



Fédération Bancaire Européenne
European Banking Federation
Le Secrétaire Général

N° 0573
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Mr. José María Roldán
Chairman
Committee of European Banking Supervisors
Floor 18, Tower 42
25 Old Broad Street
London EC2N 1HQ

Brussels, 30 September 2005

Subject: Consultation Paper (CP07) on the recognition of External Credit Assessment Institutions

Dear Mr. Roldán,

The European Banking Federation (FBE)¹ welcomes the opportunity to comment on the Committee of European Banking Supervisors' (CEBS) consultation paper on the recognition of External Credit Assessment Institutions (ECAIs).

We support CEBS' overall approach to ECAI recognition, and we especially welcome CEBS' initiative to co-ordinate the mapping of ECAIs' credit assessments into the credit quality scales.

However, we strongly believe that CEBS' approach should be more ambitious and that there is further scope for promoting a really common approach to ECAI recognition, in particular with regard to the application pack and the recognition process. It must by all means be ensured that supervisors come to a shared conclusion on an ECAI's eligibility. To this end, the decision-making process should be built into the joint assessment process. We would also urge CEBS to ensure that the common mapping process results in the consistent assignment of risk weights throughout all jurisdictions.

In addition, the FBE wishes to underline that the process of ECAI recognition must not impose any disproportionate additional entrance barriers to the rating market for start-ups.

¹ Set up in 1960, the European Banking Federation (FBE) is the voice of the European banking sector. It represents the interests of over 4,500 European banks, large and small, with total assets of more than €20,000 billion and over 2.3 million employees.

In this light we strongly encourage CEBS to pay particular attention to the principle of proportionality.

Please find our comments attached. For any questions, please don't hesitate to contact either myself or my colleague Uta Wassmuth, u.wassmuth@fbe.be or +32 2 508 37 41.

Yours sincerely,



Guido RAVOET
Secretary General

Enclosure: 1



Fédération Bancaire Européenne
European Banking Federation

Response: CEBS Consultation Paper On the Recognition of External Credit Assessment Institutions

General remarks

1. The European Banking Federation (FBE) welcomes the opportunity to comment on CEBS' Consultation Paper on the recognition of External Credit Assessment Institutions (ECAIs). Our members being arrangers, investors and issuers, it is of utmost importance to the FBE that the quality of ratings provided by ECAIs is maintained.
2. **We support CEBS' overall approach to ECAI recognition, and we especially welcome CEBS' initiative to co-ordinate the mapping of ECAIs' credit assessments into the credit quality scales. A common approach to mapping is essential in order to ensure consistency and reduce regulatory divergence.** In addition, cooperation arrangements which work well are of particular importance as the mapping of credit assessments to credit quality steps may change on a yearly basis.
3. The FBE welcomes CEBS' objective of enhancing convergence and its specific proposal for a common application pack. **We support the proposed joint assessment process as an important step towards supervisory convergence.** In this context we especially welcome the concept of a "process facilitator" who will be responsible for co-ordinating the tasks and for producing the ultimate assessment. In the coming years, the role of the process facilitator should be developed in line with the general evolution of the supervisory environment towards enhanced convergence.
4. However, in the context of supervisory convergence we would urge CEBS to adopt a more ambitious approach towards the provision of common guidelines for ECAI recognition, especially with regard to the application pack and the recognition process, and to a lesser extent for the mapping.
5. In particular, it must be assured that all supervisors come to a common conclusion on an ECAI's eligibility and that the same risk weights are assigned to the same ECAI's quality steps. **Whilst we acknowledge that the CRD provides that each competent authority shall come to its own decision on recognition, we believe that this could be built into the joint assessment process.** The co-operation framework would be of little use if supervisors came to differing decisions on whether or not an ECAI should be recognised.
6. **Moreover, the initiative of drafting a common application pack can only be successful in reducing workload if supervisors accept the scope of the pack to be sufficient.** To the extent that all supervisors are involved in drawing up the pack we do not see any reason why supervisors would add additional requirements to the framework. The parallel use of different application packs would be contrary to single market principles and to the overarching objective of supervisory convergence.

7. In this context, we consider that indirect recognition, in parallel with the proposals for joint recognition, is an important feature of the framework. In the FBE's view, indirect recognition should become the norm over time to ensure a true Single Market for ECAs and to increase the choice to banks using ECA ratings. With an agreed pack of common information required by supervisors it would necessarily lead to duplication of work if individual supervisors were not to rely on each other's evaluations. Indirect recognition should not, however, be used where an ECA has different methodologies in different jurisdictions.
8. A clear distinction is needed in CEBS' guidance between the regulatory and self-regulatory elements. A Credit Rating Agencies (CRA's) role as an ECA under the capital adequacy framework is based on the provisions set out in Annexes VI.2 and IX of the Capital Requirements Directive (CRD). Any guidelines relating in general to its business as a CRA and beyond its scope as an ECA should be based on self-regulation according to the Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organisation of Securities Commissions in December 2004. and supported by the Committee of European Securities Regulators (CESR) in its technical advice to the Commission in March 2005. In this context, we believe that the CEBS paper should make clear reference to the IOSCO Code of Conduct Fundamentals. In addition to the extent that the CRD leaves room for interpretation, CEBS should refer to specific chapters of the IOSCO Code Fundamentals, in particular Chapters 3 and 4.
9. It is essential that the ECA recognition framework does not result in an unlevel playing field between banks with internal ratings based systems and ECAs. The supervisory standards to which banks and ECAs are subject in relation to rating must be equivalent. The FBE would, however, stress that **recognition of ECAs should not imply regulation beyond the requirements of the CRD. We therefore welcome CEBS' clarification that ECA recognition does not constitute a form of regulation or of licensing of rating agencies to do business in Europe. We find CEBS' approach to consider the processes around the methodologies, rather than to assess the methodologies themselves, appropriate in this regard. We furthermore welcome the recognition in the CEBS paper that the onus is on the ECAs to design and implement their own policies.**
10. Paragraph 11 states that institutions retain ultimate responsibility for assessing whether an ECA's credit assessments are appropriate for risk weighting or any other purpose. We have some concerns over how this paragraph could be interpreted. Whilst it is true that institutions make the final choice about which recognised ECA to use, this should in no way imply any form of liability if the ECA has been recognised by a supervisor. It is important to stress that banks which make use of ECAs' credit assessments will do so because they do not have the capability to rate internally. We would, therefore, encourage CEBS to clarify the exact meaning of this paragraph.
11. We would also emphasise the principle of proportionality in the framework. In particular, detailed disclosure requirements that could constitute an undue entry barrier for start-ups or that would impose excessive additional burdens on smaller firms must be kept to a minimum to avoid competitive distortions.
12. With regard to the Question 1 put forward by CEBS, the FBE would suggest that the issue be addressed to the Consultative Panel. Institutions' use of the recognition process will vary widely and we believe that the Consultative Panel could give valuable input on this issue.

13. As part of the framework for supervisory disclosure, it has been agreed to include disclosures on the mutual recognition of other supervisors' ECAI assessments. **The FBE fully welcomes this feature of the framework.** We would like to reiterate the importance of **supervisory transparency** in this regard, and we support CEBS' commitment for supervisors to disclose an explanation of their recognition process. In addition, we would suggest that CEBS annually discloses a compilation of the main reasons why applications for ECAI recognition were declined. However, this must be without prejudice to the imperative that no information shall be disclosed that concerns or can be linked to any specific institution.
14. Supervisory disclosures should furthermore be made on additional national requirements and their justifications. Moreover, an explanation should be provided within this framework where supervisors decide not to make use of the procedure of indirect ECAI recognition.
15. We would encourage CEBS to present this framework to the AIG as a basis for discussion of ECAI recognition in other jurisdictions.

Detailed comments

Part 1: The recognition process

16. The FBE believes that an essential part of the framework for ECAI recognition should be a common definition of eligible institutions. We would therefore call on CEBS to delete the national discretions in paragraphs 12 and 20 of the consultation paper. The group of potential applicants should be consistent and include credit institutions and their central associations where applicable as well as ECAIs.
17. Given the lead time for implementing IT systems we would urge CEBS and national authorities to undertake the informal recognition and mapping process and give a provisional indication of the outcome as early as possible.
18. CEBS stipulates that the competent authority would only undertake an assessment of an ECAI's eligibility if at least one institution intends to use the ECAI's credit assessments for risk-weighting purposes. We would request CEBS to clarify that this provision does not imply any formal contractual obligation for banks, but that it is merely used as an indicator of a potential ECAI's activities.
19. On the form of recognition, we acknowledge that the CRD does not provide the possibility for EU Member States to recognise an ECAI on the basis of recognition by a regulator in a non-EU country. However, we would encourage CEBS to examine the possibilities for improving the working relations with both IOSCO and, in particular, with the US, Swiss, Canadian, Japanese and the respective EEA (European Economic Area) authorities to ensure future consistency with international standards.
20. Within the scope of the joint assessment process procedures must work quickly. To this end we would encourage CEBS to clarify that the one month period mentioned in paragraph 37 will cover initial consideration of the application amongst the supervisors and, in particular, by the process facilitator prior to the physical meeting.

21. Whilst provision is made in the consultation paper for the possibility of de-recognition, there is no proposal on how this will be carried out in a transparent manner. It is important that firms, as well as other competent authorities, are given sufficient notice and justification for a withdrawal of recognition. We also recommend that national authorities include a possibility for appeal within the de-recognition procedure.
22. For the sake of transparency it is essential that all public information be available in a language customary in the sphere of international finance. This would be in line with the provisions of the Transparency Directive and would also fit with CEBS efforts to present the supervisory disclosure framework in English on a best efforts basis.
23. For cross-border ECAIs it should be possible to apply simultaneously in all constituencies where it is active by way of sending the same application to all competent authorities concerned. The same procedure should be accepted if the application is submitted by an institution rather than the ECAI itself.

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

24. The FBE notes that the provisions on independence as well as those on transparency and disclosure included in the consultation paper are less precise than the corresponding chapters in the IOSCO Code of Conduct Fundamentals. In this light we would request CEBS to make explicit reference to Chapters 2 through 4 of the IOSCO document.
25. According to paragraph 86, “the assessment of the ECAI’s methodology *should* remain high-level”. The FBE underlines that this is not merely desirable but necessary to guarantee that the recognition process does not turn into a regulatory exercise.
26. We welcome the specification that ECAIs do not necessarily have to have an internal audit function in place, but that they may otherwise demonstrate the existence of alternative means to ensure the effective implementation of internal procedures. This is particularly important in the context of delivering a proportionate regime.

Part 3: Mapping

27. We support the proposal that mapping will be addressed under the joint process for treating applications of ECAIs that intend to become active in several EU countries. We wish to stress that supervisory flexibility should under no circumstances result in different risk weights being assigned to the same ECAI’s credit quality steps. This should especially be ensured with regard to paragraph 145: additional information required by one supervisor must not result in distortions of the common approach to mapping.
28. Regarding the general principles of mapping laid down in paragraph 122, we agree that appropriate conservatism should be applied where no significant amounts of data are available. However, this should not become a stress-testing exercise and it should not lead to credit institutions being put at a disadvantage as a result of an ECAI’s comparatively low amount of quantitative data.

29. When mapping credit quality steps to credit assessments, competent authorities should as far as possible rely on aggregated European data rather than national data with a view to ensuring a high degree of statistical significance.
30. On the parameters for mapping securitisation credit assessments, the FBE does not consider it appropriate for supervisors to prescribe which methodology should be used. Where ECAs provide ratings, through internally consistent methodologies, they should be allowed to use the same basis for securitisation. The same considerations apply for CIU assessments.
31. We welcome the reference to the requirements of the Basel Committee on Banking Supervision in paragraph 119 with regard to a level playing field. However, these requirements raise a number of issues which need to be addressed. First of all, the significance of the long-run three-year Cumulative Default Rate (CDR) seems to be unclear. We believe that it is sufficient in terms of statistical significance to take into account the two latest three-year CDRs. Furthermore we would request clarification as to how the assessment categories respective to the risk weights shall correspond to the classification in five categories of Annex 2 of the Basel Framework. For example, Annex VI of the Directive 2000/12/EC forces in each case six assessment categories. In addition, the definitions of the categories of claims on sovereigns and claims on banks provided by the Basel Framework do not correspond to the Tables 2 and 3 of Annex 2. Finally, the mapping of claims on corporate debtors remains ambiguous given that only four assessment categories exist with regard to this group.

Part 4: Export Credit Agencies

32. The FBE would request clarification on whether paragraph 162 means that institutions must not use ECAI ratings on a certain portfolio if they use the ratings of an Export Credit Agency (ECA) within the same portfolio. Given that the ECA might provide ratings for only a few exposures within the portfolio, the institution would be obliged to leave the remaining positions unrated. Whilst we agree in general that provision must be made against the risk of arbitrage, we believe that the parallel use of ECA and ECAI ratings should be permitted in this case.

Annex I: Common Basis Application Pack

33. When assessing an applicant's eligibility, supervisors should especially take into account whether the ECAI monitors its ratings on an ongoing basis. We believe that the ECAI recognition framework should place particular emphasis on the need for professionalism in this regard and that the new framework could act as a positive catalyst in ensuring that ratings are consistent with changing market conditions in the EU. The provision that ECAs must demonstrate that they review each credit assessment at least annually seems sufficient in this respect. However, we underline that on this point no exceptions must be made for smaller institutions. Reference should be made in the consultation paper to the relevant part in the IOSCO Code of Conduct Fundamentals.
34. With regard to paragraph 3 of the requirements of an ECAI's on-going review of its ratings, we esteem that the requirement that the back-testing system has been up and running for at least one year is completely insufficient. The ECAI should have an adequate history of monitoring and updating ratings.

35. Under the criterion of independence, ECAs will be requested to demonstrate and certify that “members of the ratings teams and committees have appropriate and requisite skills (...) and experience in credit assessment”. The FBE fully supports this provision. However, we would request CEBS to clarify that this must not lead to detailed instructions by supervisors on the exact skills and training that ECAI staff should possess.
36. Furthermore, ECAs should be requested to explain on the basis of which parameters they define their assets groupings.