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CEBS Consultation Paper Recognition of External Credit Assessment Institutions

Representing the entire Austrian banking industry the Bank and Insurance Division would like to comment on CEBS' Consultation Paper 7 as follows:

1 The recognition process

(a) General Principles

CEBS' more detailed regulation of the recognition process of ECAs is welcomed. In this respect the following general principles are considered particularly beneficial:

- ECAs are assessed and supervised by the supervisory authority which is also in charge of supervision of banks. (Article 10).
- The bank retains ultimate responsibility for assessing what credit assessments of an ECAI are appropriate for risk weighting. (Article 11)
- The supervisory authorities of different Member States will adopt a single joint approach for applications for recognition filed in more than one Member State. (Article 16).
- Clear obligations are laid down for supervisory authorities regarding disclosure and explanation of their decisions on recognition. (Article 19).

However, the statement of CEBS to the effect that a bank may not use ratings of an ECAI which itself is a subsidiary of the bank seems to be problematic (see, above all, Article 14 and Article 90). With respect to assessment of this problem two important aspects have not sufficiently been taken into consideration:

- Article 81 of the Directive provides that objectivity, independence and transparency must be safeguarded with respect to recognition of the rating method. However, the Directive contains no express regulation on whether an external credit assessment may be made by a subsidiary of the bank or not. This means, that the regulation is incomplete in this respect.
- When applying the IRB Approach banks are, *inter alia*, allowed to use internal ratings (see Article 84). The decisive criterion for permission to use an internal rating model is that the bank uses a sound system for management and rating of credit risk exposures which is implemented with integrity and, in particular, fulfils the requirements set forth in Article 84 (2) (a) to (e). In this respect item (c) is of especially interesting, which contains the requirement that the bank's credit risk control unit must be appropriately independent of and protected against undue influence. This shows that also with respect to internal rating independence is considered a problem, however, one that can be solved.

By taking these two aspects into consideration a bank may use a rating prepared by an ECAI which is its own subsidiary if appropriate measures are evidenced and applied to safeguard the subsidiary's independence when it comes to preparing the rating. Considering of ratings prepared by a bank's own subsidiary as "dependent" is not justified, although, to safeguard independence, especially strict mechanisms must be applied and disclosed in such a constellation.

(b) Applications

The right to file an application for recognition should exclusively be reserved to the ECAI since it is the ECAI which is party to the administrative proceeding and also responsible for presentation of the required documentation (see Article 24). The possibility that in an ECAI/bank relationship the latter may carry out the administrative steps of the recognition procedure is not excluded by such a provision. However, by restricting the right to file an application the procedure could be simplified and made easier to control even if the applicant is domiciled in a different Member State.

We support the division into the three market segments public finance, commercial entities and structured finance, and also CEBS's requirement that in case recognition is sought in more than one Member State such circumstance is to be indicated when

filing the application in order to ensure adequate co-operation among the competent supervisory authorities. Only through efficient co-operation of the competent national supervisory authorities at European level can a homogenous and efficient implementation of Basle II be safeguarded in the EU.

(c) The form of recognition

According to Article 81 (3) of the Directive a rating agency that has already been recognised as eligible by the competent authority of a Member State may be recognised as eligible by the competent authority of another Member States without a new evaluation being necessary (safeguarding of a level playing field). The national authorities should agree on such a procedure as the standard procedure and carry out their own evaluation only in the following cases:

- if justified concerns exist regarding the decision on recognition rendered in a different Member State (procedural errors, insufficient information, etc.),
- if the situation of the ECAI has changed or indications of such a change exist and an evaluation is already required in this respect, or
- if the framework conditions in a Member State deviate from the framework conditions in the recognising Member State to such an extent that a separate evaluation is absolutely necessary.

(d) The level of recognition

We support CEBS's requirement that a subsidiary of an ECAI group of companies is required to file a separate application only if the ECAI group is unable to demonstrate that the procedures and practices set at group level are used by all subsidiaries without material differences. In this respect, the criterion "material" should, however, be interpreted in a strict sense.

Within the scope of the CEBS the supervisory authorities should, in addition, draw up detailed interpretation criteria, which should be amended and/or reviewed on the basis of the experience gained from the application procedures.

(e) Application in more than one Member State

The co-ordinated approach of the different national supervisory authorities designed by the CEBS is welcomed. By way of such approach it may be possible to ensure that the requirements demanded by the CRD are fulfilled both in case of direct recognition and in case of indirect recognition of ECAIs, and that the decision-making process of the supervisory authorities is speeded up.

The proposal does not provide for a procedure on selection of the "process facilitator". In this respect abstract selection criteria should already exist in the forefront in order to prevent disputes over competence. The same applies to the question as to when a case predominantly concerns one Member State ("an ECAI operates predominantly in a single Member State") and when it is the other way round.

2 Common understanding of the ECAI recognition criteria laid down in the CRD

(a) Methodology

Large parts of the technical criteria of the recognition procedure have been designed well. Nonetheless we would like to draw your attention to the following aspects.

As already said under Paragraph 1 (Recognition process) access to the market by newly founded companies is made more difficult by such technical criteria, too. It is obvious that a comprehensive track record and/or good national or international reputation of the ECAI may facilitate the assessment procedure of the competent authority, however, it should be pointed out that newcomers should be enabled to gain access to the market.

Accordingly, summarizing the above it should be put on record that a method should basically be considered in compliance with the Directive if either

1. the presented statistics (not only those regarding the company itself) suggest that the methodology applied by the ECAI assesses the credit risk in detail (requirement a), that risk-influencing factors (as, e.g., economic growth, prices of raw materials, etc.) are incorporated into the applied credit assessment methodology by the ECAI itself on an on-going basis and that such methodology is revised, if necessary, (requirement b) and, finally, that the methodology is consistently applied by the ECAI (requirement c), or
2. to the extent that no statistics are available or can be presented regarding reliability and accuracy of the assessment methodology, the applied methodology not only fulfils requirements b and c above but is also considered a reliable methodology of credit risk assessment by financial experts.

(b) Independence

The question of whether an ECAI is independent or not should always be answered by the competent supervisory authority on a case-by-case basis, following general principles. Neither the wording of the Directive nor the current market situation allows the conclusion that an ECAI is to be deemed dependent only because it is owned by the government, a large banking institution or a trade organisation. It is rather decisive whether the ECAI is able to prove functioning mechanisms that ensure independence of the persons involved in the rating process. It is not a question of independence of the ECAI itself but rather of independence in the decision-making process and the results shown (see paragraph 1 (a) of this opinion).

(c) On-going review and transparency and disclosure

Article 1.3 and Article 1.4 of Annex VII Part 2 of the Directive already describe on-going review of ECAIs and the obligation of transparency and disclosure in a comprehensive way. CEBS has been correct in improving the existing regulation.

3 Mapping

The general principles of mapping and, in particular, the fact that the mapping process does not impose additional eligibility requirements on ECAIs (Article 118) as well as the recommendation to use the guidance provided by the revised Basel II framework of the Basel Committee for Banking Supervision into consideration with respect to benchmarking and monitoring of ECAIs' credit assessment (Article 119) are welcomed.

Yours sincerely,

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Bank Division