2016, p. 3-18

³ In this regard, please consider https://www.esma.europa.eu/sites/default/files/library/esma_2015-1473_report_on_the_possibility_of_establishing_one_or_more_mapping.pdf.

5. The resulting mapping tables have been specified in Annex III of the revised draft ITS on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of Regulation (EU) No 575/2013. Figure 1 below shows the result for the Global long-term rating scale.

Figure 1: Mapping of Spread Research Global long-term rating scale

Credit assessment	Credit quality step
AAA	1
AA	1
A	2
BBB	3
BB	4
B	5
CCC	6
CC	6
C	6
D	6

2. Introduction

6. Spread Research (SR) is a credit rating agency that has been registered with ESMA in 1 July 2013 and therefore meets the conditions to be an eligible credit assessment institution (ECAI)⁴.
7. The methodology applied to produce the mapping is the one specified in the Implementing Regulation. This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) of the CRR. The information base used to produce this mapping report reflects additional quantitative and qualitative information collected after the submission of the draft Implementing Technical Standards by the JC to the European Commission. The quantitative information is drawn from data available in the ESMA's central repository (CEREP⁵) based on the credit rating information submitted by the ECAIs as part of their reporting obligations.
8. Section 3 describes the relevant ratings scales of SR for the mapping. Section 4 contains the methodology applied to derive the mapping of SR's rating scale Global long-term rating scale. Section 5 refers to the mapping of the short-term credit rating scale. The mapping tables are shown in Appendix 4 of this document and have been specified in Annex III of the revised draft ITS on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of Regulation (EU) No 575/2013.

3. SR credit ratings and rating scales

9. SR produces a variety of credit ratings, shown in Column 2 of Figure 2 in Appendix 1. These credit ratings may be used by institutions for the calculation of risk weights under the Standardised Approach (SA)⁶:
 - **Long-term issuer rating**, defined as measure of the future credit quality of an issuer that is closely linked to a Probability of Default (and not an Expected Loss).
 - **Long-term obligation rating**, which is derived from the issuer long term rating on which a notching is applied to a specific debt instrument. This rating takes into consideration a recovery rate in order to capture a loss given a default rate..
 - **Short-term issuer rating**, which is a measure of the future credit quality of an issuer that is closely linked to a Probability of Default within a 12 to 15 months period of time.
 - **Short-term obligation rating**, which is derived from the issuer short term rating on which a notching is applied to a specific debt instrument. This rating takes into consideration a recovery rate in order to capture a loss given a default rate.

⁴ It is important to note that the mapping does not contain any assessment of the registration process of SR carried out by ESMA.

⁵ <https://cerep.esma.europa.eu/cerep-web/>

⁶ As explained in recital 4 ITS, Article 4(1) CRA allows the use of the credit assessments for the determination of the risk-weighted exposure amounts as specified in Article 113(1) CRR as long as they meet the definition of credit rating in Article 3(1)(a) CRA.

10. SR assigns these credit ratings to the Global long-term rating scale and to the Global short-term rating scale, as illustrated in column 3 of Figure 2 in Appendix 1. Therefore, specific mappings have been prepared for these rating scales. The specification of the Global long-term rating scale is described in Figure 3 of Appendix 1 and that of the Global short-term rating scale is described in Figure 4 of Appendix 1.

11. The mapping of the Global long-term credit rating scale is explained in Section 4 and it has been derived in accordance with the quantitative factors, qualitative factors and benchmarks specified in the ITS.

12. The mapping of the Global short-term issuer rating scale is explained in Section 5 and it has been indirectly derived from the mapping of the Global long-term issuer ratings scale and the internal relationship established by CI between these two scales, as specified in Article 13 of the Implementing Regulation. This internal relationship is shown in Figure 5 of Appendix 1.

4. Mapping of SR's Global long-term rating scale

13. The mapping of the Global long-term rating scale has consisted of two differentiated stages where the quantitative and qualitative factors as well as the benchmarks specified in Article 136(2) CRR have been taken into account.

14. In the first stage, the quantitative factors referred to in Article 1 of the Implementing Regulation have been taken into account to differentiate between the levels of risk of each rating category. The *long run default rate* of a rating category has been calculated in accordance with Article 6 of the Implementing Regulation, as the number of credit ratings cannot be considered to be sufficient.

15. In a second stage, the qualitative factors proposed in Article 7 of the Implementing Regulation have been considered to challenge the result of the previous stage.

4.1. Initial mapping based on the quantitative factors

16. This mapping report reflects additional quantitative information collected after the submission of the draft ITS by the JC to the Commission.

4.1.1. Calculation of the long-run default rates

17. CEREP contains four observations for SR, which span from 2014H1 to 2015H2. The calculation of the short and long run default rates cannot be made as specified in Articles 3 – 5 of the Implementing Regulation, as the data availability precludes the calculation of the 3-year horizon established on Article 4(2).

18. Therefore, the allocation of the CQS has been made in accordance with Article 6 of the Implementing Regulation, as shown in Figure 4 and of Appendix 3.

19. For D rating category, no calculation of default rate has been made since it already reflects a 'default' situation.

4.1.2. Mapping proposal based on the long run default rate

20. As illustrated in the second column of Figure 7 in Appendix 4, the assignment of the rating categories to credit quality steps has been initially made in accordance with Article 6 of the ITS. Therefore, the numbers of defaulted and non-defaulted rated items have been used together with the prior expectation of the equivalent rating category of the international rating scale.

- **AAA/AA/A/BBB/BB/B:** the number of rated items in each of these categories is equal or larger than the respective minimum required number of observed items given the number of defaulted items in the rating category. Thus the credit quality step associated with the AAA/AA, A, BBB, BB, B rating categories in the international rating scale (CQS 1, CQS 2, CQS 3, CQS4 and CQS 5 respectively) can be assigned.
- **CCC-C:** since the CQS associated with the equivalent rating category of the international rating scale is 6, the proposed mapping for these rating categories is also CQS 6.

4.2. Final mapping after review of the qualitative factors

21. The Joint Committee of the European Supervisory Authorities has not received the consent from Creditreform Rating AG to publish the information transmitted by the ECAI.

5. Mapping of SR's Global Short-Term rating scale

22. SR also produces short-term corporate ratings and assigns them to the Global short-term rating scale (see Figure 4 in Appendix 1). Given that the default information referred to these rating categories cannot be comparable with the 3-year time horizon that characterizes the benchmarks established in the Implementing Regulation, the internal relationship established by SR between these two rating scales has been used to derive the mapping of the Global short-term rating scale. This should ensure the consistency of the mappings proposed for SR.

23. The Joint Committee of the European Supervisory Authorities has not received the consent from Creditreform Rating AG to publish the information transmitted by the ECAI.

Appendix 1: Credit ratings and rating scales

Figure 2: SR's relevant credit ratings and rating scales

SA exposure classes	Name of credit rating	Credit rating scale
Long-term ratings		
Corporates	Long-term issuer rating	Global long-term rating scale
Corporates	Long-term obligation rating	Global long-term rating scale
Short-term ratings		
Corporates	Short-term issuer rating	Global short-term rating scale
Corporates	Short-term obligation rating	Global short-term rating scale

Source: Spread Research

Figure 3: Global long-term rating scale

Credit assessment	Meaning of the credit assessment
AAA	Highest credit quality and extremely low business and financial risk.
AA	Very large scale and very high level of diversification, very low-risk business (proven resilience through economic crisis), very high FCF and very low leverage
A	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), high FCF and low leverage
BBB	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), positive FCF and/or low leverage
BB	Medium/low-risk business (stable and predictable cash flows), positive FCF and/or low leverage
B	High-risk business , negative FCF and/or high leverage
CCC	Very high leverage, negative FCF, weak liquidity and/or restructuring/default likely
CC	Out-of-court consensual restructuring
C	In-court restructuring
D	Missed payment on interest or principal (post-grace period)

Source: Spread Research

Figure 4: Global short-term rating scale

Credit assessment	Meaning of the credit assessment
SR 0	Very low short term risk and very strong ability to reimburse short term debt.
SR 1	Low short term risk linked to the issuer's ability to anticipate short term funding risks.
SR 2	Moderate short term risk linked to potential external risks.
SR 3	Medium short term risk. The issuer's ability to reimburse its short term debt may be hampered by external or specific risks.
SR 4	High short term risk
SR 5	Very high short term risk / In- restructuring.
SR D	Default on the short term debt

Source: Spread Research

Appendix 3: Default rates of each rating category

Figure 6: Mapping proposal for rating categories with a non-sufficient number of credit ratings

	AAA/AA	A	BBB	BB	B	CCC-C
CQS of equivalent international rating category	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6
N. observed defaulted items	0	0	0	0	0	0
Minimum N. rated items	0	0	0	0	0	n.a.
Observed N. rated items	0	0	0	0	0	0
Mapping proposal	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6

Source: Joint Committee analysis

Appendix 4: Mappings of each rating scale

Figure 7: Mapping of SR's Global long-term credit rating scale

Credit assessment	Credit Quality Step
AAA	1
AA	1
A	2
BBB	3
BB	4
B	5
CCC	6
CC	6
C	6
D	6

Figure 8: Mapping of SR's Global short-term credit rating scale

Credit assessment	Credit Quality Step
SR0	1
SR1	3
SR2	3
SR3	4
SR4	4
SR5	4
SRD	4