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The Committee of European Banking Supervisors
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30 September 2005

Dear Sirs

CEBS Consultation on the recognition of External Credit Assessment Institutions

The London Investment Banking Association (LIBA), the British Bankers' Association (BBA) and the International Swaps and Derivatives Association (ISDA) welcome the opportunity to comment on the proposed framework for the recognition of External Credit Assessment Institutions (ECAIs) and the mapping of their ratings to the credit quality steps.

Our Members consider that early agreement on a common interpretation and process for recognition and mapping, (both singly and jointly) of international ECAIs is imperative for the efficient implementation of the Capital Requirements Directive (CRD). As such, firms support CEBS involvement in this area.

Key points

Firms consider that independent, good quality ratings are essential to the transparency and smooth running of capital markets. Our Members do not think that ECAIs should be regulated and are pleased to note that the CRD does not provide for such a remit. However, firms consider that some of the recognition provisions in the CRD are very similar to the type of requirement that would be included in a regulatory framework, notably in relation to the conditions around rating methodologies. Firms would be concerned if, as a result, regulators were to influence the rating methodologies used and therefore endorse CEBS commitment that the appropriateness of the processes around the rating rather than the methodology itself should be the focus of review.

While our smaller Members are likely to use the Standardised Approach and therefore ECAI ratings in relation to domestic or European exposures; for our larger Members the use of ECAI ratings is likely to be in relation to non-EU overseas operations (such as those significant exposures in Brazil, South Africa, and parts of Asia). As such, our larger Members in particular, are disappointed to note that the CRD does not provide for indirect

recognition for Third Country EU equivalent regulatory regimes. However, our Members support the efforts of CEBS in engendering co-operation between national authorities and consider that this will be essential for both EU and non EU rating recognition. In particular, firms would urge CEBS to consider the circumstances under which supervisors can together make use of work done by third country regulators in arriving at the decisions on recognition and mapping.

Firms fully support the proposal to allow recognition at a group level and for a joint recognition and mapping process for ECAIs operating across jurisdictions. Our Members consider that this will make the direct recognition process more efficient. Effective communication between regulatory authorities on applications received will be an important factor in ensuring that all relevant supervisors are included in the joint recognition process. A co-ordinating role for CEBS should be an essential part of that process.

Our Members consider that the indirect recognition is also an important feature of the framework. They think that the default presumption should be toward indirect recognition rather than it being an option, where they joint recognition process is not used. Not to have such a presumption, could potentially create a block to competition in those markets where ECAI access is restricted. National authorities should be required to explain why indirect recognition has not been used.

Given the lead time for implementing related IT systems firms would urge national authorities to undertake the informal recognition and mapping process as soon as practicable. Our Members note from CEBS Consultation Paper (CP) 05 that there is provision on the CEBS website for disclosure of ECAI recognition and mapping in each Member State; they suggest that the provisional results of this informal process be posted on the website at the earliest opportunity, rather than waiting for all Member States to have completed the process. In addition they consider it inadvisable to delay the entire process until the work on securitisation and CIUs has been agreed.

Our Members support the concept of a common application pack, as it provides clarity on the areas that concern supervisors and will make the process more efficient. Our Members would urge CEBS to consider where the requirements overlap with the IOSCO code endorsed by CESR, to ensure that duplicative processes are not created. In addition they see no need for national supervisors to add to the common application pack. Firms consider that imposing additional requirements at a national level runs counter to the theme of better regulation espoused in the Commission's Green Paper on Financial Services Policy, could delay recognition and mapping decisions, increase the costs of the process and create a competitive disadvantage.

Given the likelihood of interpretation issues arising during the early phase of CRD implementation, our Members suggest that CEBS maintain a contact group for supervisors, in order that questions can be resolved speedily and consistently across the EU.

International comparability is a vital component of these proposals; therefore our Members fully support the proposed use of the Basel mapping methodology.

Our Members look forward to working with CEBS in finalising the proposals. Please contact Diane Hilleard (diane.hilleard@liba.org.uk), Ed Duncan (eduncan@isda.org) and

Ross Barrett (ross.barrett@bba.org.uk) if you would like to discuss any of the aspects of this letter.

Yours faithfully,



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Annex 1 - Questions

- 1 If you are an institution or an ECAI, how do you envisage using the proposed recognition process, in particular in cases where applications for the same ECAI are submitted in more than one Member State at the same time?**

Our Members envisage that the majority of ECAIs will nominate themselves for recognition. However, where firms have exposures in more remote locations, they may wish to nominate ECAIs for recognition and mapping. However, this could potentially lead to a significant duplication of effort. Therefore it would be helpful if ECAI applications could also be disclosed on the CEBS website as part of the CP 05 disclosures. Firms also envisage liaising with peers through trade associations on ECAIs in use in particular jurisdictions. Our Members would therefore support any initiative to promote information sharing and co-operation between firms and regulators to avoid duplication of effort and divergence of practice.

- 2 Do you support the proposed joint assessment process? Does it address the need for efficiency, consistency and reduced administrative burdens in light of the CRD requirement that each competent authority make its own decision (direct or indirect) on eligibility?**

Our Members fully support the concept of a joint assessment process as a vehicle for a more efficient, consistent and administratively effective process. However, they have made the following suggestions:

- The joint assessment process should not be further embellished by national regulators asking for additional information.
- While recognising the constraints of the CRD, our Members urge CEBS to consider incorporating an informal decision making process within the joint assessment procedure, i.e. joint recognition should aim to reach a consensus view on the suitability of a particular ECAI for recognition, but that the formal process of implementation be maintained at a national level.

- 3 What are your views on the proposed common understanding of the CRD recognition criteria to be implemented by supervisors in determining the eligibility of ECAIs?**

Our Members support CEBS' proposal to achieve a common understanding of the recognition criteria. They have the following comments on the detail of the proposals:

- Our Members are surprised to note that adherence to the IOSCO code only 'may' increase the comfort level of national authorities that the ECAI conforms to certain CRD criteria. Firms believe that compliance with the code, which has been endorsed both by CESR and the European Commission, should provide regulators significant comfort that the criteria have been met.

Objectivity:

- Credit assessments should be based on all relevant and material information. To require all relevant information without qualification would impose an undue burden on ECAIs.
- Our Members seek greater clarity on the in the way in which regulators intend to map the segments to the exposure types envisaged by the CRD since these do not precisely mirror one another. This is of particular interest if, as suggested, a different basis for rating for securitisation exposures may be used.
- As mentioned above, firms consider that regulators confine themselves to the internal processes that ensure high quality and consistent application of that rating methodology rather than assess the methodology itself.
- Firms seek greater clarity on the factors regulators intend to take into consideration where there is less quantitative information available, as this will have an impact on the likelihood of recognition for new or niche agencies.
- Our Members are concerned that the requirement in paragraph 87 for assessments to be robust, powerful and consistent across different market segments will preclude the recognition of an ECAI that specialises in a particular area.

Independence:

- Firms would like clarification as to whether it would be possible for a firm to nominate an ECAI that is a joint venture in which it participates.
- Our Members would like confirmation that the items noted as examples of situations where conflict of interest may arise are merely illustrations and would not necessarily preclude an ECAI being considered independent if adequate mitigants have been put in place.

Ongoing review:

- Our Members support the proposed interpretation of ‘backtesting’.
- While the CP acknowledges the possibility of de-recognition (paragraph 64), there is no proposal explaining how this will be achieved in a transparent manner. An ECAI should be given every opportunity to remedy identified shortcomings before a regulator sought to remove its recognised status.. A reasoned dialogue should take place over an extended period of time before any change in status. It is also important that firms, as well as other competent authorities, are given adequate notice of a withdrawal of ECAI recognition, as systems will need to be adjusted to accommodate the change.

Credibility and market assessments:

- The CP seems to assume that ECAIs are all operating in well established markets. Clearly for many of our larger Members who operate in emerging markets this will not be the case. It would be useful if CEBS could provide more information on how national regulators plan to assess credibility and market acceptance of such credit rating agencies.

4 What are your views on the proposed approach for implementing the mapping process?

Our Members support the proposal to use the mapping process outlined in Basel, on the grounds of international comparability. However, they seek clarification on whether the proposal is to have one mapping scale or different mapping scales for different market segments or exposure types. Clearly it is important that ratings from the same ECAI are given the equivalent mappings in each Member State. However, Members also queried how the range of ratings available will be accommodated within the process, for example where domestic and foreign currency ratings are issued on the same entity.

5 Do you support the proposal that the ‘mapping’ of credit assessments to risk weights should also be addressed under the joint process set out in Part 1 for applications made in more than one Member State?

Our Members fully support the proposal for joint mapping process and encourage national authorities to ‘indirectly’ recognise the mapping of other Member States where they are not part of the joint mapping process. As indicated in our comments on the recognition process, our Members consider that effective communication and participation from all interested supervisors is imperative.

6 Do you think that the concept of loss rather than default probability alone, is the appropriate key parameter for mapping securitisation credit assessments? If not, what should be the appropriate parameter? How should it be measured statistically? To what extent do the same considerations apply for CIU assessments?

Our Members do not consider that it is appropriate for regulators to prescribe the parameter used as this goes beyond the requirements of the CRD and will have the effect of specifying the methodology used. Where ECAIs are preparing ratings, through internally consistent methodologies, they should be allowed to use the same basis for securitisation. Firms accept, however, that the methodology used may impact on the mapping. The same considerations should also apply for CIU assessments.

Annex 2 – Other comments

Our Members have identified the following additional points:

Paragraph 11 – Our Members fully support CEBS sentiments in respect of firms retaining responsibility for determining the most appropriate ECAI to use for risk weighting purposes for a particular portfolio.

Paragraphs 25 to 29 – Firms support the proposal that ECAIs may be recognised at a group level rather than by legal entity. However, firms would question why affiliates and joint ventures should not be included where they use the same methodologies, procedures and adhere to the same code of conduct?

Paragraphs 32 to 45 – It would be helpful if CEBS set out a draft timetable for the informal joint recognition process, in the same way certain national authorities have done for IRB approval.

Paragraph 36 – It would be efficient if CEBS provided a clearing house function for applications to streamline the process of recognition for international ECAIs. However, firms recognise that this would impose an additional resource burden on CEBS in the short term.

Footnote 11 – This footnote constitutes a requirement and should be included within the main body of the text.