



**Bank Austria
Creditanstalt**

HypoVereinsbank

**Comments of HVB Group
on the Consultation Paper**

**"Recognition of External Credit Assessment Institutions"
of the
CEBS (Committee of European Banking Supervisors)**

HVB Group welcomes the possibility to comment on the proposals of the green-book "Financial Services Policy 2005-2010".

HVB Group is Germany's second-largest private banking group, and with Bank Austria Creditanstalt the undisputed market leader in Austria. With more than 60,000 employees, 2,062 branches and 9.8 million customers we are the top providers of financial services in the heart of Europe, i.e. in our core markets of Germany, Austria, and in the fast-growing region of Central and Eastern Europe, where we have positioned ourselves as the leading banking network. In this context our operations focus on European retail and corporate customer business, complemented by capital market activities for our customers.

Further information on HVB Group is available at www.hvb.com.

HVB Group is pleased to provide its comments.

1. Recognition process

a. General principles

HVB Group welcomes the more detailed rules for the recognition of ECAIs by CEBS. In this connection we believe that the following general principles, in particular, will have a significant positive impact:

- Responsibility for the recognition process for, and the supervision of, ECAIs lies with the same authority which is responsible for the credit institutions (marginal note 10).
- Responsibility for assessing whether an ECAI's credit assessments are appropriate for risk weighting ultimately lies with the credit institution (marginal note 11).
- The competent authorities of the different Member States will adopt a single joint approach in cases where applications are received from more than one Member State (marginal note 16).
- Each competent authority is required to disclose an explanation of its recognition process and a list of eligible ECAIs (marginal note 19).

CEBS (marginal notes 13 and 21) requires an ECAI wishing to submit an application to demonstrate that at least one credit institution intends to use its credit assessments. This could impede the availability of eligible ECAIs. Companies and credit institutions will consider using ECAI's credit assessments only if the ECAI is eligible. Eligibility should be dependent on strict compliance with the criteria outlined in marginal notes 74-101. An ECAI should be deemed eligible if the supervisory authorities believe that these quality criteria have been fulfilled.

A further problematic issue is CEBS's assertion that credit institutions may not use the ratings of an ECAI which is itself a subsidiary of the credit institution (see marginal notes 14 and 90). In its consideration of this problem, CEBS has overlooked two important points:

- Art. 81 of the Directive states that the recognition requirements for the eligibility of an ECAI must be the rating method, objectivity, independence and

transparency. The Directive explicitly does not make this conditional on whether an external rating may or may not be given by subsidiary companies of the credit institution. In the absence of a specific rule, the outcome is open.

- A credit institution using the IRB approach is permitted to use an internal rating (see Art. 84). Pursuant to the Directive, an internal rating model may be used if the credit institution employs a system for the management and rating of its credit risks which is sound and implemented with integrity, and which in particular fulfils the requirements of Art. 84 (2), a) to e). In this connection item c is particularly interesting: it requires that a credit institution's risk management department has a sufficient degree of independence and that it is protected against being unduly influenced by other interests. The question of independence is consequently also considered to be a problem for internal rating, but it is presented as a problem that can be solved.

If one considers these two legal appraisals in the context of the above problem, the answer can only be that a credit institution can use the ratings of an ECAI which is a subsidiary of the credit institution if it can provide evidence that appropriate protective measures ensuring the independence of the rating are in place and are actually applied. While a per se appraisal as "dependent" is not justified, such an arrangement requires a rigorous mechanism to protect the credit institution's independence, and the mechanism must be disclosed.

b. Application

The right of application for recognition should be limited to ECAIs as these are party to the administrative procedure and ultimately also responsible for delivering the relevant documents to the competent authority (see marginal note 24). Such a regulation does not of course preclude the possibility for the credit institution to settle the administrative details for ECAI recognition instead of the ECAI itself. Limiting applicants to ECAIs would simplify the process, and the process could then be more easily handled from within another Member State.

HVB Group supports the classification into three main market segments: public finance, commercial entities and structured finance, and the requirement by CEBS that competent

authorities, in the application, be made aware of the jurisdictions in which recognition is sought if this involves more than one Member State. This will ensure adequate cooperation between the competent authorities. HVB Group is convinced that a homogenous and efficient application of Basel II implementation in the EU is assured only through efficient cooperation between the nationally competent authorities at a European level. The cooperation model proposed in the Consultation Paper makes an important contribution in this regard.

c. The form of recognition

Pursuant to Art. 81 (3) of the Directive, a rating agency which has already been recognised by the competent authority of a Member State can also be recognised in another Member State without the competent authority of this Member State having to carry out its own direct recognition process (ensuring a level playing field). HVB Group believes it would be expedient for the national supervisory authorities to reach agreement for this to become standard practice, and that an additional direct recognition process be initiated only under one of the following conditions:

- if the decision to recognise an ECAI gives the other Member State justified cause for concern (errors in the recognition process, insufficient information etc.),
- if the circumstances of ECAI have changed or if there are signs that this is the case, making a review of the situation necessary,
- the national conditions deviate from the case in respect of which the decision to recognise an ECAI has already been made to an extent which makes a separate recognition process mandatory.

d. The level of recognition

HVB Group supports the requirement of CEBS that a subsidiary from an ECAI group needs a separate application only if the group cannot demonstrate that the procedures and practices of the group can be adhered to by all subsidiaries without any material deviations. The term "material" should however be precisely defined.

The supervisory authorities should moreover prepare detailed interpretation criteria on behalf of CEBS, and they should in each case modify or review the criteria based on their experience of application procedures.

e. Application in more than one Member State

HVB Group welcomes the procedure developed by CEBS for cooperation between the national supervisory authorities. This could ensure the fulfilment of the requirements of the CRD in regard to both the direct and indirect recognition of ECAIs, while enabling the supervisory authorities to take decisions without losing any time. Details of course still need to be worked out.

The appointment of the process facilitator for example still needs to be clarified. An abstract selection procedure should already be available to avoid any disputes relating to competencies. This also applies to cases largely involving one Member State ("an ECAI operates predominantly in a single Member State") or where the converse applies.

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

a. Methodology

CEBS in large part succeeded very well in defining the material criteria of the recognition process. HVB Group would nonetheless like to make the following comments:

As already criticised under Point 1, the definition of the material criteria makes it more difficult for newcomers to enter the market. HVB Group is of course aware that a comprehensive track record and/or a good national or international reputation of the ECAI can facilitate the assessment process for the competent authorities, but it needs to be pointed out that newcomers must be given the possibility to have access to the market. Marginal note 75 makes this questionable and to a certain degree contradicts marginal note 85 which states that insufficient quantitative evidence to support the outputs can be compensated by a greater assessment of the methodological process.

To sum up, it should therefore be stated that the methodology should be seen to be in conformity with the Directive if either

1. The statistical evidence (not mandatory, only those of the company) suggests that the methodology used by the ECAIs accurately assesses the credit risk (precondition a), the ECAI itself consistently includes the risk-inducing factors (e.g. economic growth, raw material prices etc.) in its methodology and, if necessary, revises the methodology (precondition b), and finally, ECAI employs the methodology in a consistent manner (precondition c).

or

2. In the absence of statistical evidence for the reliability and accuracy of the methodological process, the methodology used, in addition to prerequisites b and c mentioned above, is recognised by the financial community as a legitimate method for credit assessment.

This should facilitate the establishment of ECAIs. Because such new ECAIs do not have a track record, the supervisory authorities will be required to assess the quality of the ECAIs on the basis of other criteria, analogous to the criteria for meeting the "Minimum Requirements for the IRB Approach" (Annex VII, Part 4 of the Directive). We also recommend more frequent and more precise monitoring of newly eligible ECAIs. This is also a requirement contained in marginal note 85.

b. Independence

HVB Group has already defined its position on "independence" in various parts of its comments on the Consultation Paper. It would like to supplement these comments with the following observation:

The question whether an ECAI is independent or not should always be decided on a case by case basis in line with general principles by the competent authorities. Neither the wording of the Directive nor the current market situation provide any indication that ECAIs are to be deemed to be independent merely because they are owned by the government, a major financial institution or a trading enterprise. We believe that it is much more important for an

ECAI to provide evidence of intact mechanisms which safeguard the independence of the persons handling the rating process. We believe that independence for the decision-making process and the resulting credit assessments should be safeguarded more than the independence of an ECAI (see Point 1.a. of our comments).

c. On-going review and transparency and disclosure

In items 1.3. and 1.4. of Annex VII, Part 2, the Directive describes in detail the on-going assessments of ECAIs and the requirement for transparency and disclosure. CEBS has fine-tuned this regulation. HVB Group supports the comments of CEBS without reservation.

3. Mapping

HVB Group welcomes the general principles for mapping, especially the fact that the mapping process does not impose any additional eligibility requirements on ECAIs (marginal note 118). The Group also supports the recommendation that the guidelines of the revised Basel II framework provided by the Basel Committee for Banking Supervision be used for benchmarking and monitoring ECAIs credit assessments (marginal note 119).