JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

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Final Report

Draft implementing technical standards amending Commission Implementing Regulation (EU) 2016/1800 on the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps in accordance with Directive 2009/138/EC

Contents

JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

1. Executive Summary

Commission Implementing Regulation (EU) 2016/1800[1] (the 'ECAI Allocation Regulation') was adopted on 11 October 2016.

The Solvency II Delegated Regulation[2] establishes in Article 4(1) that insurance or reinsurance undertakings may use an external credit assessment for the calculation of the Solvency Capital Requirement in accordance with the standard formula only where it has been issued by an External Credit Assessment Institution (ECAI) or endorsed by an ECAI in accordance with the CRA Regulation[3]. In accordance with Article 109a(1) of Directive 2009/138/EC [4] (the 'Solvency II Directive'), the ECAI Allocation Regulation lays down technical standards on the allocation of relevant credit assessments of 26 external credit assessment institutions (ECAIs) to the credit quality steps set out in Article 3 of Commission Delegated Regulation (EU) 2015/35[5] (the 'Solvency II Delegated Regulation). The ECAI Allocation Regulation is based on draft Implementing Technical Standards (ITS) that were submitted by the Joint Committee of the European Supervisory Authorities (ESAs) to the European Commission for endorsement in 2015.

The annex to the ECAI Allocation Regulation provides for allocation tables for 26 ECAIs, and covers one central bank and all the CRAs registered or certified under the CRA Regulation at the time the ESAs started preparing the original draft ITS for the ECAI Allocation Regulation. Since then, ESMA has withdrawn the registration of one CRA[6] and five new CRAs have been recognised[7]. Therefore, the ECAI Allocation Regulation needs to be amended to provide for the up-to-date allocation of external credit assessment of all registered/certified ECAIs, including the newly established ECAIs, and to remove the reference to the de-registered ECAI.

[1] Commission Implementation Regulation (EU) 2016/1800 of 11 October 2016 laying down implementing technical standards with regard to the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps in accordance with Directive 2009/138/EC of the European Parliament and of the Council (OJ L 275, 12.10.2016, p. 19).

[2] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.01.2015, p. 1-797).

[3] Regulation (EC) No 1060/2009 (OJ L 302, 17.11.2009, p. 1-33).

[4] Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

[5] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.1.2015, p. 1).

[6] https://www.esma.europa.eu/sites/default/files/library/esma71-99-376_feri_eurorating_services_credit_rating_agency_registration_withdrawn.pdf

[7] Please refer to the ESMA website for a list of CRAs registered or certified in accordance with the CRA Regulation. https://www.esma.europa.eu/supervision/credit-rating-agencies/risk

To this end, the ESAs have put forward this draft ITS, which is aligned to the revisions proposed to Commission Implementing Regulation (EU) 2016/1799[8] (the 'CRR Mapping Regulation') that establishes the mapping methodology for the use of external credit assessments of ECAIs in the calculation of the capital requirements for credit institutions and financial institutions, in particular the rules on how the relevant credit assessments are made correspondent to the six credit quality steps laid down in Regulation (EU) No 575/2013[9] (the 'Capital Requirements Regulation' (CRR)). This alignment is required under Article 111(1)(n) of the Solvency II Directive that necessitates the consistency of the external credit assessment allocations with the use of external credit assessments of ECAIs in the calculation of the capital requirements for credit institutions and financial institutions under the CRR.

Specifically, this draft ITS revises the external credit assessment allocations set out in the ECAI Allocation Regulation to reflect the currently registered/certified ECAIs. For this purpose, the draft ITS establishes external credit assessment allocations for the five new ECAIs together with unchanged allocations for the 25 ECAIs[10] covered in the ECAI Allocation Regulation.

The ESAs publicly consulted all relevant stakeholder groups on these draft ITS.

The consultation was launched on 18 July 2017 for the period of 2 months, and ended on 18 September 2017. No responses were received.

8 Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 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 (OJ L 275, 12.10.2016, p. 3).

9 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, p. 1).

10 The ECAI Allocation Regulation provided for allocations regading 26 ECAIs, including Feri EuroRating Services AG (Feri). Feri no longer meets the ECAI definition as set out in Article 13(40) of Solvency II, given the withdrawal of its CRA registration by ESMA.

2. Background and rationale

Legal basis of this draft ITS

The draft ITS revising the ECAI Allocation Regulation is developed on the basis of Article 109a(1) of the Solvency II Directive, and in accordance with the procedures set out in Article 15 of Regulation (EU) No 1093/2010 (EBA regulation)[11], Article 15 of Regulation (EU) No 1094/2010 (EIOPA Regulation)[12] and Article 15 of Regulation (EU) No 1095/2010 (ESMA Regulation)[13].

Background to these revised draft ITS

Use of external credit assessments in the Solvency II framework

Article 4(1) of the Solvency II Delegated Regulation provides that external credit assessments can only be used by insurance and reinsurance undertakings if they have been issued or endorsed by an ECAI in accordance with the CRA Regulation. This draft ITS specifies the allocations that should be used for determining the credit risk for the purpose of calculating the Solvency Capital Requirement with the standard formula.

In addition, Article 44(4a) of the Solvency II Directive provides for specific appropriateness assessments (re-/)insurance undertakings need to make when using of external credit assessments of ECAIs for purpose of calculating technical provisions and the Solvency Capital Requirement. This provision represents an element of risk-sensitivity and prudential soundness of the credit risk rules.

In line with the G-20 conclusions and the Financial Stability Board (FSB) principles for reducing reliance on external credit ratings the analysis behind the allocation of each ECAI and its regular monitoring over time should alleviate any mechanistic overreliance of the credit risk rules on external assessment, insurance and reinsurance undertakings are required to assess the appropriateness of external credit assessments as part of their risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments (Article 44(4a) of Solvency II).

[11] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC(OJ L 331, 15.12.2010, p.12).

[12] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

[13] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

ECAIs and relevant external credit assessments

ECAIs are defined as credit rating agencies registered or certified in accordance with the CRA Regulation or any central bank issuing credit ratings that are exempt from the application of the CRA Regulation.

The Annex of the ECAI Allocation Regulation provides for allocation tables for 26 ECAIs, and covers one central bank and all the CRAs registered or certified in accordance with the CRA Regulation as at the time the ESAs started preparing the original draft ITS for the ECAI Allocation Regulation. Since then:

- Five additional ECAIs have been recognised: Egan-Jones Ratings Co., HR Ratings de México, S.A. de C.V., INC Rating Sp. z o.o., modeFinance S.r.l. and Rating-Agentur Expert RA GmbH.

- The CRA registration of Feri EuroRating Services AG (Feri) has been withdrawn by ESMA. Feri renounced to its registration under the conditions set out in Article 20(1)(a) of the CRA Regulation, as it no longer performed credit rating activities and no longer existed as a separate legal entity following acquisition by Scope KGaA.

This draft ITS provides for a revision of the ECAI Allocation Regulation to the effect of establishing allocations for the up-to-date registered/certified ECAIs, namely allocations for the five newly established ECAIs together with unchanged allocations for the 25 ECAIs[14] covered in the ECAI Allocation Regulation.

Remarks on the mapping methodology

The method for deriving the mapping for Solvency II is one of the most crucial policy decision that was taken, as lots of elements are closely connected with each other.

Given the identified differences between the insurance and the banking framework, some adaptations to the current method developed by EBA for the banking sector have been investigated by EIOPA ahead of the Public Consultation of the draft ITS in 2014. The purpose of this analysis was to seek for consistency with the Solvency II principles and with the criteria used for the calibration of the Standard Formula, without losing connection with the credit assessment mapping principles developed by EBA.

In light of these aspects, any methodology considered in the policy decision made has been fully tested in terms of final results (mapping tables): the output of all policy options has been derived for some representative ECAIs in order to get an idea of the dimension of any preliminary difference

[14] The Solvency II Allocation Regulation provides allocations for 26 ECAIs, including Feri. Feri no longer meets the ECAI definition in article 13(40) Solvency II Directive, given the withdrawal of its CRA registration by ESMA. Allocations for those 25 ECAIs remain unchanged.

between the results produced by EBA for the banking sector and those coming from any alternative method.

Given the differences in the banking and insurance framework, and required consistency in these technical standards, several options have been considered to arrive at a mutatis mutandis application of the EBA mapping methodology for insurance and re-insurance undertakings. From these, the 3-years benchmarks as described in the banking ITS was chosen on the basis of the Public Consultation held in 2014.

The default rate can be defined in multiple ways. All options proposed reflect the criteria which are of interest from a prudential perspective and at the same time guarantee consistency with Solvency II principles.

From a practical perspective, a 3-year time horizon would allow the observation of a sufficient number of defaults in low risk credit assessments. A three-year time horizon would guarantee a sufficient level of reliable and stable data on default. Therefore a 3-year time horizon can be anyway relevant for the purpose of the mapping.

In addition a requirement that the size of the pool of rated items is sufficiently numerous was proposed.

The contribution of withdrawn ratings is also addressed in the mapping framework. It is acknowledged that they provide some evidence of the default behaviour of a credit assessment. However, such evidence should be less conclusive than the case of credit assessment that have been observed for the whole 1-year period because it cannot be guaranteed that a default has not taken place after withdrawal. In order not to affect those rating businesses where withdrawals are more frequently observed, no weighting is applied as long as the default behaviour has been observed after the credit assessment has been withdrawn.

In 2014 a quantitative impact study has been performed for 3 large, 2 medium and 2 small ECAIs. In terms of mapping outcomes, the results were as follows:

The mappings are identical to the EBA mapping for all ECAIs, except AAA rating category which is allocated consistently to a different CQS (e.g. CQS 0 instead of CQS 1 for large ECAIs). However, this is a result of the different total credit quality steps between the insurance and banking regulation frameworks, i.e. the highest CQ for insurance is 0 while the highest CQ for banking is 1.

Therefore, the applied methodology ensures

- coherence with the mapping tables provided for previous EIOPA Impact Studies and

- consistency with the mapping framework and output of EBA, Furthermore, the methodology does not lead to breach of the fundamentals of SII or wide-ranging reassessment of previous work. Finally among the objectives of the ECAI mapping ITS there is the need to ensure a methodological cross-sectorial consistency between the banking and the insurance sector in terms of output.

Structure of the ITS

Specifically, this draft ITS revises the Annex of the ECAI Allocation Regulation to take into account changes to the ECAI population. This revision complies with the consistency requirement under Article 111(1)(n) of the Solvency II Directive by being aligned to the revision of the CRR Mapping Regulation, made in accordance with the second subparagraph of Article 136(1) of the CRR.

Individual mapping reports are published on the EBA website to illustrate how the methodology is applied to derive the mappings for each of the newly established ECAIs within the banking framework. Allocations to the seven credit quality steps (CQS) of the insurance/reinsurance framework build on this work.

3. Draft implementing technical standards amending Commission Implementing Regulation (EU) 2016/1800 on the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps in accordance with Directive 2009/138/EC

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amending Implementing Regulation (EU) 2016/1800 laying down implementing technical standards with regard to the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps in accordance with Directive 2009/138/EC of the European Parliament and of the Council

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)[15], and in particular Article 109a(1) thereof,

Whereas:

(1) Commission Implementing Regulation (EU) 2016/1800 needs to be amended to provide for allocations of credit assessments of newly registered or certified external credit assessment institutions to the scale of credit quality steps for the purposes of the calculation of the solvency capital requirement, and to remove the outdated allocations for the deregistered institutions.

(2) This Regulation is based on the draft implementing technical standards submitted by the European supervisory authorities (ESAs) (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) to the Commission.

(3) The ESAs have conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[16], of the Insurance and Reinsurance Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council[17], and of the Securities and

[15] Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

[16] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC(OJ L 331, 15.12.2010, p.12).

[17] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[18].

HAS ADOPTED THIS REGULATION:

Article 1
Amending provisions

Implementing Regulation (EU) No 2016/1800 is amended as follows:

The Annex to Implementing Regulation (EU) No 2016/1800 shall be replaced by the Annex to this Regulation.

Article 2
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

Jean-Claude Juncker

[18] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

ANNEX

Allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps

Credit quality step	**0**	**1**	**2**	**3**	**4**	**5**	**6**
AM Best Europe-Rating Services Ltd							
Long-term issuer credit ratings scale	aaa	aa+, aa, aa-	a+, a, a-	bbb+, bbb, bbb-	bb+, bb, bb-	b+, b, b-	ccc+, ccc, ccc-, cc, c, rs
Long-term debt ratings scale	aaa	aa+, aa, aa-	a+, a, a-	bbb+, bbb, bbb-	bb+, bb, bb-	b+, b, b-	ccc+, ccc, ccc-, cc, c, d
Financial strength ratings scale		A++, A+	A, A-	B++, B+	B, B-	C++, C+	C, C-, D, E, F, S
Short-term ratings scale		AMB-1+	AMB-1-	AMB-2, AMB-3	AMB- 4		
ARC Ratings S.A.							
Medium- and long-term issuers rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Medium- and long-term issues rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Short-term issuers rating scale		A-1+	A-1	A-2, A-3	B, C, D		
Short-term issues rating scale		A-1+	A-1	A-2, A-3	B, C, D		

ASSEKURATA Assekuranz Rating-Agentur GmbH							
Long-term credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC/C, D
Short-term corporate rating scale		A++	A		B, C, D		
Axesor S.A.							
Global rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D, E
Banque de France							
Global long-term issuer credit ratings scale		3++	3+, 3	4+	4, 5+	5, 6	7, 8, 9, P
BCRA – Credit Rating Agency AD							
Bank long-term ratings scale	AAA	AA	A	BBB	BB	B	C, D
Insurance long-term ratings scale	iAAA	iAA	iA	iBBB	iBB	iB	iC, iD
Corporate long-term ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Municipality long-term ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Issue long-term ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Bank short-term ratings scale		A-1+	A-1	A-2, A-3	B, C, D		

Corporate short-term ratings scale		A-1+	A-1	A-2, A-3	B, C, D		
Municipality short-term ratings scale		A-1+	A-1	A-2, A-3	B, C, D		
Issue short-term rating scale		A-1+	A-1	A-2, A-3	B, C, D		
Capital Intelligence							
International long-term issuer rating scale	AAA	AA	A	BBB	BB	B	C, RS, SD, D
International long-term issue rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
International short-term issuer rating scale		A-1+	A-1	A-2, A-3	B, C, D		
International short-term issue rating scale		A-1+	A-1	A-2, A-3	B, C, D		
Cerved Rating Agency S.p.A.							
Corporate long-term rating scale	A1.1	A1.2, A1.3	A2.1, A2.2, A3.1	B1.1, B1.2	B2.1, B2.2	C1.1	C1.2, C2.1
Creditreform Ratings AG							
Long-term rating scale	AAA	AA	A	BBB	BB	B	C, D
CRIF S.p.A.							
Global long-term rating scale	AAA	AA	A	BBB	BB	B	CCC, D1, D2
Dagong Europe Credit Rating							

Long-term credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Short-term credit rating scale		A-1		A-2, A-3	B, C, D		
DBRS Ratings Limited							
Long-term obligations rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Commercial paper and short-term debt rating scale		R-1 H, R-1 M	R-1 L	R-2, R-3	R-4, R-5, D		
Claims paying ability rating scale		IC-1	IC-2	IC-3	IC-4	IC-5	D
Egan-Jones Ratings Co.							
Long-term credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Short-term credit rating scale		A-1+	A-1	A-2	A-3, B, C, D		
Euler Hermes Rating GmbH							
Global long-term rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, SD, D
European Rating Agency, a.s.							
Long-term rating scale			AAA, AA, A	BBB	BB	B	CCC, CC, C, D

Short-term rating scale			S1	S2	S3, S4, NS		
EuroRating Sp. z o.o.							
Global long-term rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Fitch France S.A.S. , Fitch Deutschland GmbH , Fitch Italia S.p.A. , Fitch Polska S.A. , Fitch Ratings España S.A.U. , Fitch Ratings Limited UK, Fitch Ratings CIS Limited							
Long-term issuer credit ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, RD, D
Corporate finance obligations – Long-term ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C
Long-term international IFS ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C
Short-term rating scale		F1+	F1	F2, F3	B, C, RD, D		
Short-term IFS ratings scale		F1+	F1	F2, F3	B, C		
GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH							
Global long-term rating scale	AAA	AA		A, BBB	BB	B	CCC, CC, C, D
HR Ratings de México, S.A. de C.V.							
Global long-term rating scale	HR AAA(G)	HR AA(G)	HR A(G)	HR BBB(G)	HR BB(G)	HR B(G)	HR C(G), HR D (G)

Global short-term rating scale	HR+1(G)	HR1(G)	HR2(G)	HR3(G)	HR4(G), HR5(G), HR D(G)		
ICAP Group S.A.							
Global long-term rating scale			AA, A	BB, B	C, D	E, F	G, H
INC Rating Sp. z o.o.							
Long-term issuer credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Japan Credit Rating Agency Ltd							
Long-term issuer ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, LD, D
Long-term issue ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Short-term issuer ratings scale		J-1+	J-1	J-2	J-3, NJ, LD, D		
Short-term issue credit ratings scale		J-1+	J-1	J-2	J-3, NJ, D		
Kroll Bond Rating Agency							
Long-term credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Short-term credit rating scale		K1+	K1	K2, K3	B, C, D		

modeFinance S.r.l.							
Global long-term rating scale	A1	A2	A3	B1	B2	B3	C1, C2, C3, D
Moody's Investors Service Cyprus Ltd, Moody's France S.A.S. , Moody's Deutschland GmbH, Moody's Italia S.r.l., Moody's Investors Service España S.A., Moody's Investors Service Ltd							
Global long-term rating scale	Aaa	Aa	A	Baa	Ba	B	Caa, Ca, C
Bond fund rating scale	Aaa-bf	Aa-bf	A-bf	Baa-bf	Ba-bf	B-bf	Caa-bf, Ca-bf, C-bf
Global short-term rating scale		P-1	P-2	P-3	NP		
Rating-Agentur Expert RA GmbH							
International credit rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D, E
International reliability rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D, E
Scope Ratings AG							
Global long-term rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Global short-term rating scale		S-1+	S-1	S-2	S-3, S-4		
Spread Research							
International long-term rating scale	AAA	AA	A	BBB	BB	B	CCC, CC, C,

							D
Standard & Poor's Credit Market Services France S.A.S., Standard & Poor's Credit Market Services Italy S.r.l., Standard & Poor's Credit Market Services Europe Limited							
Long-term issuer credit ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, R, SD/D
Long-term issue credit ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D
Insurer financial strength ratings scale	AAA	AA	A	BBB	BB	B	CCC, CC, SD/D, R
Fund credit quality ratings scale	AAAf	AAf	Af	BBBf	BBf	Bf	CCCf
Mid market evaluation ratings scale			MM1	MM2	MM3, MM4	MM5, MM6	MM7, MM8, MMD
Short-term issuer credit ratings scale		A-1+	A-1	A-2, A-3	B, C, R, SD/D		
Short-term issue credit ratings scale		A-1+	A-1	A-2, A-3	B, C, D		
The Economist Intelligence Unit Ltd							
Sovereign rating band scale	AAA	AA	A	BBB	BB	B	CCC, CC, C, D

4. Accompanying documents

4.1 Cost-Benefit Analysis/Impact Assessment

Procedural issues

In accordance with the Regulations of the three ESAs, an analysis of costs and benefits is conducted when drafting ITS, unless the analysis are disproportionate in relation to the scope and impact of the draft ITS concerned.

Problem definition

The Solvency II Directive permits the use of external credit ratings for the calculation of the Solvency Capital Requirement. Article 44(4a) of the Solvency II Directive aims at avoiding overreliance by insurance and reinsurance underlyings on ECAIs when they use external credit rating assessment in the calculation of technical provisions and the Solvency Capital Requirement. In this case, insurance and reinsurance undertakings shall assess the appropriateness of those external credit assessments as part of their risk management by using additional assessments wherever practically possible in order to avoid any automatic dependence on external assessments. In addition to these requirements, Article 259(4) of the Solvency II Delegated Regulation states that internal risk management methodologies shall not rely solely or automatically on external credit assessments. Where the calculation of technical provisions or of the Solvency Capital Requirement is based on external credit assessments by an ECAI or based on the fact that an exposure is unrated, that shall not exempt insurance and reinsurance undertakings from additionally considering other relevant information.

Article 4(1) of the Solvency II Delegated Regulation sets out that insurance or reinsurance undertakings may use an external credit assessment for the calculation of the Solvency Capital Requirement in accordance with the standard formula only where it has been issued by an ECAI or endorsed by an ECAI in accordance with the CRA Regulation.

As stated before, Article 111(1)(n) of the Solvency II Directive requires consistency with the framework of the use of ECAI ratings for the calculation of capital requirements in the banking sector as set out in the CRR. Recital 98 of the CRR advises that the ECAI market should be open to more credit rating agencies given the dominance of three undertakings. Accordingly, Article 4(98) of the CRR automatically recognises credit rating agencies registered or certified in accordance with the CRA Regulation as ECAIs. Central bank issuing credit ratings which are exempt from the application of the CRA Regulation are also recognised as ECAIs.

The usage of external credit ratings for determining own fund requirements requires an allocation of the credit assessments issued by an ECAI to the credit quality steps (CQS) of the Solvency II framework as set out in Article 3 of the Solvency II Delegated Regulation.

Allocations should be made available for all existing credit rating agencies registered or certified in accordance with the CRA Regulation and to central banks producing ratings that are not subject to that Regulation.

Objectives

The Commission adopted on 11 October 2016 the ECAI Allocation Regulation.

The ECAI Allocation Regulation provided allocation tables for 26 ECAIs, which covered one central bank and all the CRAs registered or certified in accordance with the CRA Regulation at the time the ESAs started preparing the draft ITS. Since then, ESMA has withdrawn the registration of one CRA and five additional CRAs have been registered or certified in accordance with the CRA.

The objective of this revised draft ITS is to amend the ECAI Allocation Regulation to include allocations for the newly established ECAIs and to remove the reference to the de-registered ECAI. The revised draft ITS will therefore register allocations for the current ECAI population, namely allocations for the 5 newly established ECAIS together with unchanged allocations for the 25 ECAIs covered in the ECAI Allocation Regulation[1].

In line with the G-20 conclusions and the Financial Stability Board (FSB) principles for reducing reliance on external credit ratings the analysis behind the allocation of each ECAI and its regular monitoring over time should alleviate any mechanistic overreliance of the credit risk rules on external assessment, insurance and reinsurance undertakings are required to assess the appropriateness of external credit assessments as part of their risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments (Article 44(4a) of Solvency II).

Figure 1: Newly registered or certified ECAIs

ECAI	Country of residence	Status
Egan-Jones Ratings Co.	USA	Certified
HR Ratings de México, S.A. de C.V.	Mexico	Certified
INC Rating Sp. z o.o.	Poland	Registered
modeFinance S.r.l.	Italy	Registered
Rating-Agentur Expert RA GmbH	Germany	Registered

These ITS will contribute to a common understanding among insurance and reinsurance undertakings and the EU's national competent authorities about the methodology that the Joint Committee should use to specify the allocations. Given that the allocations of any ECAI will be equally applicable in all EU Member States, these ITS will also contribute to ensure a high level of

[1] The ECAI Allocation Regulation provided allocations for 26 ECAIs, including Feri. Currently Feri no longer meets the ECAI definition in article 13(40) of Directive 2009/138/EC (Solvency II), given the withdrawal of its CRA registration by ESMA. Allocations for those 25 ECAIs remain unchanged.

harmonisation and consistent practice in this area and contribute to achieving the objectives of Solvency II of enhancing the risk sensitivity of the capital requirements.

Technical options considered

The elements to characterise the degree of risk expressed by a credit assessment of an ECAI (quantitative and qualitative factors) and the levels of risk that should be used to characterise each credit quality step ("benchmarks") remain unchanged with respect to the ECAI Allocation Regulation adopted by the Commission in October 2016.

As noted in recital 8 of the adopted ECAI Allocation Regulation, in March 2016 the Commission notified the JC of the ESAs of its intention to endorse the draft ITS[2] with amendments, which affected the level of conservatism of the allocations. In May 2016, an Opinion was issued by the ESAs rejecting the amendments proposed by the Commission[3].

The ESAs considered it appropriate, in line with their prudential objectives, that ECAIs with small pools of ratings should not be assigned allocations where the highest credit quality step could be achieved, given that creditworthiness cannot be adequately assessed against historical performance. The ESAs agreed in their final draft ITS to provide a phase-in period of three years for ECAIs with limited ratings' data and thereafter to apply conservative allocations. The Commission rejected this approach, which would have applied to all five newly registered or certified ECAIs considered in this consultation paper, on market competition grounds and adopted the ITS with an "indefinitely extended" phase-in period.

As indicated in recital 9 of the ITS, the Commission proceeded to amend the draft ITS in respect of the provisions that may cause undue material disadvantage to smaller/newer ECAIs due to their more recent entry in the market. As a result the application of a more conservative treatment in cases of limited data, after the end of the phase-in period in 2019, was not adopted. Therefore, the approach of an "indefinitely extended" phase-in period has also been adopted here.

[2] https://eiopa.europa.eu/Publications/Technical%20Standards/JC%202015%20068%20-%20Final%20Draft%20ITS%20on%20ECAIs%20mapping%20under%20Solvency%20II.PDF

[3] https://eiopa.europa.eu/Publications/Joint%20Committee/ESAs%202016%2041%20(JO_EC_amend_ITS_ECAI_Map_CRR-S2).pdf

Impact of the allocation for newly established ECAIs

Costs

The allocation is produced following the methodology for the banking regulation adopted by the Commission. The Commission highlights the need to avoid the automatic application of a more conservative allocation to all ECAIs which did not produce sufficient ratings, for the sole reason that they did not produced sufficient ratings, without taking into account the quality of their ratings.

There are potential risks that ECAIs with limited ratings could leverage on the Commissions amendments and produce credit assessments that are less conservative than the allocation would suggest. Less conservative credit assessments could result in an underestimation of capital requirements. Subsequent monitoring of mapping reports should allow identifying these situations, which would warrant a review of the allocations.

Benefits

Five additional ECAIs will be provided with a correspondence between their credit assessments and the seven CQS of the Solvency II framework, which allows the use of those credit assessments for determining own fund requirements. This increases competition in the industry, where certain ECAIs exercise a significant market power[4].

The analysis performed to arrive at each individual allocation and its regular monitoring over time should contribute to mitigate any mechanistic overreliance of the credit risk rules on external ratings, although due caution should continue to be exercised. This is one of the objectives of the G-20 conclusions and the FSB principles for reducing reliance on external credit ratings.

[4] The market share is concentrated in three ECAIs that represent around 90% of the market. Market share calculation based on 2015 applicable turnover from credit rating activities and ancillary services in the EU. Please refer to https://www.esma.europa.eu/sites/default/files/library/2016-1662_cra_market_share_calculation.pdf