

**Supplementary note to Consultation Paper on ECAIs recognition
Draft Guidelines on a common framework for the mapping of the
credit assessments' of securitisation positions and Collective
Instruments undertakings.**

Executive Summary

1. This consultation note sets out a proposed framework within which competent authorities will carry out the mapping of securitisation credit assessments and short guidelines on the eligibility and the mapping of the credit assessments of Collective Investment Undertakings (CIUs).
2. CP07 noted that the Capital Requirements Directive (CRD) requires a separate mapping of securitisation credit assessments. It also noted that the mapping of securitisations under the Internal Risk-Based (IRB) Approach would be more finely graduated than the mapping of general credit assessments in the Standardised Approach – giving rise to additional challenges with respect to mapping.
3. CEBS proposes that the mapping of securitisation credit assessments, like the mapping of other credit assessments, should be carried out within the framework of the joint assessment process outlined in CP07.
4. As for other ECAIs' credit assessments, the CRD requires the mapping of securitisation credit assessments to be objective and consistent. The CRD does not, however, require competent authorities to create a 'benchmark' for default rate comparison. This reflects the difficulties that would surround the creation of such a benchmark at this stage in the development of securitisation markets. The CRD requires competent authorities to consider "quantitative factors, such as default and/or loss rates, and qualitative factors such as the range of transactions assessed by the ECAI and the meaning of the credit assessment."
5. In this context, the proposed framework provides a context within which competent authorities, working together within the 'joint assessment process' described in CP07, can achieve the goals of objectivity and consistency, which are made more difficult by the fact that default and recovery studies relating to securitisation assessments continue to evolve, and by the range of different approaches adopted by ECAIs.
6. The framework is designed to have a significant forward-looking aspect, both to take account of the accumulation of additional data as the securitisation market continues to mature, and to fulfil the CRD's requirement that mappings should be modified as appropriate on an ongoing basis.

7. With regard to the CIU credit assessments, it is proposed that:
- To be eligible, a CIU credit assessment must primarily depend on the credit worthiness of the underlying assets.
 - CIUs credit assessments will not be subject to a separate mapping approach but will be mapped according to the mapping of 'conventional' credit assessments as set out in CP07.
 - The proposals apply to fixed-income funds. Equity funds should be treated in accordance with the equity treatment of the CRD which does not recognise credit assessments for this purpose.
8. The proposals put forward have been informed by dialogue and meetings with a number of ECAIs with a significant role in the rating of asset-backed securities and CIUs.
9. The consultation period is one month and will run until **30 November 2005**. Comments received will be published on the CEBS website unless respondents request otherwise. Feedback on the responses received will be published as part of the CP07 overall feedback.
10. CEBS would especially welcome responses to the following questions:

(1) Does the proposed framework appropriately address the objectives of consistency and objectivity stated in the Capital Requirements Directive?

(2) Are the listed indicative quantitative and qualitative factors appropriate to carry out the mapping of the securitisation position credit assessments? What additional factors would you be worth considering?

(3) What are your views on the proposed approach to the credit assessments of Collective Investment Undertakings?

The mapping of Securitisation position credit assessments

11. In mapping the Securitisation position credit assessments into the Credit quality steps of the CRD, supervisors will take into consideration quantitative factors and qualitative information as set out in the following paragraphs:

Quantitative factors

12. Quantitative factors will be a key consideration in mapping securitisation credit assessments, as they are in mapping other credit assessments. CEBS recognises that many potential ECAIs do not target quantitative outcomes for their assessments, seeking instead to achieve consistent rank ordinal assessments. Nonetheless, consideration of quantitative 'performance' studies of those assessments over time, in line with the

CRD's requirement, is a key element in providing a mapping in a consistent and objective manner.

13. Competent authorities will consider data relating to the default/impairment rates associated with different credit assessments. Competent authorities remain open as to the extent to which impairment rates can provide an appropriate proxy for the measurement of the 'performance' of securitisation ratings over time in the absence of more complete recovery rate data.
14. In comparing default/impairment rates, competent authorities will work with the ECAIs in question to seek to understand fully the definition of default/impairment on the basis of which they carry out their data analysis. It will be important for competent authorities to understand the approach adopted by an ECAI to this issue. In view of the long maturity of many securitisation transactions and the fact that contractual default/impairment may be tied to this long maturity, ECAIs may use varying definitions of default/impairment as alternatives to or proxies for contractual default.
15. It is expected that most ECAIs will produce ratings performance data using a 'cohort' approach – i.e. an approach that incorporates the effect of ratings migration in its analysis of the performance of the rating. While ECAIs may also produce data based on an 'original rating' analysis, CEBS considers that – as for other credit assessments – a 'cohort' approach is likely to be the most meaningful for the purposes of mapping securitisation assessments.
16. In considering quantitative factors, competent authorities will also consider the approach of the ECAI to aspects such as 'curing' (the subsequent repayment of missed payments) and withdrawn ratings, and how these affect the ECAI's ratings 'performance' studies.
17. 'Seasoning' is another factor that competent authorities will consider. In particular, given the possible difference between the loss-distribution curve for asset-backed securities as compared with corporate and other debt, the period over which rating performance is considered – e.g. three years versus five years – may be significant.
18. Different ECAIs have different approaches to the meaning of their securitisation ratings. For example, some seek to produce a rank ordering with respect to the loss that may be suffered by the tranche in question, while others base their rank ordering to a greater extent on the likelihood of the tranche suffering 'first euro' impairment. Nonetheless, there seems to be a broad consensus that the question of loss is an important factor to be taken into consideration. At this stage in the development of the market, it seems likely that the amount of loss data available will continue to grow. Competent authorities will seek to take into account the loss/recovery rate data that are available in relation to the different ECAIs ratings. It is expected that these data will improve in significance over time and that recovery rate studies will become an increasingly rich source of information.

Qualitative factors

19. The CRD requires competent authorities to take qualitative as well as quantitative factors into consideration in mapping securitisation credit assessments into credit quality steps. Competent authorities believe that this is likely to be an important aspect in mapping such credit assessments. As CP07 noted in its discussion of mapping non-ABS credit assessments, consideration of qualitative aspects is likely to be of particular importance when quantitative data is less than conclusive.
20. In assigning securitisation credit assessments, ECAIs often adopt an 'indicative' approach. That is, they indicate what is required in order for a particular tranche of a transaction to achieve a particular credit assessment level. This means that an ECAI's assignment methodology for ABS credit assessments can provide important insights in the mapping process. It is also likely to be very useful, where relevant, to consider the relationship between an ECAI's securitisation credit assessments and its other credit assessments – in particular in relation to the 'meaning' of the different assessments.
21. A notable feature in the development of the securitisation market over recent years has been the degree to which the market has been 'ratings-driven.' That is, the credit assessments assigned by ECAIs have played an important role in the structuring and marketing of transactions and in the provision of investor information.
22. In this context, competent authorities think that it will be highly relevant to consider the way in which market participants view the published credit assessments of different ECAIs. Accordingly, in mapping an ECAI's securitisation credit assessments to the CRD's credit quality steps, competent authorities will take into account market information concerning the degree to which the published credit assessments of the ECAI in question are regarded as being similar in meaning, as an indicator of creditworthiness, to those of its peers. There is some evidence to indicate that market participants regard the published securitisation credit assessments of a number of relevant ECAIs as being in many respects equivalent. It is expected that studies on market information - e.g. credit spreads on securitisations rated by an ECAI as compared to its peers - will also become an increasingly rich source of information.

Question (1): Does the proposed framework appropriately address the objectives of consistency and objectivity stated in the Capital Requirements Directive?

Question (2): Are the listed indicative quantitative and qualitative factors appropriate to carry out the mapping of the securitisation position credit assessments? What additional factors would you be worth considering?

Credit Assessments of Collective Investment Undertakings

23. According to the CRD (Annex VI, Part 1, paragraph 72), the risk weight of a Collective Investment Undertaking (CIU) shall be determined by credit assessments of nominated ECAIs, provided these are available.
24. For CIUs, however, ECAIs usually issue several assessments with distinct meanings (e.g. assessments of the asset quality of a fund, of the quality of the management of the fund, or of the volatility of the fund).
25. It is therefore necessary to define which of the assessments of a CIU should be eligible for risk weighting purposes in the context of the CRD and how they should be mapped to the individual credit quality steps.

Eligible assessments

26. In order to be eligible for the purposes of the CRD, credit assessments for CIUs must fulfil the following criteria:
- The assessment of the credit quality of the CIU must depend primarily on the credit quality of the underlying assets (for example, by using a weighted average of the individual credit assessments to derive the assessment of the CIU). Even though the rating of a CIU may not be interpreted as information about the PD of a CIU (since funds normally do not default as a whole), the credit assessment of a CIU should be comparable to a 'look-through' credit assessment of the individual assets within the fund (based on the fundamental credit assessment approach).
 - Other factors, such as the volatility of the CIU or the quality of its management, must not have a material positive influence on the assessment of the credit quality of the fund. Any non-material influence that such factors have on the assessments should be taken into account in the mapping of the assessments.
 - Only assessments for fixed-income CIUs should be eligible, since the CRD does not allow the use of credit assessments for other asset classes (e.g. equity) within the Standardised Approach.

Mapping

27. An assessment of the credit quality of a CIU which meet the criteria set out above can be mapped similarly to the other fundamental credit assessments of the respective ECAI. Therefore, CEBS does not consider it necessary to develop an alternative mapping approach for CIU assessments.

Question (3): What are your views on the proposed approach to the credit assessments of Collective Investment Undertakings?
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