Draft mapping of NCR's credit assessments under the Standardised Approach

1. Executive summary

1. This report describes the exercise carried out by the Joint Committee (JC) of the European Supervisory Authorities (ESAs) to determine the 'mapping'[1] of the credit assessments of Nordic Credit Rating AS (NCR).

2. The methodology applied to produce the mapping remains as specified in the Commission's Implementing Regulation (EU) 2016/1799 ('the Implementing Regulation')[2] 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 Capital Requirements Regulation – 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 the European Securities and Markets Authority (ESMA) shall report on in accordance with Article 21(4b) of Regulation (EC) No 1060/2009 (the 'CRA Regulation') with the objective of allowing investors to easily compare all credit ratings that exist with regard to a specific rated entity[3] nor should be understood as a comparison of the rating methodologies of NCR with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of NCR 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 is relaxed. This allows ECAIs which present limited quantitative information to enter the market and

---

increases competition. Updates to the mapping should be made whenever this becomes necessary to reflect additional quantitative and qualitative information.

5. The resulting mapping has been specified in Annex III of the Consultation Paper on the revised draft ITS on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of the CRR. Figure 1 below shows the result for the main rating scale of NCR, the long-term rating scale.

Figure 1: Mapping of NCR's 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/SD	6

2. Introduction

6. This report describes the exercise carried out by the JC to determine the 'mapping' of the credit assessments of NCR.

7. NCR is a credit rating agency that registered with ESMA on 3 August 2018 and therefore meets the conditions to be an eligible ECAI[4].

8. The methodology applied to produce the mapping remains as specified in Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 (the Implementing Regulation)5 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.

9. The quantitative information reflects the statistics on the rating activity and performance of ECAIs established by ESMA in its Central Repository of credit rating data (CEREP)[6]. The qualitative information was collected bilaterally from NCR.

10. The following sections describe the rationale underlying the exercise carried out by the JC to determine the mapping. Section 3 describes the rating scales of NCR for the purposes of the mapping, Section 4 contains the methodology applied to derive the mapping of NCR's long-term rating scale, whereas Section 5 refers to the mapping of the short-term rating scale. The mapping table is shown in Appendix 4 of this document.

3. NCR credit ratings and rating scales

11. NCR produces a variety of credit ratings; Column 2 of Figure 2 in Appendix 1 show the relevant credit ratings that may be used by institutions for the calculation of risk weights under the Standardised Approach (SA)[7]:

- **Long-term issuer rating:** it is a forward-looking opinion of the relative ranking of an issuer's overall credit quality and takes into account its ability to service financial debt obligations (with an original maturity of one year or more), in full and in a timely manner, according to agreed terms and conditions.

- **Long-term issue rating**: it is a forward-looking opinion of the credit quality of individual debt instruments with an original maturity of one year or more.

---

[4] The mapping does not contain any assessment of the registration process of NCR carried out by ESMA.

[5] OJ L 275, 12.10.2016, p. 3-18

[6] These statistics are computed from individual rating information provided by registered or certified Credit Rating Agencies to ESMA, as required as per Article 11(2) of the CRA Regulation. http://cerep.esma.europa.eu/cerep-web/

[7] Article 4(1) CRA allows the use of the credit assessments for regulatory purposes as long as they meet the definition of credit rating as per Article 3(1)(a) of the CRA Regulation.

- **Short-term issuer rating**: Short-term ratings assigned on NCR's short-term scale provide a forward-looking opinion of the relative ranking of an issuer's ability to service instruments with original maturity of no more than one year. The short-term rating is assigned on a separate scale, which is correlated to the long-term rating, indicating short-term credit quality.

- **Short-term issue rating**: Issue ratings assigned on NCR's short-term rating scale are forward-looking opinions of the credit quality of individual debt instruments with an original maturity of no more than one year.

12. NCR assigns these credit ratings to two different rating scales, as illustrated in column 3 of Figure 2 in Appendix 1:

- **Long-term rating scale:** the specification of this rating scale is described in Figure 3 of Appendix 1.

- **Short-term rating scale:** the specification of this rating scale is described in Figure 4 of Appendix 1.

13. The mapping of the 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 Implementing Regulation.

14. The mapping of the short-term credit rating scale is explained in Section 5 and it has been indirectly derived from the mapping of the long-term rating scale and the internal relationship established by NCR 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 NCR's long-term rating scale

15. The mapping of the long-term rating scale consisted of two different stages, where quantitative and qualitative factors were considered.

16. 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 a sufficient number of credit ratings is not available.

17. In a second stage, the qualitative factors proposed in Article 7 of the Implementing Regulation have been considered to challenge the initial mapping produced in the previous stage.

4.1. Initial mapping based on the quantitative factors

4.1.1. Calculation of the long-run default rate

18. CEREP does not reflect information regarding the credit ratings issued by NCR. Therefore the allocation of Credit Quality Steps (CQS) has been made in accordance with Article 6 of the Implementing Regulation, as shown in Figure 6 of Appendix 3.

19. For rating category "D/SD" default rates were not calculated 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 CQS was initially made in accordance with Article 6 of the Implementing Regulation. 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 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/CC/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.

21. The calculation of the number of items assigned the same rating category weights withdrawn ratings by 50% as indicated in Article 4(3) of the Implementing Regulation.

22. The definition of default has been taken into account for the calculation of the quantitative factors, following Article 8 of the Implementing Regulation.

4.2. Final mapping after review of the qualitative factors

23. The qualitative factors specified in Article 7 of the Implementing Regulation have been used to challenge the mapping proposed by the default rate calculation. Qualitative factors acquire more importance for rating categories where quantitative evidence is not sufficient to test the default behavior[8], as it is the case for all NCR's rating categories.

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

---

[8] The default behavior of a rating category is considered to be properly tested if a sufficient number of credit ratings is available, i.e. the quantitative factors for that rating category are calculated under Articles 3 – 5 of the Implementing Regulation.

- The types of default events considered are described in Appendix 2 and are consistent with events (a), (b), (c) and (d) of the benchmark definition of default specified in Article 4(4) of the Implementing Regulation.

- As NCR does not have any default recorded, there is no information on the share of bankruptcy-related default events.

No change is proposed to the mapping based on this factor.

25. The mapping proposal resulting from the quantitative factors complies with the qualitative criteria on the **meaning and relative position** of a rating category, as specified in Article 10 of the Implementing Regulation.

26. Regarding the **time horizon**, NCR's rating methodology focuses on the long-term. However, the stability cannot be assessed given the lack of data. No adjustment is proposed based on this factor.

27. Following Article 12 of the Implementing Regulation, the **estimate provided by the ECAI of the long-run default rate** should be taken into consideration, as long as it has been adequately justified. The estimate is conditioned by limited data history. Therefore no specific adjustment has been proposed based on this factor.

28. 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 rating categories under Article 6 of the ITS.

5. Mapping of NCR short-term rating scale

29. NCR also produces short-term issuer and obligation ratings (see Figure 2 in Appendix 1). Given that the default information referred to these rating categories cannot be comparable with the 3-year time horizon that characterises the benchmarks established in the Implementing Regulation, the internal relationship established by NCR between these two rating scales (described in Figure 5 of Appendix 1) has been used to derive the mapping of the short-term credit rating scale. This is in line with Article 13 of the Implementing Regulation and should ensure the consistency of the mappings proposed for NCR.

30. More specifically, as each short-term rating category can be associated with a range of long-term rating categories, the CQS assigned to each short-term rating category has been determined based on the most frequent CQS assigned to the related long-term rating categories. In case of draw, the most conservative CQS has been considered. According to article 140(1) CRR, short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to institutions and corporates. Following article 131 CRR, exposures to institutions and corporates with a short-term assignment are assigned a 150% risk

weight if they are allocated to CQS 4, 5 or 6. Therefore if the most frequent step associated to the short-term scale is identified with CQS 5 or 6, then the allocation is made to CQS 4.

31. The result is shown in Figure 8 of Appendix 4:

- **N-1+:** this rating category indicates the issuer has the highest capacity for the payment of short-term debt obligations and maintains the lowest risk. It is internally mapped to the long-term categories BBB and above. The most conservative mapping has been assigned, CQS3.

- **N-1**: this rating category indicates the issuer has high capacity for the payment of short-term debt obligations. It is internally mapped to the long-term category BBB-, BB+ and BB, which are mapped to CQS 3, 4 and 4. Therefore, CQS 4 is the proposed mapping.

- **N-2:** this rating category denotes that the issuer has satisfactory capacity for the payment of short-term debt obligations. In this case, It is internally mapped to the long-term category BB, BB- and B+,, which are mapped to CQS 4, 4 and 5. As the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed for this category is CQS 4.

- **N-3:** this rating category indicates that the issuer has moderate capacity for the payment of short-term debt obligations. It is internally mapped to the long-term category B, which is mapped to CQS5. As the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed for this category is CQS 4.

- **N-4:** in this rating category the issuer has weak capacity for the timely payment of short-term debt obligations and maintains an increased risk compared with higher-rated instruments. It is internally mapped to the long-term categories B-, CCC, CC and C, which are respectively mapped to CQS 5,6, 6, and 6. However, as the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed for this category is CQS 4.

Appendix 1: Credit ratings and rating scales

Figure 2: Relevant credit ratings and rating scales

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

Source: NCR.

Figure 3: Long-term rating scale

Credit assessment	Meaning of the credit assessment
AAA	Highest credit quality and lowest expectation of default risk
AA	Very high credit quality with a very low default risk
A	High credit quality with a low default risk
BBB	Medium credit quality with a moderate default risk
BB	Speculative credit quality with a slightly increased default risk
B	Highly speculative credit quality with an increased default risk
CCC	Very low credit quality with a high default risk
CC	Very low credit quality and an event of default is very likely
C	Lowest credit quality and an event of default is imminent
D/SD	'D' rated entities and instruments have defaulted, as defined by NCR. 'SD' (selective default) rated entities have only defaulted on certain debt obligations.

Source: NCR.

Figure 4: Short-term rating scale

Credit assessment	Meaning of the credit assessment
N-1+	The issuer has the highest capacity for the payment of short-term debt obligations and maintains the lowest risk.
N-1	The issuer has high capacity for the payment of short-term debt obligations
N-2	The issuer has satisfactory capacity for the payment of short-term debt obligations
N-3	The issuer has moderate capacity for the payment of short-term debt obligations
N-4	The issuer has weak capacity for the payment of short-term debt obligations and maintains an increased risk compared with higher-rated instruments

Source: NCR.

Figure 5: Internal relationship between NCR's long term and short-term rating scale

Long-term credit rating scale	Short-term credit rating scale
BBB+ and above	N-1+
BBB	N-1+
BBB-	N-1+, N-1
BB+	N-1
BB	N-1, N-2
BB-	N-2
B+	N-2, N-3
B	N-3
B-	N-3, N-4
CCC	N-4
CC	N-4
C	N-4
SD	SD
D	D

Source: NCR.

Appendix 2: Definition of default

The "D" rating is not forward looking and is only used when a default has actually occurred and not when it is merely expected. NCR defines default as any scenario whereby an issuer has failed to fulfil its original commitment on a debt obligation. Specifically, NCR changes ratings to 'D':

- Following the failure to make principal or interest payments in accordance with the contractual terms of a rated financial instrument (after a contractual grace period, if applicable).

- Upon bankruptcy filing or similar action that will likely cause a miss or delay in future contractually required debt service payments.

- Upon completion of a distressed exchange, whereby existing debt obligations are replaced with a new obligation with a lower value than the original commitment (such as a swap of debt with lower coupon or face value, lower seniority, or with longer maturity) or the exchange is carried out in order to avoid a near-term default of the issuer; and

- The rated entity is under significant form of regulatory supervision owing to its financial condition which is likely to prohibit its ability to fulfill contractual debt service payments.

NCR does not consider a technical default (i.e. a covenant violation) as sufficient for assigning a "D" rating unless it is accompanied by a bankruptcy filing.

With respect to issuer ratings, a failure to meet a financial obligation leads to an issuer rating of either 'D' or ''SD' (selective default). In situation where an issuer defaults on all of its obligations, the issuer is rated 'D'.

The 'SD' issuer rating is assigned when an issuer defaults on selective debt obligations but continues to fulfil its original commitment on other obligations. A common example is a targeted distressed exchange offer, whereby an issuer restructures part of its capital structure in order to avoid a general bankruptcy.

Source: NCR.

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/CC/C
CQS of equivalent international rating category	CQS 1	CQS 2	CQS 3	CQS 4	CQS5	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: JC calculations based on CEREP data.

Appendix 4: Mappings of each rating scale

Figure 7: Mapping of NCR's long-term rating scale

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

Figure 8: Mapping of NCR's short-term rating scale

Credit assessment	Range of CQS of corresponding to the long-term scale	Final review *based on qualitative factors* (CQS)	Main reason for the mapping
N-1+	1,2,3	3	The final CQS has been determined based on the most frequent step associated with the corresponding short-term rating category. The most conservative mapping has been provided.
N-1	3, 4, 4	4	
N-2	4, 4, 5	4	The risk weights assigned in the CRR article 131 for CQS 4 to 6 are all equal to 150%, The mapping proposed for this category is CQS 4.
N-3	5	4	
N-4	5, 6, 6, 6	4	