Investment Management Association

29 November 2005

The Committee of European Banking Supervisors
Floor 18, Tower 42
25 Old Broad Street
London EC2N 1HQ

Dear Sir/Madam

CP07a draft guidelines on mapping ECAI's credit assessments of CIUs

IMA represents the UK-based investment management industry. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of about £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

We support the proposal not to have a separate mapping approach for CIUs. However, similar to IMMFA we are concerned that CEBS proposes that only ECAI credit assessments that meet the following three conditions will be eligible under the CRD:

- The assessment of the credit quality of the CIU must depend primarily on the credit quality of the underlying assets (for example, by using a weighted average of the individual credit assessments to derive the assessment of the CIU). Even though the rating of a CIU may not be interpreted as information about the PD of a CIU (since funds normally do not default as a whole), the credit assessment of a CIU should be comparable to a 'look-through' credit assessment of the individual assets within the fund (based on the fundamental credit assessment approach).
- Other factors, such as the volatility of the CIU or the quality of its management, must not have a material positive influence on the assessment of the credit quality of the fund. Any non-material influence that such factors have on the assessments should be taken into account in the mapping of the assessments.

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- Only assessments for fixed income CIUs should be eligible, since the CRD does not allow the use of credit assessments for other asset classes (e.g. equity) within the Standardised Approach.

We are concerned that the first condition fails to reflect how ECAIs actually carry out credit assessments of CIUs, and therefore makes their credit assessments ineligible for the purposes of the CRD. In particular, the first condition is too prescriptive in requiring the credit assessment of a CIU to be comparable to a 'look through' credit assessment of its individual assets. In practice, some ECAIs take account of the maturity of individual assets in the portfolio because there is a trade-off between credit risk and maturity – the longer a security is outstanding, the greater its expected loss. Equally, some ECAIs take account of the effect of portfolio diversification on the credit assessment of a CIU. For example, nobody would suggest that a bank's credit assessment should be based on a simple 'look through' of its loan book, and the same is true of the holdings of a CIU. We therefore recommend that the first condition should be revised to enable different methodologies employed by different ECAIs. CEBS itself provides a better alternative (in paragraph 7 of CP07a):

> *"To be eligible, a CIU credit assessment must primarily depend on the credit worthiness of the underlying assets."*

This alternative condition is preferable because, whilst requiring that the credit assessment of a CIU should depend 'primarily' on the credit worthiness of its underlying assets, it also leaves room for ECAIs to take account of other factors such as maturity and diversification.

In respect of the second condition, we are also concerned that the quality of a CIU's management can have on its rating not properly reflected.

Should you wish to discuss any of these issues, I would be happy to assist.

Yours faithfully

Üner Nabi
Senior Adviser – Financial Regulation