

17 December 2010

Feedback document to CP43

Introduction

1. On 13 October 2010, the Committee of European Banking Supervisors (CEBS) submitted for public consultation its draft advice to the European Commission (hereafter 'the Commission) on the non-eligibility of entities only producing credit scores for ECAI recognition (CP43).¹
2. The consultation period ended on 13 November 2010. Four responses were received all of which are published on the CEBS website.² One of the respondents is an international banking association representing one of the largest European retail banking networks; the other three respondents are credit assessment entities.
3. This paper includes a feedback table which presents a summary of the key points arising from the responses to the consultation and CEBS's views on them.

General comments

4. The respondent that is an international banking association supported CEBS's proposal to introduce a requirement that an ECAI has to be registered in accordance with Regulation EC 1060/2009 on Credit Rating Agencies (hereafter '*Regulation on CRAs*')³ as a precondition for being recognised as an eligible ECAI for capital requirement purposes. The respondent also agreed that entities

¹ CP43 is published under: <http://www.c-eps.org/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP43.aspx>

² The responses to CP43 are published under: <http://www.c-eps.org/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP43/Responses-to-CP43.aspx>

³ The *Regulation on CRAs* is published under: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0001:0031:EN:PDF>

only producing credit scores (hereafter 'credit scoring entities' or 'CSEs'), which are excluded from the scope of the Regulation, should not be considered eligible to apply for ECAI recognition.

5. One of the three credit assessment entity respondents commented on the lack of competition in the CRAs market, in particular for securitisation ratings, but offered no concrete feedback on CEBS's proposals regarding the need for consistency between Directive 2006/48/EC and the *Regulation on CRAs*.
6. The other two respondents objected to CEBS's proposals. One of these respondents identified as consequences of the proposal a reduction of competition in the market and a reduction in the quality of the offer of rating tools. This respondent recommended that the Regulation recognises that credit scoring techniques remain an instrument amongst others for producing credit assessments and that entities that make use of such techniques remain legitimate candidates for ECAI recognition. The other respondent recommended that the level playing field between CRAs and CSEs is solved through the creation of a legislative and supervisory framework that specifically addresses the requirements that have to be met by CSEs in the ECAI recognition process. Both respondents argued in favour of the use of credit scores for solvency purposes when assessing SMEs' credit risk.
7. CEBS clarifies that the aim of its proposals is primarily to ensure consistency between the ECAI recognition under the Capital Requirements Directive (hereafter 'CRD') and the *Regulation on CRAs*. As a consequence, the CEBS's proposals would prevent the use of credit scores for regulatory purposes, in particular their use in the calculation of capital requirements of financial institutions. CEBS further clarifies that its proposals do not prevent in any way financial institutions from using credit scores in their internal risk management.
8. In addition, CEBS notes that at present there are only a few Member States (i.e. EL, FR, IT, PT and SI) that have recognised as ECAIs entities that feature characteristics which may qualify them as CSEs in accordance with the *Regulation on CRAs*. Empirical evidence provided by these Members did not indicate, in most cases, that the assessments provided by these entities represent a material input in the calculation of supervisory capital requirements, especially for systemic institutions, so that the impact of the (potential) de-recognition of CSEs will be immaterial for most of these Member States.



ANNEX

Feedback table on CP43: summary of the responses and suggested amendments

CP43	Summary of comments received	CEBS's response	Amendments to the guidelines N/R: No change required
Paragraphs 4, 8 and 9	<p>One respondent, representing an international banking association, fully agreed with the proposal to introduce a requirement that an ECAI has to be registered in accordance with the <i>Regulation on CRAs</i> as a precondition for being recognised as an eligible ECAI for capital requirement purposes.</p> <p>The respondent also agreed with CEBS that entities only producing credit scores, which are excluded from the scope of the Regulation, should not be considered eligible to apply for ECAI recognition.</p>	CEBS acknowledges the support for its proposals.	N/R
Paragraph 5 to 7	The same respondent was not in favour of the proposal that central banks that are excluded from the scope of the Regulation should still be eligible for ECAI recognition. The	CEBS notes that this issue is out of the scope of its draft advice as set out in CP43.	N/R

	<p>respondent recognised that central banks are exempted from the CRA Regulation (in Article 2 (3)); however it did not support the idea that these bodies should nevertheless be eligible for ECAI recognition. In the respondent's view it would be important to distinguish between private ratings (those rightly linked to the ECAI recognition process) and official ratings, issued by central banks or supranational organisations.</p>		
<p>Paragraph 8</p>	<p>One respondent representing a credit assessment entity strongly objected to the suggestion that the possible recognition of entities only producing only credit scores would create an unlevel playing field between CRAs and entities only producing credit scores.</p> <p>This respondent also believed that the change proposed by CEBS would significantly alter the present playing field as it would automatically reduce the number of eligible companies and reduce competition by eliminating all companies which are only producing scores. In this respondent's view the reduction in the number of players would greatly advantage the 3 leading CRAs and would lead to a reduction in the quality of the offer, since tools and techniques to build a good rating or to build a good score are totally different.</p> <p>Furthermore, the respondent strongly objected to the suggestion that the possible recognition of entities only producing credit scores would create a lack of transparency for both supervisors and the market.</p> <p>This respondent argued that all entities which have been recognised as ECAI fully meet the transparency's requirements set out in Annex IX, part 3 of Directive 2006/48/EC.</p> <p>The respondent also argued that supervisors and users are fully aware of the difference between a credit score and a credit rating so there is no lack of transparency regarding these instruments.</p>	<p>CEBS is of the opinion that the recognition of CSEs as eligible ECAIs would not necessarily have an impact on competition due to the fact that there is usually no overlap between the entities assessed by CRAs and the entities and instruments assessed by CSEs. Only if CSEs started producing credit ratings could competition be increased. In this case, CSEs would have to register and could then also be recognised as eligible ECAIs. However, the only credit assessments that could be used for regulatory purposes (in particular, for the calculation of capital requirements) would be credit ratings produced by them (and not the credit scores).</p> <p>CEBS clarifies that the aim of its proposals is primarily to ensure consistency between the ECAI recognition under the CRD and the <i>Regulation on CRAs</i>.</p>	<p>New paragraph 10</p>

<p>Paragraph 8</p>	<p>Another respondent representing a credit assessment entity believed that an appropriate solution to address the issue raised by CEBS (on the unlevel playing field between CRAs and entities only producing credit scores, and also to the lack of transparency for both supervisors and the market) would be to create a legislative and supervisory framework that specifically addresses the requirements that must be met by issuers that use credit scores to rate companies and want to be eligible to apply for ECAI recognition.</p> <p>This respondent added that it is puzzling that the lack of legislation on credit scoring is used as a reason to ban the use of credit scores for the purposes of the calculation of capital requirements.</p>	<p>CEBS notes that the creation of 'a legislative and supervisory framework' for credit scoring entities is outside the scope of CEBS's work.</p> <p>CEBS clarifies that the aim of its proposals is primarily to ensure consistency between ECAI recognition under the CRD and the <i>Regulation on CRAs</i>.</p>	<p>N/R</p>
<p>Paragraph 9</p>	<p>One respondent representing a credit assessment entity highlighted that the change proposed by CEBS would strongly penalise the SME sector and its financing.</p> <p>This respondent argued that the CRA approach to SMEs is inefficient and the cost of a full rating process is not affordable, while the score approach is very efficient for assessing the credit risk of SMEs and is used by all financial institutions.</p> <p>The other respondent representing a credit assessment entity argued that the focus is erroneously placed on the methodology used and the assumption of the greater value of the involvement of an analyst in the rating process vs. other methodologies like credit scorings. In the opinion of this respondent certain credit scoring methodologies when applied to certain portfolios could have better predictive power than traditional credit rating methodologies.</p> <p>This respondent also argued that credit scoring tools are the only efficient way to rate SME portfolios, in addition to being more objective and independent.</p>	<p>CEBS clarifies that the aim of its proposals is primarily to ensure consistency between the ECAI recognition under the CRD and the <i>Regulation on CRAs</i>. As a consequence, the CEBS's proposals would prevent the use of credit scores for regulatory purposes, in particular their use in the calculation of capital requirements of financial institutions. CEBS further clarifies that its proposals do not prevent in any way financial institutions from using credit scores in their internal risk management.</p> <p>CEBS notes that it is not assessing whether credit scores are more or less efficient than credit ratings when exempting CSEs from ECAI recognition. It is CEBS's view that credit scores should not be used for regulatory purposes in the</p>	<p>New paragraph 10</p> <p>New paragraph 12</p> <p>N/R</p>

	<p>The respondent also mentioned a contradiction in the regulatory support for the use of credit scoring tools for capital purposes under the IRB models and limiting their use by ECAIs as the principles for development of these tools are very similar.</p>	<p>Standardised Approach, and that the recognition of a CSE as an eligible ECAI implies that elements that are typical for IRB models would be recognised for supervisory purposes under the Standardised Approach without having the same strict process, implementation and validation requirements that must be fulfilled under the IRB approach.</p> <p>As stated before CEBS notes that at the present there are only a few Member States (i.e. EL, FR, IT, PT and SI) that have recognised as ECAI entities that feature characteristics which may qualify them as CSEs in accordance with the <i>Regulation on CRAs</i>. Empirical evidence provided by these Members did not indicate, in most cases, that the assessments provided by these entities represent a material input in the calculation of supervisory capital requirements, especially for systemic institutions, so that the impact of a (potential) de-recognition of CSEs will be immaterial for most of these Member States.</p>	
Paragraph 12	<p>The respondent, representing an international banking association, supported the proposed amendment to Article 97 (paragraph 2).</p>	<p>CEBS acknowledges the support for its proposals.</p>	N/R
-	<p>One respondent representing a credit assessment entity expressed concern about the lack of competition in the CRAs market, in particular for securitisation ratings, and presented a number of proposals to create legal incentives to enhance competition amongst CRAs in this market segment.</p>	<p>CEBS notes that this issue is outside the scope of its draft advice as set out in CP43.</p>	N/R

