Amended Mapping of EthiFinance's credit assessments under the Standardised Approach

1. Executive summary

1. This report describes the mapping exercise carried out by the Joint Committee (JC) of the European Supervisory Authorities (ESAs) to determine the 'mapping'[1] of the credit assessments of EthiFinance Ratings S.L. (former Axesor Risk Management SL), with respect to the version published in June 2021.

2. The methodology applied to produce the mapping remains as specified in Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 (the Implementing Regulation)[2] 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.

3. The information base used to produce this mapping report reflects additional quantitative and qualitative information collected after the production of the mapping report published in June 2021. Following the acquisition of Axesor in February 2022 by the French group Qivalio SAS, the rating agency operates under the name EthiFinance Ratings S.L. Regarding qualitative developments, the qualitative factors as described in the Implementing Regulation remain unchanged, while EthiFinance made changes to their Global short-term and long-term rating scales.

4. 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[3] nor should be understood as a comparison of the rating methodologies of EthiFinance with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of EthiFinance with a regulatory scale which has been defined for prudential purposes.

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

[3] In this regard please consider ESMA's Report on the possibility of establishing one or more mapping.

5. 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.

6. The resulting mapping tables have 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 Regulation (EU) No 575/2013. Figure 1 below shows the result for the main credit rating scale of EthiFinance, the Global long-term rating scale.

Figure 1: Mapping of EthiFinance'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

7. This report describes the mapping exercise carried out by the JC to determine the 'mapping' of the credit assessments of EthiFinance Ratings, with respect to the version published in June 2021.

8. EthiFinance was formed in February 2022 after the acquisition of the credit rating agency Axesor Risk Management S.L. by Qivalio SAS. EthiFinance operates under Axesor's license. The credit agency has been registered with ESMA on 1 October 2012 and therefore meets the conditions to be an eligible credit assessment institution (ECAI).[4]

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

10. The information base used to produce this mapping report reflects additional quantitative information collected after the submission of the draft Implementing Technical Standards by the JC to the European Commission. The quantitative information is drawn from data available in the ESMA's central repository (CEREP[5]) and RADAR[6] based on the credit rating information submitted by the ECAIs as part of their reporting obligations.

11. Regarding qualitative developments, the qualitative factors as specified in the Implementing Regulation remain mostly unchanged with respect to the mapping report published in June 2021. EthiFinance introduced for their Global short-term rating scale new symbols for the rating categories and amended the meaning of the credit assessment. EthiFinance further amended the internal mapping between the Global short-term rating scale and the Global long-term rating scale and removed rating category E from their Global long-term rating scale.

12. 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 EthiFinance for the purpose of the mapping. Section 4 contains the methodology applied to derive the mapping of the Global long-term rating scale, whereas Section 5 refers to the mapping of the Global short-term rating scale. The mapping tables are shown in Appendix 4 of this document and have 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 Regulation (EU) No 575/2013.

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[4] It is to be noted that the mapping does not contain any assessment of the registration process of EthiFinance carried out by ESMA.

[5] https://cerep.esma.europa.eu/cerep-web/

[6] Commission Delegated Regulation (EU) 2015/2 RADAR RTS.

3. EthiFinance credit ratings and rating scales

13. EthiFinance produces general corporate, insurance, bank and sovereign ratings which may be used by institutions for the calculation of risk weights under the Standardised Approach (SA),[7] as shown in column 2 of Figure 2 in Appendix 1.

14. EthiFinance assigns these credit ratings to the **Global long-term and short-term rating scales** as illustrated in column 3 of Figure 2 in Appendix 1. Therefore, a specific mapping has been prepared for these rating scales.

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

15. The mapping of the Global 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.

16. 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 Implementing Regulation, as the number of credit ratings cannot be considered to be sufficient, as per Article 3(1)(a) of the Implementing Regulation. This is determined by comparing the number of ratings representing the inverse of the long-run default rate benchmark of the rating category, as referred to in point (a) of Article 14 of the Implementing Regulation.

17. 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.

4.1. Initial mapping based on the quantitative factors

4.1.1. Calculation of the long-run default rates

18. The number of credit ratings for all rating categories of the long-term credit rating scale cannot be considered to be sufficient for the calculation of the short run and long run default rates specified in Articles 3 – 5 of the Implementing Regulation. Therefore, the allocation to the CQS has been made in accordance with Article 6 of the Implementing Regulation, as shown in Figure 9 of Appendix 3.

[7] 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.

4.1.2. Mapping proposal based on the long run default rate

19. The assignment of the rating categories to credit quality steps has been initially made in accordance with Article 6 of the Implementing Regulation

- **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 step 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/D:** since the CQS associated with the equivalent rating category of the international rating scale is 6, the proposed mapping is also CQS 6.

- **E**: risk category E (Default) was removed from the Global long-term rating scale by EthiFinance.

4.2. Final mapping after review of the qualitative factors

20. 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 in the rating categories where quantitative evidence is not sufficient to test the default behavior,[8] as it is the case for all EthiFinance's rating categories.

21. EthiFinance has not registered material changes in the qualitative factors described in the Implementing Regulation, with respect to the mapping report published in June 2021. Therefore, no adjustments are made based on qualitative factors.

5. Mapping of EthiFinance's global short-term rating scale

22. EthiFinance has reported a short-term rating scale. 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 amended internal relationship established by EthiFinance between these two rating scales will be used to derive the mapping of the short-term credit rating scale. This is in line with Article 13 of the Implementing Regulation and ensures consistency across the mappings proposed for EthiFinance.

- **EF1+**. Very low short-term risk, and very strong ability to reimburse short-term debt. It is internally mapped to rating categories AAA to A. The most frequent CQS is 1, which is therefore the proposed mapping.

[8] 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 ITS.

- **EF1.** Low short-term risk linked to the issuer's ability to anticipate short-term funding risks. It is mapped to the long-term scale rating categories A to BBB. There is a draw between CQS 2 and CQS 3. The most conservative mapping, CQS 3, has been assigned.

- **EF2.** Moderate short-term risk linked to potential external risks. It has been mapped to the long-term scale rating categories BBB to BB+. The most frequent CQS is 3, which is therefore the proposed mapping.

- **EF3**. Medium short-term risk. The issuer's ability to reimburse its short-term debt may be hampered by external or specific risks. It has been mapped to the long-term scale rating categories BB+ to B+. The most frequent CQS is 4, which is therefore the proposed mapping.

- **EF4.** High short-term risk. It is internally mapped to rating categories BB- to CCC. The most frequent CQS are 5 and 6. Since the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed is CQS 4.

- **EF5.** Very high risk / In or out-of-court restructuring. It is internally mapped to rating categories CCC+ to C. The most frequent CQS is 6. Since the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed is CQS 4.

- **EFD**. Default on the short-term debt. It is mapped to rating category D. Therefore, CQS 6 is the proposed mapping. Since the risk weights assigned to CQS 4 to 6 are all equal to 150% according to Article 131 CRR, the mapping proposed for the C rating category is CQS 4.

Appendix 1: Credit ratings and rating scales

Figure 2 EthiFinance's relevant credit ratings and rating scales

SA exposure classes	Name of credit rating	Credit rating scale
Long-term ratings		
Central governments or central banks	Long-term sovereign rating	Global long-term rating scale
Regional governments or local authorities	Long-term sub-sovereign rating	Global long-term rating scale
Corporates	Long-term corporate rating	Global long-term rating scale
	Long-term insurance corporate rating	Global long-term rating scale
Institutions	Long-term institution rating	Global long-term rating scale
Short-term ratings		
Corporates	Short-term corporate rating	Global short-term rating scale
	Short-term insurance corporate rating	Global short-term rating scale
Institutions	Short-term institution rating	Global short-term rating scale

Source: EthiFinance

Figure 3: Global long-term rating scale

Credit assessment	Meaning of the credit assessment
AAA	Highest credit quality and extremely low business and financial risk.
AA	Very large scale and very high level of diversification, very low-risk business (proven resilience through economic crisis), very high FCF and very low leverage.
A	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), high FCF and low leverage.
BBB	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), positive FCF and/or low leverage.
BB	Medium/low-risk business (stable and predictable cash flows), positive FCF and/or low leverage ratio.
B	High-risk business, negative FCF and/or high leverage.
CCC	Very high leverage, negative FCF, weak liquidity and/or restructuring/ probable default.
CC	Out-of-court consensual restructuring
C	In-court restructuring without failure to fulfil financial obligations
D	Missed payment on interest or principal (post-grace period), or in-court restructuring with a failure to fulfil financial obligations, or liquidation.

Source: EthiFinance

Figure 4: Global short-term rating scale: previous and new credit assessment symbols

Previous credit assessment symbols	New credit assessment symbols
AS1+	EF1+
AS1	EF1
AS2	EF2
AS3	EF3
AS4	EF4
AS5	EF5
ASD	EFD

Source: EthiFinance

Figure 5: Global short-term rating scale

Credit assessment	Amended meaning of the credit assessment
EF1+	Very low short-term risk, and very strong ability to reimburse short-term debt.
EF1	Low short-term risk linked to the issuer's ability to anticipate short-term funding risks.
EF2	Moderate short-term risk linked to potential external risks.
EF3	Medium short-term risk. The issuer's ability to reimburse its short-term debt may be hampered by external or specific risks.
EF4	High short-term risk.
EF5	Very high risk / In or out-of-court restructuring.
EFD	Default on the short-term debt.

Source: EthiFinance

Figure 6: Internal relationship between EthiFinance's Global long-term and Global short-term rating scales

Global long-term rating scale	Global short-term rating scale
AAA	EF1+
AA+	EF1+
AA	EF1+
AA-	EF1+
A+	EF1+
A	EF1+, EF1
A-	EF1
BBB+	EF1
BBB	EF1, EF2
BBB-	EF2
BB+	EF2, EF3
BB	EF3
BB-	EF3, EF4
B+	EF4
B	EF4
B-	EF4
CCC+	EF4, EF5
CCC	EF4, EF5
CCC-	EF5
CC	EF5
C	EF5
D	EFD

Source EthiFinance

Appendix 2: Definition of default

The definition of default at EthiFinance varies from one asset class to the other in order to reflect the idiosyncrasies of each asset class as can be seen in the following classification

Corporate default definition

A company is considered to be in default when any of the following occurs:

- The company has breached any of its financial obligations.
- The company is undergoing Insolvency Proceedings or is in a situation involving similar protective measures.

Banks and other financial institutions default definition

A bank or other types of financial institutions are considered to be in default when any of the following occurs:

- Default: non-payment by the financial institution of its commitments to third parties or the initiation of bankruptcy proceedings.
- Failure: inability to continue with the activity in the absence of extraordinary support. This support is defined as that coming from public institutions directly or through delegated mechanisms, the acquisition by another company or the recapitalization of this from its shareholding.

Sovereign / sub-sovereign default definition

We consider that a sovereign government is in default if one of the following events occurs:

- If upon expiration of any financial facility (direct or issued by a sub-sovereign and/or a decentralized body but guaranteed by the sovereign government) it does not pay the principal and / or interest / coupon payment accrued.
- If the refinancing / restructuring of any financial facility is closed under worse conditions for the creditors than those maintained in the original facility.

Source: EthiFinance

Appendix 3: Default rates of each rating category

Figure 7: Number of weighted items[9]

	A	BBB	BB	B	CCC	CC	C
01 Jan 2013	4.0	10.0	9.5	11.0	8.5	8.0	3.5
01 Jul 2013	2.5	11.0	8.5	8.0	7.0	10.5	3.5
01 Jan 2014	2.5	10.0	6.5	8.0	5.0	5.0	6.0
01 Jul 2014	2.5	9.0	10.5	6.5	6.0	5.0	2.5
01 Jan 2015	2.5	9.0	11.0	6.0	5.5	4.0	2.5
01 Jul 2015	2.0	8.5	11.5	4.5	5.0	4.0	2.5
01 Jan 2016	1.5	11.5	13.0	5.0	3.5	4.0	1.5
01 Jul 2016	1.0	11.0	12.5	4.0	3.0	3.0	1.5
01 Jan 2017	1.0	12.5	12.5	4.5	2.0	2.5	0.5
01 Jul 2017	0.5	16.0	10.0	4.5	2.5	2.0	
01 Jan 2018	0.5	16.0	11.0	4.0	1.0		0.5
01 Jul 2018	0.5	13.5	7.5	2.5	1.0		0.5
01 Jan 2019	1.5	8.5	5.5	2.0	1.5		
01 Jul 2019	1.5	8.5	5.5	1.5	0.5		
01 Jan 2020	2.5	10.0	7.0	2.0			
01 Jul 2020	3.0	9.0	8.5	1.0			
01 Jan 2021	3.5	9.0	10.0	1.0			

Source: Joint Committee calculations based on CEREP and RADAR data

[9] Withdrawn ratings have been weighted by 50% in accordance with Article 4(3) of the ITS.

Figure 8: Number of defaulted rated items

	A	BBB	BB	B	CCC	CC	C
01 Jan 2013	0	0	0	2	0	0	1
01 Jul 2013	0	0	0	0	1	0	1
01 Jan 2014	0	0	0	0	0	0	1
01 Jul 2014	0	0	0	0	0	0	0
01 Jan 2015	0	0	0	0	0	0	0
01 Jul 2015	0	0	0	0	0	0	0
01 Jan 2016	0	0	0	0	0	0	0
01 Jul 2016	0	0	0	0	0	0	0
01 Jan 2017	0	0	0	0	0	0	0
01 Jul 2017	0	0	0	0	0	0	
01 Jan 2018	0	0	0	0	0		0
01 Jul 2018	0	0	0	0	0		0
01 Jan 2019	0	0	0	0	0		
01 Jul 2019	0	0	0	0	0		
01 Jan 2020	0	0	0	0			
01 Jul 2020	0	0	0	0			
01 Jan 2021	0	0	0	0			

Source: Joint Committee calculations based on CEREP and RADAR data

Figure 9: Mapping proposal for rating categories with a non-sufficient number of credit ratings

Most recent data cohort	**AAA/AA**	**A**	**BBB**	**BB**	**B**
CQS of equivalent international rating category	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5
N. observed defaulted items	0	0	0	0	0
Minimum N. rated items	0	0	0	0	0
Observed N. rated items	0	14.5	117	106	49.5
Mapping proposal	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5

Source: Joint Committee calculations based on CEREP and Radar data

Appendix 4: Mappings of each rating scale

Figure 10: Mapping proposal for rating categories with a non-sufficient number of credit ratings

Credit assessment	Initial mapping *based on LRDR* (CQS)	Review *based on SRDR* (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**	
BB	4	n.a.	**4**	
B	5	n.a.	**5**	
CCC	6	n.a.	**6**	
CC	6	n.a.	**6**	
C	6	n.a.	**6**	
D	n.a.	n.a.	**6**	The meaning and relative position of the rating category is representative of the final CQS.

Figure 11: Mapping of EthiFinance's Global short-term rating scale

Credit assessment	Corresponding rating category long-term scale	Range of corresponding CQS	Final review *based on qualitative factors* (CQS)	Main reason for the mapping
EF1+	AAA/AA+/AA/A A-/A+/A	1/1/1/1/2/2	**1**	The final CQS has been determined based on the most frequent step associated with the corresponding long-term credit rating category.
EF1	A/A-/BBB+/BBB	2/2/3/3	**3**	
EF2	BBB/BBB-/BB+	3/3/4	**3**	
EF3	BB+/BB/BB-/B+	4/4/4/5	**4**	
EF4	BB-/B+/B/B-/CCC+/CCC	4/5/5/5/6/6	**4**	The final CQS has been determined based on the most frequent step associated with the corresponding long-term credit rating category. The risk weights assigned to CQS 4 to 6 are all 150%, therefore CQS 4.
EF5	CCC+/CCC/CCC-/CC/C	6/6/6/6/6	**4**	