



## European Banking Industry Committee

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European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB)  
European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)  
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)  
European Association of Public Banks (EAPB)

### **Response: CEBS Consultation Paper 7 On the Recognition of External Credit Assessment Institutions**

1. The European Banking Industry Committee (EBiC) welcomes the opportunity to comment on CEBS' Consultation Paper 7 on the recognition of External Credit Assessment Institutions (ECAIs). We support CEBS' overall approach to ECAI recognition in general and especially welcome the progress it has made in finding a common approach.
2. **The EBiC wishes to underline that a common approach to mapping is essential in terms of ensuring consistency and reducing regulatory divergence. Well working cooperation arrangements are of the highest importance in this context as the mapping of credit assessments to credit quality steps may change on a yearly basis.**
3. The rationale of the current framework has to be seen in the context of the Capital Requirements Directive (CRD). The provisions laid down in the paper should be limited to responding to the Annexes VI.2 and IX of the CRD. Any guidelines that go beyond this and that relate in general to ECAIs' business as credit rating agencies should be based on self-regulation according to the IOSCO Code of Conduct Fundamentals endorsed by CESR and should not be duplicated through the current paper. In this context, we believe that the CEBS paper should make clear reference to these internationally accepted Fundamentals. To the extent that the CRD leaves room for interpretation, supervisors should refer to the IOSCO Fundamentals.
4. **It is essential that the ECAI recognition framework does not result in an unlevel playing field between banks with internal ratings based systems and ECAIs.**
5. The EBiC also stipulates that the recognition of ECAIs should not imply regulation beyond the requirements of the CRD. **We therefore welcome CEBS' clarification that ECAI recognition does not constitute a form of regulation or of licensing of rating agencies to do business in Europe.** We find CEBS' approach to consider the processes around the methodologies, rather than to assess the methodologies themselves, appropriate in this regard. Furthermore, we welcome the recognition in the CEBS paper that the onus is on the ECAIs to design and implement their own policies.
6. **We wish to stress that the initiative of drafting a common application pack can only be successful in reducing workload if supervisors accept the scope of the pack to be sufficient.** To the extent that all supervisors are involved in drawing up the pack we do not see any reason why supervisors would add additional requirements to the framework.

7. **Whilst we acknowledge that the CRD provides that each competent authority shall come to its own decision on recognition, we believe that this could be built into the joint assessment process. It is essential for the success of the proposed framework that supervisors come to the same decision on whether or not an ECAI should be recognised.**
8. **As set out in paragraph 11 of the consultation paper institutions should retain ultimate responsibility for assessing whether an ECAI's credit assessment is appropriate for risk weighting, or any other purpose. It should be substantiated how this requirement is to be understood. After a successful recognition of an ECAI, little scope is left as the responsibility of an institution. A separate responsibility may be acceptable when substantial doubts concerning the quality of the external assessment exist.**
9. We consider that indirect recognition, in parallel with the proposals for joint recognition, is an important feature of the framework. The default presumption should be toward indirect recognition rather than it being an option to ensure a true Single Market for ECAIs. To the extent that indirect recognition is not used national authorities should provide an explanation for this decision in the framework for supervisory disclosure.
10. The recognition process should not build up disproportionate additional obstacles to market entry of potential competitors of external credit assessments. Therefore, we would emphasise the principle of proportionality. In particular, detailed disclosure requirements that could constitute an undue entry barrier for start-ups or that would impose excessive additional burdens on smaller firms must be kept to a minimum.
11. As part of the framework for supervisory disclosure, it has been agreed to include disclosures on the mutual recognition of other supervisors' ECAI assessments. **The EBIC fully welcomes this feature of the framework.** We would like to reiterate the importance of **supervisory transparency** in this regard, and we support CEBS' commitment for supervisors to disclose an explanation of their recognition process. Although we acknowledge that the framework for Supervisory Disclosure is not yet finalised we underline that relevant information should be disclosed by mid-2006 to assist institutions in a timely changeover to the CRD requirements on 1 January 2007.
12. In the light of ECAIs' global range of operations we would encourage CEBS to present this framework to the AIG as a potential basis for the discussion of ECAI recognition in other jurisdictions and especially in the countries that are represented in the Basel Committee.

## **Detailed comments**

### **Part 1: The recognition process**

13. The EBIC believes that an essential part of the framework for ECAI recognition should be a common definition of eligible institutions. We would therefore call on CEBS to remove the national discretions in paragraphs 12 and 20 of the consultation paper. The group of potential applicants should be consistent and include institutions and their central associations as well as ECAIs.

14. Within the scope of the joint assessment process it has to be ensured that procedures work swiftly. To that end we understand the timing of one month mentioned in paragraph 37 not just as a requirement for a common meeting but also for a final decision. We would suggest that the process facilitator undertakes an initial analysis prior to the meeting to ease and speed up the process.
15. Given the lead time for implementing IT systems we would urge CEBS and national authorities to undertake the informal recognition and mapping process and give a provisional indication of the outcome as early as possible.
16. CEBS stipulates that the competent authority would only undertake an assessment of an ECAI's eligibility if at least one institution intends to use the ECAI's credit assessments for risk-weighting purposes. We would request CEBS to clarify that this provision does not imply any formal nor implicit obligation for banks but that it is merely used as an indicator of a potential ECAI's reliability.
17. On the form of recognition (paragraph 31), we understand that the CRD does not provide the possibility for EU Member States to recognise an ECAI on the basis of recognition by a regulator in a non-EU country. However, we encourage CEBS to examine the possibilities for improving the working relations with both IOSCO and, in particular, with the US, Swiss, Canadian and Japanese and the respective EEA (European Economic Area) authorities to ensure future consistency with international standards.
18. Whilst provision is made in the consultation paper for the possibility of de-recognition, there is no proposal how this will be achieved in a transparent manner. It is important that firms, as well as other Competent Authorities, are given sufficient notice of a withdrawal of recognition. We also recommend that national authorities include a possibility for appeal within the de-recognition procedure.
19. For the sake of transparency it is essential that all public information be available in a language customary in the sphere of international finance. This would be in line with the provisions of the Transparency Directive and would also fit with CEBS efforts to present the supervisory disclosure framework in English on a best efforts basis.
20. For cross-border ECAIs it should be possible to apply simultaneously in all constituencies where it is active by way of sending the same application to all competent authorities concerned. The same procedure should be accepted if the application is submitted by an institution rather than the ECAI itself.
21. With regard to the Question 1 put forward by CEBS, the EBIC would suggest that the issue be addressed in the Consultative Panel.

## **Part 2: Common understanding of the ECAI recognition criteria laid down in the CRD**

22. The EBIC notes that the provisions on independence as well as those on transparency and disclosure included in the consultation paper are less precise than the corresponding chapters in the IOSCO Code of Conduct Fundamentals. In this light we would request CEBS to make explicit reference to the Chapters 2 respectively 4 of the IOSCO document.

23. According to paragraph 86, “the assessment of the ECAI’s methodology *should* remain high-level”. The EBiC underlines that this is not merely desirable but necessary to guarantee that the recognition process does not turn into a regulatory exercise.
24. We welcome the specification that ECAIs do not necessarily have to have an internal audit function in place, but that they may otherwise demonstrate the existence of alternative means to ensure the effective implementation of internal procedures. This is particularly important in the context of delivering a proportionate regime.

### **Part 3: Mapping**

25. The EBiC supports the proposal that mapping will be addressed under the joint process for treating applications of ECAIs that intend to become active in several EU countries. We wish to stress that supervisory flexibility should under no circumstances result in different risk weights being assigned to the same ECAI’s credit quality steps. This should especially be ensured with regard to paragraph 145: additional information required by one supervisor must not result in distortions of the common approach to mapping.
26. Regarding the general principles of mapping laid down in paragraph 122, we agree that appropriate conservatism should be applied where no significant amounts of data are available. However, this should not become a stress-testing exercise and it should not lead to credit institutions being put at a disadvantage as a result of an ECAI’s comparatively low amount of quantitative data.
27. When mapping credit quality steps to credit assessments, competent authorities should as far as possible rely on aggregated European data rather than national data with a view to ensuring a high degree of statistical significance.
28. On the parameters for mapping securitisation credit assessments, the EBiC does not consider it appropriate for supervisors to prescribe which methodology should be used. Where ECAIs provide ratings, through internally consistent methodologies, they should be allowed to use the same basis for securitisation. The same considerations apply for CIU assessments.
29. We welcome the reference to the requirements of the Basel Committee on Banking Supervision in paragraph 119 with regard to a level playing field. However, these requirements raise a number of issues which need to be addressed. First of all, the significance of the long-run three-year Cumulative Default Rate (CDR) seems to be unclear. We believe that it is sufficient in terms of statistical significance to take into account the two latest three-year CDRs. Furthermore we would request clarification as to how the assessment categories respectively the risk weights shall correspond to the classification in five categories of Annex 2 of the Basel Framework. For example, Annex VI of the Directive 2000/12/EG forces in each case six assessment categories. In addition, the definitions of the categories of claims on sovereigns and claims on banks provided by the Basel Framework do not correspond to the Tables 2 and 3 of Annex 2. Finally, the mapping of claims on corporate debtors remains ambiguous given that only four assessment categories exist with regard to this group.

#### **Part 4: Export Credit Agencies**

30. The EBIC would request clarification on whether paragraph 162 means that institutions must not use ECAI ratings on a certain portfolio if they use the ratings of an Export Credit Agency (ECA) within the same portfolio. Given that the ECA might provide ratings for only a few exposures within the portfolio, the institution would be obliged to leave the remaining positions unrated. Whilst we agree in general that provision must be made against the risk of arbitrage, we believe that the parallel use of ECA and ECAI ratings should be permitted in this case.

#### **Annex I: Common Basis Application Pack**

31. Concerning the ECAI recognition criteria, supervisors should especially take into account whether the ECAI monitors its ratings on an ongoing basis. In this regard no exceptions must be made for smaller institutions. The framework for ECAI recognition could act as a positive catalyst in ensuring that ratings are consistent with changing market conditions in the EU. We would suggest that a link to the guidelines of the IOSCO – Code of Conduct be embedded in this context.
32. With regard to paragraph 3 of the requirements of an ECAI's on-going review of its ratings, we esteem that the requirement that the back-testing system has been up and running for at least one year is completely insufficient.
33. Under the criterion of independence, ECAIs will be requested to demonstrate and certify that “members of the ratings teams and committees have appropriate and requisite skills (...) and experience in credit assessment”. The EBIC fully supports this provision. However, we would request CEBS to clarify that this must not lead to detailed instructions by supervisors on the exact skills and training that ECAI staff shall possess.