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# Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 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 (Text with EEA relevance)

## COMMISSION IMPLEMENTING REGULATION (EU) 2016/1799

## of 7 October 2016

## 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

## (Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms[(1)], and in particular the third subparagraph of Article 136(1) and the third subparagraph of Article 136(3) thereof,

Whereas:

(1) The provisions in this Regulation are closely linked, since they deal with the mapping of credit risk assessments with the exception of those assigned to securitisation positions. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by those subject to those obligations, it is desirable to include all the implementing technical standards required by Regulation (EU) No 575/2013 in relation to the mapping of credit risk assessments with the exception of those assigned to securitisation positions in a single Regulation.

(2) Article 136(1) of Regulation (EU) No 575/2013 requires the specification, for all External Credit Assessment Institutions (ECAIs), of the correspondence of the relevant credit assessments issued by an ECAI to the credit quality steps set out in Section 2 of that Regulation ('mapping'). ECAIs are credit rating agencies that are registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council[(2)] or a central bank issuing credit ratings which are exempt from the application of that Regulation.

(3) Certain similar terms and concepts used in Regulation (EC) No 1060/2009 and in Regulation (EU) No 575/2013 can be the subject of confusion. 'Credit assessment' is a term used under Regulation (EU) No 575/2013 to refer both to the 'labels' of the different categories of ratings by ECAIs, and to the assignment of one such rating to

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a particular item. However, points (h) and (a) of Article 3(1) of Regulation (EC) No 1060/2009 clearly distinguish between these two concepts with the use of the terms 'rating category' and 'credit rating', respectively. To avoid confusion, given the need to refer to these two particular concepts separately, and given the complementarity of the two Regulations, the terminology of Regulation (EC) No 1060/2009 should be used as more specific.

(4) Given that Article 4(1) of Regulation (EC) No 1060/2009 permits the use of credit ratings for regulatory purposes by credit institutions and investment firms only if issued by credit rating agencies established in the Union and registered or certified in accordance with that Regulation, the mapping of ECAIs credit assessments should cover credit assessments that comply with the definition of 'credit rating' according to point (a) of Article 3(1) of that Regulation. Further, given that by virtue of Article 136 of Regulation (EU) No 575/2013, a mapping is required for all ECAIs, the definition of which includes, by virtue of Article 4(98) of that Regulation also credit ratings produced by central banks exempted from the application of Regulation (EC) No 1060/2009, the mapping of ECAIs rating categories should also cover such credit ratings as well. Regulation (EU) No 575/2013 prevents the use of credit ratings for certain asset classes (such as equity) within the Standardised Approach. Therefore, with regards to assessments for fixed-income collective investment undertakings (CIUs), only those that solely depend on the credit quality of the underlying assets should be covered by the mapping of ECAIs' credit assessments.

(5) The mapping has the objective of assigning the appropriate risk weights of Regulation (EU) No 575/2013 to the rating categories of an ECAI. Therefore, it should be able to identify not only relative differences of risk but also the absolute levels of the risk of each rating category, ensuring appropriate levels of capital under the Standardised Approach.

(6) Given the wide range of methodologies across ECAIs, objectivity and consistency of the mapping methodology are key aspects for ensuring a level playing field for institutions as well as fairness of treatment for ECAIs. For this reason, when elaborating rules on the use of quantitative and qualitative factors and their comparison with the benchmark, it is necessary to build upon the previous regulatory framework, namely Part 3 of the 'Revised Guidelines on the recognition of External Credit Assessment Institutions' dated 30 November 2010, with a view to ensuring a smooth transition to the mapping set out in this Regulation. This would also ensure consistency with international standards in this area, reflected, in turn, in Annex 2 of the 'Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework — Comprehensive Version' dated June 2006.

(7) The default definitions used by ECAIs may differ from the one set forth in Article 178 of Regulation (EU) No 575/2013, as reflected in Regulation (EC) No 1060/2009 and Commission Delegated Regulation (EU) 2015/2[(3)]. Nevertheless, in order to ensure that the overall level of the capital required to externally rated exposures is not changed, the types of default events used for the calibration of the benchmark referred to in point

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(c) of Article 136(2) of Regulation (EU) No 575/2013 should be used as the default definition for the purposes of this Regulation.

(8) The mapping should be understood as the correspondence of the rating categories of an ECAI with a regulatory scale which has been defined for prudential purposes. Therefore it should be considered as a distinct concept from the one the European Securities and Markets Authority (ESMA) is required to provide in the form of a report, by virtue of Article 21(4b) of Regulation (EC) No 1060/2009 aiming at allowing investors to easily compare all credit ratings that exist with regard to a specific rated entity. Also for the purposes of this Regulation 'mapping' does not refer to mappings which are developed under other frameworks, such as the Eurosystem Credit Assessment Framework, as these may operate on different methodologies and definitions.

(9) A different mapping should be conducted for each relevant set of rating categories ('rating scale'). When the rating scale of an ECAI is the same across exposure classes, the mapping should not differ in order to guarantee the differentiation of risk weights across exposure classes established by Regulation (EU) No 575/2013. When an ECAI has several rating scales, the relationship established by the ECAI among them should be considered for the mapping.

(10) Unsolicited ratings, as referred to in point (x) of Article 3(1) of Regulation (EC) No 1060/2009, should be included in the mapping of an ECAI as long as these ratings can be used for regulatory purposes in accordance with Article 4(1) of Regulation (EC) No 1060/2009 and the European Banking Authority (EBA) has confirmed that they do not differ in quality from solicited credit ratings of this ECAI in accordance with Article 138 of Regulation (EU) No 575/2013.

(11) Both quantitative and qualitative factors should be used to produce a mapping, with the qualitative factors being considered in a second stage, as and when necessary and especially where quantitative factors are not adequate. As a result qualitative factors should assist in reviewing, correcting and enhancing any initial mapping done based on quantitative factors, where such review is justified and necessary. This two-step approach is required in order to contribute to the objectivity of the mapping and to ensure that the mapping actually represents the correspondence of the rating categories of an ECAI with a regulatory scale which has been defined for prudential purposes.

(12) 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 the quantitative factors for deriving the mapping should be relaxed. Updates to the mapping should be made whenever this becomes necessary to reflect quantitative information collected after the entry into force of the present Regulation.

(13) The default rate associated with items assigned the same rating category should be considered as the most representative quantitative factor, and should be calculated from default data corresponding to such items. Where sufficient default data corresponding to these items is not available, an estimate of the default rate should still be calculated on the basis of the opinion of the relevant ECAI and any default evidence associated with the items assigned the same rating category for which the mapping is being performed.

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(14) The calculation of the default rate should meet certain requirements in order to ensure that it is comparable across ECAIs. For example, it should be measured over a 3-year time horizon in order to allow the observation of a significant number of defaults when risk is very low and it should account for withdrawals to avoid an underestimation of risk. In addition, it should include neither public sector ratings nor issue ratings, given the scarcity of defaults for the former type of ratings, and to avoid biasing the default rates towards issuers with higher number of issues by using the latter ratings.

(15) Default rates should be calculated for each rating category to the extent possible over a long term and a short term observation period. The former should provide the basis for the mapping, whereas the latter should provide an early warning about a potential increase, or decrease, in the level of risk of the rating category. Where a sufficient number of credit ratings is not available, only the long run default rate should be calculated due to the high degree of uncertainty regarding the calculation of short run default rates. In this case, a warning about a potential increase in the level of risk of the rating category should be provided by the qualitative factors.

(16) The definition of default established by the ECAI to calculate the default rate associated with items assigned the same rating category is a key element of the mapping. A stricter definition of default may produce higher default rates compared to other less strict default definitions. Therefore the impact of the definition of default on the calculation of the default rate should be estimated in order to ensure an accurate mapping.

(17) When only scarce default data is available, the time horizon considered in a rating category should be taken into account for the purpose of the mapping to ensure consistency across ECAIs. Thus, where a short term horizon has been chosen, some items may qualify for a particular level of risk. However, these same items may represent a significantly different level of risk if evaluated over the 3-year time horizon chosen for the calculation of the default rate. This factor should be recognised and appropriately reflected in the mapping.

(18) The meaning of the rating category and its relative position within the rating scale should be especially helpful when there is no quantitative factor available and the mapping of adjacent rating category is known. For that purpose, credit quality steps should be characterised in terms of aspects such as the capacity of the issuer to meet its financial obligations, its sensitivity to the economic situation or its proximity to the default status.

(19) General risk drivers of the items assigned a rating category should also be taken into account. The size and the degree of activity diversification of the items assigned a rating category should be considered as relevant indicators of their underlying risk profile. It should also be possible to consider as qualitative factors other measures of creditworthiness assigned to items of the same rating category, in order to convey additional information with respect to the default behaviour of the relevant rating category. The relevance, objectivity and reliability of the different measures of creditworthiness should be carefully analysed before their application for the purpose of the mapping exercise.

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(20) With a view to ensuring consistency with international standards, the benchmarks of the long-run and short run default rates provided in the document 'Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework — Comprehensive Version' dated June 2006, should be used for the purpose of the mapping exercise. However, more detailed rules should be provided to account for the variety of ECAIs that currently operate in the EU market and whose default rates may significantly deviate from the pattern of the international ECAIs underlying the current benchmark. More concretely, the long-run benchmark should be defined in terms of intervals to acknowledge that a range of values can be compatible with each credit quality step.

(21) Rating categories should be initially mapped to a credit quality step based on the comparison of their long-run default rate with the long-run benchmark and the information provided by the qualitative factors.

(22) Pursuant to Article 136(1) second subparagraph of Regulation (EU) No 575/2013 the adequacy of the mapping should be reviewed frequently because the long-run default rate could change and become representative of a different credit quality step. To that end, recent short run default rates experienced within a rating category should be regularly confronted with their relevant short run benchmarks ('monitoring' and 'trigger' levels). A breach of the short run benchmarks for a consecutive period of 2 years could signal a weakening of assessment standards which could imply that the new underlying long-run default rate is representative of a less favourable credit quality step. This signal would be more relevant where the trigger level is breached instead of the monitoring level. In particular, a single defaulted item associated with the highest rating categories could trigger consideration of the review of the mapping assigned to the single ECAI that rated that item.

(23) Revised draft implementing technical standards should be submitted where necessary to include newly established ECAIs in the mapping.

(24) Given that compliance with Regulation (EU) No 575/2013 is required at all times, it is necessary to monitor the performance of the mappings on a continuous basis.

(25) This Regulation is based on the draft implementing technical standards submitted by EBA, ESMA and European Insurance and Occupational Pensions Authority (EIOPA) jointly (the 'European Supervisory Authorities (ESAs)') to the Commission.

(26) On 29 March 2016, the Commission notified the Joint Committee of the ESAs of its intention to endorse the draft implementing technical standards with amendments in order to ensure a balance between a solid prudential approach and the need to avoid further concentration in an already very concentrated credit rating market dominated by three large ECAIs with a combined market share of around 90 %. In its notification, the Commission highlighted in particular the need to avoid the automatic application after 3 years of a more conservative mapping to all ECAIs which did not produced sufficient ratings and irrespective of the quality of their ratings, as this approach would risk to create a regulatory barrier to market entry and undermine the competitive position of smaller/newer ECAIs simply because they do not produce as many ratings as large