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Mapping of GBB 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 GBB-Rating Gesellschaft fuer Bonitaets-beurteilung mbH’s (GBB).
2. The methodology applied to produce the mapping is a combination of the provisions laid down in Article 136(2) Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) and those proposed in the Consultation paper on draft Implementing Technical Standards on the mapping of ECAIs’ credit assessments under Article 136(1) and (3) of Regulation (EU) No 575/2013 published on 5 February 2014 (draft ITS).
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 entity nor should be understood as a comparison of the rating methodologies of GBB with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of GBB 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. The resulting mapping tables have been specified in Annex III of the addendum to the draft ITS published today. Figure 1 below shows the result for the GBB ratings scale, the Global long-term rating scale, together with a summary of the main reasons behind the mapping proposal for each rating category.

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).

Figure 1: Mapping of GBB's Global long-term rating scale

Credit assessment	Credit quality step	Main reason
AAA	2	The quantitative factors are representative of the final CQS.
AA	2	
A	3	The quantitative factors are representative of the final CQS.
BBB	3	The quantitative factors are representative of the final CQS.
BB	4	The quantitative factors are representative of the final CQS.
B	5	The quantitative factors are representative of the final CQS.
CCC	6	The quantitative factors are representative of the final CQS.
CC	6	
C	6	
D	6	The meaning and relative position of the rating category is representative of the final CQS.

2. Introduction

5. This report describes the mapping exercise carried out by the Joint Committee (JC) to determine the 'mapping' of the credit assessments of GBB-Rating Gesellschaft fuer Bonitaets-beurteilung mbH's (GBB).
6. GBB is a credit rating agency that has been registered with ESMA in 28 July 2011 and therefore meets the conditions to be an eligible credit assessment institution (ECAI)². GBB is a credit rating agency focused on financial institutions and medium-sized businesses of other industries.
7. The methodology applied to produce the mapping is a combination of the provisions laid down in Article 136(2) CRR and those proposed in the Consultation paper on draft Implementing Technical Standards on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of Regulation (EU) No 575/2013 published on 5 February 2014 (draft ITS). Two sources of information have been used. On the one hand, the quantitative and qualitative information available in CEREP has been used to obtain an overview of the main characteristics of this ECAI and to calculate the default rates of its credit assessments. On the other hand, specific information has also been directly requested to the ECAI for the purpose of the mapping, especially the list of relevant credit assessments, detailed information regarding the default definition and comparable data sets from benchmark ECAIs to evaluate the comparability of GBB's definition of default.
8. 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 entity nor should be understood as a comparison of the rating methodologies of GBB with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of GBB 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.
9. Section 3 describes the relevant ratings scales of GBB for the purpose of the mapping. Section 4 contains the methodology applied to derive the mapping of GBB rating. The mapping table is shown in Appendix 4 of this document and have been specified in Annex III of the addendum to the draft ITS published today.

² It is important to note that the mapping does not contain any assessment of the registration process of GBB carried out by ESMA.

3. GBB credit ratings and rating scales

10. GBB produces one credit rating - **Long-term credit rating (issuer rating)** - that may be used by institutions for the calculation of risk weights under the Standardised Approach (SA)³. The rating is shown in Column 2 of Figure 2 in Appendix 1 shows.
11. Long-term credit rating (issuer rating) is an evaluation of the creditworthiness of (i) private sector banks, which are associated to the Deposit Protection Fund of the German banks or seek to be associated to the Deposit Protection Fund of the German banks, (ii) building societies, (iii) companies moving leasable assets and (iv) small- and medium-sized corporates.
12. GBB 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. 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 draft ITS.

4. Mapping of GBB'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 as well as the benchmarks specified in Article 136(2) CRR have been taken into account. Figure 20 in Appendix 4 illustrates the outcome of each stage.
15. In the first stage, the quantitative factors referred to in Article 1 draft 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 7 draft ITS, as the number of credit ratings cannot be considered to be sufficient.
16. In a second stage, the qualitative factors proposed in Article 8 draft ITS have been considered to challenge the result of the previous stage, especially in those ratings categories where less default data has 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. The number of credit ratings for all rating categories of the GBB Global rating scale cannot be considered to be sufficient and therefore the calculation of the long run default rate has been made in accordance with Article 7 draft ITS, as shown in Figure 7 of Appendix 3.

³ As explained in recital 2 draft 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.

18. Therefore, 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.

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

20. Withdrawn ratings have been weighted by 50% as proposed in Article 3(5) draft ITS because no default information has been available after withdrawal.

21. The default definition applied by GBB, 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

22. As illustrated in the second column of Figure 9 in Appendix 4, the rating categories of the Global long-term rating scale of GBB have been initially allocated to CQS based on the comparison of the assigned CQS and required number of observed items according to Article 7 draft ITS. The result, as shown in Figure 7 of Appendix 3, confirms that the CQS assigned is the one of the equivalent international rating category, except in the case of the AAA/AA and A rating categories, where the required number of rated items to be mapped to CQS 1 and CQS 2 respectively is higher, especially for AAA and AA categories.

4.2. Final mapping after review of the qualitative factors

23. The qualitative factors specified in Article 8 draft 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 behavior as is the case for all rating categories of the Global long-term rating scale.

24. The **definition of default** applied by GBB 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 3(6) draft ITS.
- Additionally, the default rates of GBB have been compared to the default rates of a pool of German banks rated by S&P's under the assumption that S&P's default definition meets the requirements in Article 3(6) draft ITS.⁴ Even though the coverage is not the same⁵, the defaults observed in the GBB-rated sample do not belong to non-S&P-rated sample. Therefore, the comparison between the default rates observed in GBB and S&P pools

⁴ Although, default data is available also for other benchmark ECAIs (Moody's, Fitch and DBRS), their respective sizes are relatively smaller with respect to CI and therefore may not be representative.

⁵ The S&P rated pool has approximately 90 rated items per period, which is twice as small as the GBB pools of rated items – approximately 180 rated items per observation period.

presented in Figure 4 of Appendix 2, suggests that the 'default' definition of GBB is, at least, as strict as the 'default' definition of S&P. **Please confirm this point.**

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

25.Regarding **the meaning and relative position of the credit assessments**, they are aligned with the initial mapping proposal resulting from the quantitative factors, except for the following rating categories:

- In the case of the AAA/AA and A, this factor suggests that these rating categories should be assigned CQS 1 and 2 respectively according to the reference definitions established in Annex II draft ITS. However, since the quantitative evidence clearly points to CQS 2 and 3 respectively, due to lack of sufficient rated items and default data, no specific adjustment has been proposed based on this factor.
- In the case of the D rating category, its meaning is consistent with the one of CQS 6 stated in Annex II draft ITS.

26.Regarding the **time horizon** reflected by the rating category, GBB applies through the cycle approach which is comparable with the 3-year time horizon that characterizes the benchmarks established in Annex I draft ITS. The transition probabilities shown in Figure 8 of Appendix 3 over the 3-year horizon are relatively high, which is explained by the recessionary observation period used to make the calculations. Therefore, no change is proposed to the mapping.

27.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 7 draft ITS.

Appendix 1: Credit ratings and rating scales

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

SA exposure classes	Name of credit rating	Credit rating scale
Long-term ratings		
Institutions	Long-term credit rating (issuer rating)	Global long-term rating scale
Corporates	Long-term credit rating (issuer rating)	Global long-term rating scale

Source: GBB

Figure 3: Global long-term rating scale

Credit assessment	Meaning of the credit assessment
AAA	Highest financial standing
AA	Very high financial standing
A	High financial standing
BBB	Good financial standing
BB	Satisfactory financial standing
B	Financial standing scarcely adequate
CCC	Inadequate financial standing
CC	Insufficient financial standing
C	Insufficient financial standing
D	Moratorium / insolvency

Source: GBB

Appendix 2: Definition of default

The default definition is the legal definition, i.e. a default occurs in case of moratorium respectively bankruptcy and missed payments for financial facilities as far it is not fixed as an option in the contract. A voluntary renunciation of payments from investor's side is not a default.

GBB also reports a default if there is a missed payment of the coupon of a debt issue as far the missed payment is not covered by contractual terms of the legal agreement or investors voluntarily renouncing their right of payment.

Source: GBB

Figure 4: Long-run default rates of GBB and S&P

Date	GBB			S&P		
	N. rated items	N. defaulted rated items	Default rate	N. rated items	N. defaulted rated items	Default rate
01/07/2007	183	3	1.64%	108	1	0.92%
01/01/2008	183	3	1.64%	101	1	0.99%
01/07/2008	183	2	1.09%	100	1	1.00%
01/01/2009	180	0	0.00%	85	0	0.00%
01/07/2009	182	0	0.00%	78	0	0.00%
01/01/2010	176	0	0.00%	76	0	0.00%
01/07/2010	178	0	0.00%	76	0	0.00%
Overall	1265	8	0.63%	627	3	0.48%

Source: Joint Committee calculations based on CEREP data

Appendix 3: Default rates of each rating category

Figure 5: Number of rated items

Date	AAA	AA	A	BBB	BB	B	CCC/CC/C
01/07/2007	0	23	98	41	18	2	2
01/01/2008	0	13	87	55	11	5	7
01/07/2008	0	23	98	41	18	2	2
01/01/2009	0	23	99	40	17	2	2
01/07/2009	0	23	101	40	16	2	2
01/01/2010	0	20	98	43	12	6	3
01/07/2010	0	21	98	43	13	6	3

Source: Joint Committee calculations based on CEREP data

Figure 6: Number of defaulted rated items

Date	AAA	AA	A	BBB	BB	B	CCC/CC/C
01/07/2007	0	0	2	0	1	0	0
01/01/2008	0	0	2	0	1	0	0
01/07/2008	0	0	2	0	0	0	0
01/01/2009	0	0	0	0	0	0	0
01/07/2009	0	0	0	0	0	0	0
01/01/2010	0	0	0	0	0	0	0
01/07/2010	0	0	0	0	0	0	0

Source: Joint Committee calculations based on CEREP data

Figure 7: Mapping proposal for rating categories with a non-sufficient number of credit ratings

2007h2 - 2010h2	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	6	0	2	0	0
Minimum N. rated items	496	867	0	27	5	n.a.
Observed N. rated items	135	664	317	97	27	26
Mapping proposal	CQS2	CQS 3	CQS 3	CQS 4	CQS 5	CQS 6

Source: Joint Committee calculations based on CEREP data

Figure 8: Transition matrix

3-year transition matrix, 3-year average (2007 - 2013)

Rating end period	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	WR
Rating start period											
AAA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AA	0.0	51.4	31.7	6.3	0.0	0.0	0.0	0.0	0.0	0.0	10.6
A	0.0	1.0	65.9	22.0	0.3	0.1	0.0	0.0	0.4	0.9	9.3
BBB	0.0	0.3	24.6	52.8	5.3	1.5	2.7	0.0	0.6	0.0	12.2
BB	0.0	0.0	2.0	25.5	33.3	9.8	14.7	1.0	2.0	2.0	9.8
B	0.0	0.0	0.0	0.0	20.0	40.0	13.3	0.0	6.7	0.0	20.0
CCC	0.0	0.0	0.0	0.0	13.3	0.0	86.7	0.0	0.0	0.0	0.0
CC	0.0	0.0	0.0	0.0	0.0	0.0	100	0.0	0.0	0.0	0.0
C	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100	0.0	0.0

Source: Joint Committee analysis based on CEREP data. Only items rated both at the beginning and at the end of the time horizon have been considered in the calculation.

1-year transition matrix, 5-year average (2007 - 2013)

Rating end period	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	WR
Rating start period											
AAA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AA	0.0	81.1	14.7	1.1	0.0	0.0	0.0	0.0	0.0	0.0	3.2
A	0.0	0.7	85.8	9.4	0.0	0.4	0.0	0.0	0.0	0.6	3.2
BBB	0.0	0.2	10.5	80.1	4.3	0.7	0.4	0.0	0.0	0.0	3.9
BB	0.0	0.0	0.0	15.3	68.1	4.2	4.2	1.4	1.4	1.4	4.2
B	0.0	0.0	0.0	0.0	12.0	56.0	20.0	0.0	4.0	0.0	8.0
CCC	0.0	0.0	0.0	0.0	0.0	19.0	76.2	0.0	4.8	0.0	0.0
CC	0.0	0.0	0.0	0.0	0.0	0.0	100	0.0	0.0	0.0	0.0
C	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	81.0	0.0	19.0

Source: Joint Committee analysis based on CEREP data. Only items rated both at the beginning and at the end of the time horizon have been considered in the calculation.

Appendix 4: Mappings of each rating scale

Figure 9: Mapping of GBB's Global long-term rating scale

Credit assessment	Initial mapping <i>based on LR</i> <i>DR</i> (CQS)	Review <i>based on SR</i> <i>DR</i> (CQS)	Final review <i>based on</i> <i>qualitative</i> <i>factors</i> (CQS)	Main reason for the mapping
AAA	2	n.a.	2	The quantitative factors are representative of the final CQS.
AA	2	n.a.	2	
A	3	n.a.	3	
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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