Draft mapping of INBONIS' credit assessments under the Standardised Approach

1. Executive summary

1. This report describes the exercise carried out by the Joint Committee (JC) to determine the 'mapping'[1] of the credit assessments of INBONIS SA (INBONIS).

2. The methodology applied to produce the mapping remains as specified in the Commission's Implementing Regulation (EU) 2016/1799 ('the Implementing Regulation')[2] laying down Implementing Technical Standards (ITS) with regard to the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk in accordance with Articles 136(1) and (3) of the Regulation (EU) No 575/2013 of the European Parliament and the Council Capital Requirements Regulation – CRR). This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) CRR.

3. The mapping neither constitutes the one which the European Securities and Markets Authority (ESMA) shall report on in accordance with Article 21(4b) of Regulation (EC) No 1060/2009 (the 'CRA Regulation') with the objective of allowing investors to easily compare all credit ratings that exist with regard to a specific rated entity[3] nor should be understood as a comparison of the rating methodologies of INBONIS with those of other ECAIs. This mapping should however be interpreted as the correspondence of the rating categories of INBONIS with a regulatory scale which has been defined for prudential purposes. This implies that an appropriate degree of prudence may have been applied wherever not sufficient evidence has been found with regard to the degree of risk underlying the credit assessments.

4. As described in Recital 12 of the Implementing Regulation, it is necessary to avoid causing undue material disadvantage on those ECAIs which, due to their more recent entrance in the market, present limited quantitative information, with the view to balancing prudential with market concerns. Therefore, the relevance of quantitative factors for deriving the mapping is relaxed. This allows ECAIs which present limited quantitative information to enter the market

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[1] According to Article 136(1), the 'mapping' is the correspondence between the credit assessments of an ECAI and the Credit Quality Steps (CQS) set out in Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR).

[2] OJ L 275, 12.10.2016, p. 3-18

[3] In this regard please see https://www.esma.europa.eu/sites/default/files/library/esma_2015-1473_report_on_the_possibility_of_establishing_one_or_more_mapping.pdf.

and increases competition. Updates to the mapping should be made wherever this becomes necessary to reflect additional quantitative and qualitative information.

5. The resulting mapping has been specified in Annex III of the Consultation Paper on the revised draft ITS on the mapping of ECAIs' credit assessments under Article 136(1) and (3) of the CRR. Figure 1 below shows the result for the rating scale of INBONIS, the EU rating scale.

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Figure 1: Mapping of INBONIS's EU rating scale

Credit assessment	Credit quality step
AAA	1
AA	1
A	2
BBB	3
BB	4
B	5
CCC	6
CC	6
C	6
D	6

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2. Introduction

6. This report describes the exercise carried out by the JC to determine the 'mapping' of the credit assessments of INBONIS.

7. INBONIS is a credit rating agency that registered with ESMA on 27 May 2019 and therefore meets the conditions to be an eligible ECAI[4].

8. The methodology applied to produce the mapping remains as specified in Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 (the Implementing Regulation)5 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 (Capital Requirements Regulation – CRR). This Implementing Regulation employs a combination of the provisions laid down in Article 136(2) of the CRR.

9. The quantitative information reflects the statistics on the rating activity and performance of ECAIs established by ESMA in its Central Repository of credit rating data (CEREP)[6]. The qualitative information was collected bilaterally from INBONIS.

10. The following sections describe the rationale underlying the exercise carried out by the JC to determine the mapping. Section 3 describes the rating scale of INBONIS for the purpose of the mapping. Section 4 contains the methodology applied to derive the mapping of INBONIS's rating scale. The mapping table is shown in Appendix 4 of this document.

3. INBONIS credit ratings and rating scales

11. INBONIS produces one type of credit ratings, namely Corporate credit ratings shown in Column 2 of Figure 2 in Appendix 1. This rating may be used by institutions for the calculation of risk weights under the Standardised Approach (SA)[7].

12. INBONIS assigns corporate credit ratings to financial and non-financial companies. The assigned rating represents the opinion of the rating agency on the entity's creditworthiness across a risk horizon of 10 years.

13. INBONIS assigns this credit rating to the Global long-term rating scale, as illustrated in column 3 of Figure 2 in Appendix 1. The rating scale is described in Figure 3 of Appendix 1.

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[4] The mapping does not contain any assessment of the registration process of INBONIS carried out by ESMA.

[5] OJ L 275, 12.10.2016, p. 3-18

[6] These statistics are computed from individual rating information provided by registered or certified Credit Rating Agencies to ESMA, as required as per Article 11(2) of the CRA Regulation. http://cerep.esma.europa.eu/cerep-web/

[7] Article 4(1) CRA allows the use of the credit assessments for regulatory purposes as long as they meet the definition of credit rating as per Article 3(1)(a) of the CRA Regulation.

14. A specific mapping has been produced for the Global long-term credit rating scale, as explained in Section 4, which has been derived in accordance with the quantitative and qualitative factors specified in the Implementing Regulation.

4. Mapping of INBONIS's long-term rating scale

15. The mapping of the Global long-term rating scale consisted of two different stages, where quantitative and qualitative factors were considered.

16. In the first stage, the quantitative factors referred to in Article 1 of the Implementing Regulation have been taken into account to differentiate between the levels of risk of each rating category. The long-run default rate of a rating category has been calculated in accordance with Article 6 of the Implementing Regulation, as a sufficient number of credit ratings is not available.

17. In a second stage, the qualitative factors proposed in Article 7 of the Implementing Regulation have been considered to challenge the initial mapping produced in the previous stage.

4.1. Initial mapping based on the quantitative factors

4.1.1. Calculation of the long-run default rate

18. CEREP did not reflect information regarding the credit ratings issued by INBONIS. Therefore the allocation of Credit Quality Steps (CQS) has been made in accordance with Article 6 of the Implementing Regulation, as shown in Figure 4 of Appendix 3.

19. For rating category "D", default rates were not calculated since it already reflects a 'default' situation.

4.1.2. Mapping proposal based on the long-run default rate

20. As illustrated in the second column of Figure 5 in Appendix 4, the assignment of the rating categories to CQS was initially made in accordance with Article 6 of the Implementing Regulation. Therefore, the numbers of defaulted and non-defaulted rated items have been used together with the prior expectation of the equivalent rating category of the international rating scale.

- **AAA/AA/A/BBB/BB/B:** the number of rated items in each of these categories is equal or larger than the respective minimum required number of observed items given the number of defaulted items in the rating category. Thus the credit quality steps associated with the AAA/AA, A, BBB, BB, B rating categories in the international rating scale (CQS 1, CQS 2, CQS 3, CQS 4 and CQS 5 respectively) can be assigned.

- **CCC/CC/C:** since the CQS associated with the equivalent rating category of the international rating scale is 6, the proposed mapping for these rating categories is also CQS 6.

21. The calculation of the number of items assigned the same rating category weights withdrawn ratings by 50% as indicated in Article 4(3) of the Implementing Regulation.

22. The definition of default has been taken into account for the calculation of the quantitative factors, following Article 8 of the Implementing Regulation.

4.2. Final mapping after review of the qualitative factors

23. The qualitative factors specified in Article 7 of the Implementing Regulation have been used to challenge the mapping proposed by the default rate calculation. Qualitative factors acquire more importance for rating categories where quantitative evidence is not sufficient to test the default behavior[8], as it is the case for all INBONIS's rating categories.

24. The **definition of default** applied by INBONIS and used for the calculation of the quantitative factors has been analysed:

- The types of default events considered are described in Appendix 2 and are consistent with events (a) and (d) of the benchmark definition of default specified in Article 4(4) of the Implementing Regulation. Public information on default events (b) and (c) is more difficult to capture given the business model of the ECAI, which is focused on SMEs.

- As INBONIS does not have any default recorded, there is no information on the share of bankruptcy-related default events.

    No change is proposed to the mapping based on this factor.

25. The mapping proposal resulting from the quantitative factors complies with the qualitative criteria on the **meaning and relative position** of a rating category, as specified in Article 10 of the Implementing Regulation.

26. Regarding the **time horizon**, INBONIS's rating methodology focuses on the twelve-month horizon. For the time being, the scarcity of data do not allow to assess the sustainability of the level of risk over the time horizon specified in Article 4(2) of the Implementing Regulation. No adjustment is proposed based on this factor.

27. Finally, it should be highlighted the use of the long-run default rate benchmark associated with the equivalent category in the international rating scale as the **estimate of the long run**

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[8] The default behavior of a rating category is considered to be properly tested if a sufficient number of credit ratings is available, i.e. the quantitative factors for that rating category are calculated under Articles 3 – 5 of the Implementing Regulation.

default rate for the calculation of the quantitative factor of rating categories under Article 6 of the Implementing Regulation.

28. Regarding the estimate provided by INBONIS of the long-term default rate associated with all items assigned the same rating category, according to Article 12 of the Implementing Regulation, it should be taken into account for the purpose of the mapping as long as it has been adequately justified.

Appendix 1: Credit ratings and rating scales

Figure 2: Relevant credit rating and rating scale

SA exposure class	Name of credit rating	Credit rating scale
Long-term rating		
Corporates	Issuer credit rating for SMEs	EU rating scale

Source: INBONIS

Figure 3: EU rating scale

Credit assessment	Meaning of the credit assessment
AAA/AA	An entity rated 'AA/AAA' has between very strong and excellent capacity to meet its financial commitments.
A	An entity rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than entity in higher-rated categories.
BBB	An entity rated 'BBB' has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to weaken the entity's capacity to meet its financial commitments.
BB	An entity rated 'BB' is less vulnerable in the near term than other lower-rated entities. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions that could lead to the entity's inadequate capacity to meet its financial commitments.
B	An entity rated 'B' is more vulnerable than the entities rated 'BB', but the entity currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the entity's capacity or willingness to meet its financial commitments.
CCC	An entity rated 'CCC' is currently vulnerable and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.
CC	An entity rated 'CC' is currently vulnerable to non-payment that would result in an 'D' issuer rating and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.
C	An entity rated 'C' is currently highly vulnerable. The 'C' rating is used when a default has not yet occurred but Inbonis expects default to be a virtual certainty, regardless of the anticipated time to default.
D	An entity rated 'D' has failed to pay one or more of its financial obligations (rated or unrated), excluding hybrid instruments classified as regulatory capital or in non-payment according to terms, when it came due. An entity is considered in default unless Inbonis believes that such payments will be made within any stated grace period.

Source: INBONIS

Appendix 2: Definition of default

INBONIS defines default as occurring if:

- The company is in default with respect to any financial obligation whose economic impact is of a significant amount.

- The company has been declared insolvent or in a similar situation.

Source: INBONIS

Appendix 3: Default rates of each rating category

Figure 4: Mapping proposal for rating categories with a non-sufficient number of credit ratings

	AAA/AA	**A**	**BBB**	**BB**	**B**
CQS of equivalent international rating category	CQS 1	CQS 2	CQS 3	CQS 4	CQS5
N. observed defaulted items	0	0	0	0	0
Minimum N. rated items	0	0	0	0	0
Observed N. rated items	0	0	0	0	0
Mapping proposal	**CQS 1**	**CQS 2**	**CQS 3**	**CQS 4**	**CQS 5**

Source: JC calculations based on CEREP data.

Appendix 4: Mappings of each rating scale

Figure 5: Mapping of INBONIS's EU rating scale

Credit assessment	Initial mapping *based on quantitative factors* (CQS)	Final review *based on qualitative factors* (CQS)	Main reason for the mapping
AAA	1	1	
AA	1	1	
A	2	2	The quantitative factors are representative of the final CQS.
BBB	3	3	
BB	4	4	
B	5	5	
CCC	6	6	
CC	6	6	The meaning and relative position of the rating category is representative of the final CQS
C	6	6	
D	6	6	