

Mapping of EuroRating credit assessments under the Standardised Approach

1. Executive summary

1. This report describes the mapping exercise carried out by the Joint Committee to determine the ‘mapping’¹ of the credit assessments of EuroRating Sp. z o.o. (EuroRating).
2. The methodology applied to produce the mapping is the one specified in the Commission’s Implementing Regulation (EU) 2016/1799 (‘the Implementing Regulation’) laying down Implementing Technical Standards (ITS) with regard to the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk in accordance with Articles 136(1) and (3) of the Regulation (EU) No 575/2013 of the European Parliament and the Council (‘the CRR’). This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) CRR.
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 entity² nor should be understood as a comparison of the rating methodologies of EuroRating with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of EuroRating with a regulatory scale which has been defined for prudential purposes. This implies that an appropriate degree of prudence may have been applied wherever not sufficient evidence has been found with regard to the degree of risk underlying the credit assessments.
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. Therefore, the relevance of quantitative factors for deriving the mapping should be relaxed. This allows ECAIs which present limited quantitative information to enter the market and increases competition. Updates to the mapping should be made wherever this

¹ According to Article 136(1), the ‘mapping’ is the correspondence between the credit assessments of and ECAI and the credit quality steps set out in Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR).

² In this regard please consider http://www.esma.europa.eu/system/files/esma__2015-1473_report_on_the_possibility_of_establishing_one_or_more_mapping....pdf.

becomes necessary to reflect additional quantitative information collected after the entry into force of the revised draft ITS.

- The resulting mapping tables have been specified in Annex III of the Implementing Technical Standards 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 EuroRating ratings scale, the Global long-term rating scale.

Figure 1: Mapping of EuroRating's 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. This report describes the mapping exercise carried out by the Joint Committee (JC) to determine the 'mapping' of the credit assessments of EuroRating Sp. z o.o. (EuroRating).
7. EuroRating is a credit rating agency that has been registered with ESMA on 7 May 2014 and therefore meets the conditions to be an eligible credit assessment institution (ECAI)³.
8. The methodology applied to produce the mapping is the one specified in the Commission's Implementing Regulation (EU) 2016/1799 ('the Implementing Regulation') laying down Implementing Technical Standards (ITS) with regard to the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk in accordance with Articles 136(1) and (3) of the Regulation (EU) No 575/2013 of the European Parliament and the Council ('the CRR'). This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) CRR. At that time the mapping report was produced, EuroRating did not yet submit information to ESMA Central Repository (CEREP⁴), the main source of information was the credit rating agency itself. On the one hand, the quantitative and qualitative information provided by EuroRating has been used to obtain an overview of the main characteristics of this ECAI. On the other hand, information regarding the types of credit ratings produced and the definition of the applicable rating scales has also been taken into account.
9. The following sections describe the rationale underlying the mapping exercise carried out by the Joint Committee (JC) to determine the mappings. Section 3 describes the relevant ratings scales of EuroRating for the purpose of the mapping. Section 4 contains the methodology applied to derive the mapping of EuroRating Global long-term rating scale. The mapping table is shown in Appendix 4 of this document and have been specified in Annex III of the Implementing Technical Standards on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of Regulation (EU) No 575/2013.

3. EuroRating credit ratings and rating scales

10. EuroRating produces one type of credit ratings - **Long-term issue/issuer credit ratings** - that may be used by institutions for the calculation of risk weights under the Standardised Approach (SA)⁵. This rating is shown in Column 2 of Figure 2 in Appendix 1.
11. The ratings assigned by the EuroRating credit rating agency represent an overall estimate of the risk of losses (that is to say, the ultimate loss of part or all of the sums owed, together with any interest payable) on the part of creditors regarding the entity in question in the event of

³ It is important to note that the mapping does not contain any assessment of the registration process of EuroRating carried out by ESMA.

⁴ CEREP is the central repository owned by ESMA to which all registered/certified CRAs have to report their credit assessments. <http://cerrep.esma.europa.eu/cerep-web/>.

⁵ 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.

default. The ratings given by EuroRating therefore represent a combination of the estimated probability of default (PD) on the part of the entity in question and an estimate of the ultimate losses likely to be incurred by its creditors if it should actually default (Loss Given Default - LGD).

12. EuroRating assigns this credit rating to the **Global long-term rating scale** as illustrated in column 3 of Figure 2 in Appendix 1. Therefore, a specific mapping has been prepared for this rating type. The specification of the Global long-term rating scale is described in Figure 3 of Appendix 1.

13. The mapping of the Global long-term 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.

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

14. The mapping of the Global long-term rating scale has consisted of two differentiated stages where the quantitative and qualitative factors were considered. In addition, the benchmarks specified in Article 136(2) CRR have been taken into account.

15. In the first stage, the quantitative factors referred to in Article 1 of the ITS 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 ITS, as the number of credit ratings cannot be considered to be sufficient.

16. In a second stage, the qualitative factors proposed in Article 7 of the ITS have been considered to challenge the result of the previous stage, especially in those ratings categories where less default data have been available.

4.1. Initial mapping based on the quantitative factors

4.1.1. Calculation of the short-run and long-run default rates

17. EuroRating has started issuing ratings since 2007. However, the number of ratings issued by the agency cannot be considered sufficient for the calculation of the short and long run default rates specified in the Articles 3 – 5 of the ITS. Therefore, the allocation of the CQS has been made in accordance with Article 6 of the ITS, as shown in Figure 4 of Appendix 3. In these cases, the long run default rate benchmark associated with the equivalent category in the international rating scale is a key qualitative factor that has been used for the mapping proposal.

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

19. The default definition applied by EuroRating, described in Appendix 2, has been used for the calculation of default rates.

4.1.2. Mapping proposal based on the long run default rate

As illustrated in the second column of Figure 5 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 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 steps associated with the AAA/AA, A, BBB, BB, B rating categories in the international rating scale (CQS 1, CQS 2, CQS 3, CQS 4 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

20. The qualitative factors specified in Article 7 of the ITS have been used to challenge the mapping proposed by the default rate calculation. Qualitative factors acquire more importance in the rating categories where quantitative evidence is not sufficient to test the default behavior⁶, as is the case for all rating categories of the Global long-term rating scale.

21. The **definition of default** applied by EuroRating and used for the calculation of the quantitative factors has been analysed:

- The types of default events considered are shown in Appendix 2 and are consistent with letter (a), (b), (c) and (d) of the benchmark definition specified in Article 4(4) of the ITS.
- Bankruptcy-related events represent 23% of the total defaults recorded by EuroRating.

Therefore, no specific adjustment has been proposed based on this factor.

22. Regarding the **meaning and relative position of the credit assessments**, they are aligned with the mapping proposal resulting from the quantitative factors. In the case of the D rating category, its meaning is consistent with the one of CQS 6 stated in Annex II ITS.

23. Regarding the **time horizon** reflected by the rating category, EuroRating's rating methodology focuses on the long-term. The stability of the rated items however cannot be confirmed due to lack of data over a 3-year time horizon.

⁶ The default behavior of a rating category is considered to be properly tested if the quantitative factors for that rating category are calculated under Articles 3 – 5 of the ITS.

24. Finally, it should be highlighted the use of the long run default rate benchmark associated with the equivalent category in the international rating scale as the **estimate of the long run default rate** for the calculation of the quantitative factor of all rating categories under Article 6 of the ITS..



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Appendix 1: Credit ratings and rating scales

Figure 2: EuroRating’s relevant credit ratings and rating scales

SA exposure classes	Name of credit rating	Credit rating scale
Long-term ratings		
Institutions	Long-term issuer rating	Global long-term rating scale
	Long-term issue rating	Global long-term rating scale
Corporates	Long-term issuer rating	Global long-term rating scale
	Long-term issue rating	Global long-term rating scale
Covered bonds	Long-term issue rating	Global long-term rating scale

Source: EuroRating

Figure 3: Global long-term rating scale

Credit assessment	Meaning of the credit assessment
AAA	Negligible credit risk. Highest level of financial credibility. Rating assigned exclusively where an entity has extremely strong capacity to meet financial commitments.
AA	Very low credit risk. Very high level of financial credibility. Very strong capacity to meet commitments. Low susceptibility to adverse economic conditions.
A	Low credit risk. High financial credibility and capacity to meet commitments. Average resistance to long-term unfavourable economic financial conditions.
BBB	Average credit risk. Good financial credibility and adequate capacity to meet commitments in the long term. Increased susceptibility to long-term adverse economic conditions.
BB	Increased credit risk. Relatively low financial credibility. Adequate capacity to meet commitments under average or favourable economic conditions. High or average likelihood of recovering debts in the event of default.
B	High credit risk. Capable of meeting commitments only under favourable external conditions. Average or low likelihood of recovering debts in the event of default.
CCC	Very high credit risk. Very low capacity to meet commitments even under favourable economic conditions. Low or very low likelihood of recovering debts in the event of default.
CC	
C	Extremely high credit risk. Total absence of capacity to meet commitments. Without additional external support, the likelihood of recovering debts is very low or close to zero.
D	



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Source: EuroRating

Appendix 2: Definition of default

EuroRating credit rating agency considers a rated entity as defaulted where any of the following type of event has occurred:

- a) a bankruptcy filing or legal receivership that will likely cause a miss or delay in future contractually required debt service payments;
- b) a missed or delayed disbursement of a contractually required interest or principal payment, unless payments are made within a contractually allowed grace period;
- c) a distressed exchange if the offer implies the investor will receive less value than the promise of the original securities;
- d) the rated entity is under a significant form of regulatory supervision owing to its financial situation (this applies only to banks).

Source: EuroRating

Appendix 3: Default rates of each rating category

Figure 4: Mapping proposal for rating categories with a non-sufficient number of credit ratings

2008h1 - 2011h1	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	10	15	0	0	0
Mapping proposal	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6

Source: Joint Committee calculations based on EuroRating data

Appendix 4: Mappings of each rating scale

Figure 5: Mapping of EuroRating's Global long-term rating scale

Credit assessment	Initial mapping based on LR DR (CQS)	Review based on SR DR (CQS)	Final review based on qualitative factors (CQS)	Main reason for the mapping
AAA	1	n.a.	1	The quantitative factors are representative of the final CQS.
AA	1	n.a.	1	
A	2	n.a.	2	
BBB	3	n.a.	3	The quantitative factors are representative of the final CQS.
BB	4	n.a.	4	The quantitative factors are representative of the final CQS.
B	5	n.a.	5	The quantitative factors are representative of the final CQS.
CCC	6	n.a.	6	The quantitative factors are representative of the final CQS.
CC	6	n.a.	6	
C	6	n.a.	6	
D	6	n.a.	6	The meaning and relative position of the rating category is representative of the final CQS.



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