



European
Commission

Study on the Feasibility of Alternatives to Credit Ratings

Annexes to Final Report

December 2015

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EUROPEAN COMMISSION

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

doi:10.2874/345030

ISBN: 978-92-79-57553-2

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Annex 2 List of interviewees

Profile	Organisation name
Within Europe	
Asset management company	Amundi
	APG Asset Management
	AXA Investment Managers
	Groupama Asset Management
	NLB Funds
	NN Investment Partners
	Nordea Investment Management
	Pioneer Investments
	UniCredit
	Union Investment
	Association (asset management)
AFG- Association Française de la Gestion Financière	
ASSOGESTIONI	
Austrian Association of Investment Fund Management Companies (VÖIG)	
Cyprus Investment Fund Association	
EFAMA - European Fund and Asset Management Association	
Association (banks)	
	EACB
	German Banking Industry Committee
	Swedish Banking Association
Association (Corporate issuers)	AEP
	EACT
	The Association of Corporate Treasurers
Association (Insurance)	ANIA -- Associazione Nazionale fra le Imprese Assicuratrici
	AMICE
	Assuralia, union professionnelle des entreprises d'assurances
	Fédération française des sociétés d'Assurance
	German Insurance Association (GDV)
	Insurance Europe
	UNESPA – Unión Española de Entidades Aseguradoras

Profile	Organisation name
	y Reaseguradoras
Association (investors)	Af2i
	Dutch Investors' Association VEB
Association (pension funds)	Agirc and Arrco
	APFIPP – Associação Portuguesa de Fundos de Investimento, Pensões e Patrimónios
	BVPI-ABIP-BAPI
Association (real estate investor)	Commercial Real Estate Finance Council (CREFC)
	INREV
Bank	Baader Bank AG
	BBVA
	Deutsche Bank
	Erste Group Bank AG
	Santander
	SFIL (Société de Financement Local)
	Sparbanken Skåne (the Savings Bank Skane)
CCP	Eurex clearing
Consumer Credit Information Suppliers	ACCIS
Insurance / Re-Insurance company	Aegon
	AG insurance
	Allianz
	Merkur and Metis Invest
	Swiss Re
Investment and Pension Fund	Inverco Member 1
	Inverco Member 2
	Inverco Member 3
	Spanish Association of Investment and Pension Funds INVERCO
Other (CSO)	Credit Utility
	Finance Watch
Other (Financial sector trade union)	FINANSFORBUNDET /Uni Europa Finance
Other (Information provider user group)	SIPUG
Other (Private Placement Initiative)	Paris IDF Chamber of Commerce and Industry

Profile	Organisation name
Pension fund	VIG
Regulator (international)	IOSCO Committee 3 / Securities and Futures Commission of Hong Kong
	IOSCO Committee 5 / AMF France
Sectoral competent authority	Securities and Futures Commission of Hong Kong
	AMF
	ESMA
In the US	
US / EU Association (asset management)	ICI Global
US Asset management company	Federated
US Association (asset management)	Securities Industry and Financial Markets Association (SIFMA)
US association (banks)	American Bankers Association
US association (insurance)	American Insurance Association
	Reinsurance Association of America
US regulator (banks)	FDIC
US regulator (insurance)	NAIC

Annex 3 Final set of research tools

Discussion topics – IOSCO Committee 3

Sound Practices at large intermediaries: Alternatives to the use of credit ratings to assess creditworthiness

IOSCO recently closed a consultation on sound practices implemented by broker dealers. The final report is expected to be published by Q1 2016, though the consultation report from May 2015¹ provides already some headline findings

- We understand from the consultation paper that major intermediaries have already developed internal credit assessment systems and do not rely mechanistically on external credit ratings. But to which extent are the draft good practices already implemented on the ground?
 - E.g. How common is it that the independent credit assessment function is clearly separated from other business units?
 - How frequent it is to incorporate qualitative benchmarks in internal markets?
- Are some good practices more challenging in implementation than others for the market participants?
- Is there a broad consensus among market participants regarding suitability and feasibility of suggested practices, or some market participants are still sceptical for one or another reason?
- How suitable are good practices for small market participants who are more constrained by costs/ know-how/ capacity to extract publically available information?
- Will it be significantly more difficult for some type of market participants (i.e. insurance companies, pension funds) / jurisdictions (i.e. EU versus US) to implement suggested practices?

Wider perspectives

- Have you noticed any material changes in terms of reduction of reliance on external credit ratings/ increase take-up of alternatives over last few years?
- How well Europe is placed compared to other jurisdictions in terms of reducing overreliance?
- In the US, have the changes introduced following to the adoption of the Dodd-Frank Act made a substantial difference? In which areas?
- What is your understanding of the main alternatives to credit ratings?
- Are there alternatives that are equally suitable for small and large market participants?
- What are the main challenges preventing large intermediaries from further using alternatives to external credit ratings/ from further reducing contractual reliance on external credit ratings?
- One often quoted limiting factor for the adoption of alternatives is the lack of available information (especially for structured finance products). Would you agree with that? In this instances, would it be considered as a sound practice to still rely on external ratings? On which sources of information are the external ratings based?

¹ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD486.pdf>

- In which cases, complete removal of references to external ratings would not be: (i) desirable, (ii) feasible and for which reasons?
- What are the specific areas (i.e. transaction in specific asset classes) where overreliance is still a significant issue?

Further sources of information

- Any relevant research or work that we could draw upon?
- By when can the individual consultation responses be expected to be made available on IOSCO's website?

Discussion topics – IOSCO Committee 5

Good Practices on Reducing Reliance on CRAs in Asset Management

IOSCO recently published a set of Good Practices on Reducing Reliance on CRAs in Asset Management².

- To which extent are these good practices already implemented on the ground?
- Are some good practices more challenging in implementation than others for the market participants?
- Is there a broad consensus among market participants regarding suitability and feasibility of suggested practices, or some market participants are still sceptical for one or another reason?
- Will it be significantly more difficult for some type of market participants (i.e. smaller asset management companies) / jurisdictions (i.e. EU versus US) to implement suggested practices?
- Compared to other sectors, is asset management a sector where overreliance on credit ratings is particularly widespread? Why?
- In the asset management sector, is contractual reliance a more important driver than regulatory demands? Is this a characteristic which is unique to this sector?

Wider perspectives

- Have you noticed any material changes in terms of reduction of reliance on external credit ratings/ increase take-up of alternatives over last few years?
- How well Europe is placed compared to other jurisdictions in terms of reducing overreliance?
- In the US, have the changes introduced following to the adoption of the Dodd-Frank Act made a substantial difference? In which areas?
- What are the main alternatives to credit ratings?
- What are the main challenges preventing the asset management sector from further using alternatives to external credit ratings/ from further reducing contractual reliance on external credit ratings?
- What are the specific areas (i.e. transaction in specific asset classes) where overreliance is still a significant issue?
- In which cases, complete removal of references to external ratings would not be: (i) desirable, (ii) feasible and for which reasons?
- In the asset management sector, the use of external ratings is often justified by the need to have "a common language". However, we have also read that ratings are ordinal measures which imply that risk levels associated to a particular rating varies over time, and across asset type (e.g. investing in a AAA structured financed instrument is more risky than investing in AAA sub-sovereign security). Are investors fully aware of that limitation? Are there any other benchmarks which could at least equally well fill in the same "common language" function?

Further sources of information

- Any relevant research or work that we could draw upon?
- Have the individual consultation responses already been made available on IOSCO's website?

² <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD488.pdf>

Discussion topics – ESMA

Insights from ESMA study (Study outlining alternatives to external credit ratings in creditworthiness Assessments)

The discussion paper (The Use of Credit Ratings by Financial Intermediaries- Article 5(a) of the CRA Regulation) painted a preliminary overview of the use of credit ratings by profile of users as well as their use of alternatives and the current limitations to their adoption, based on an initial input provided by the SCAs.

- What is the outcome of the consultation process? Did the actors generally agree with the preliminary portrait painted in the discussion paper? Would there be any difference worth highlighting?
- Has the study found evidence that the market players do over-rely on credit ratings? For which purposes? Has the study found evidence of any material changes in terms of reduction of reliance on external credit ratings/ increase take-up of alternatives?
- Were contractual provisions found to be the main driver to over-rely on ratings?
- Based on the study, what alternatives are currently being used by the industry in lieu of / in complement to external credit ratings? How commonly?
- Did the study identify any alternatives that are still not used in the market but have the potential for considerable take-up?
- Advantages and disadvantages of these alternatives vis-à-vis external credit ratings.
- Challenges in promoting alternatives
 - What are the main challenges preventing your SCAs / market players from using alternatives to external credit ratings?
 - What are the main challenges preventing SCAs / market players from reducing contractual reliance on external credit ratings?
- Based on the results of the study, what further actions should be taken to further reduce mechanistic reliance on external credit ratings in contracts? Would those actions be supported by regulators / market players? Why?
 - Prompts:
 - Would the prohibition of rating triggers be considered as a proportionate option?
 - What other requirements are regarded as desirable? (Disclosure of rating triggers towards the markets? Disclosure of rating triggers towards rating agencies? Other requirements?)
- Are there any industry standards, laws and/or regulation applicable to your industry that still contain references to external credit ratings that could be viewed as “sole and mechanistic”?

ESMA’s action to address overreliance on credit ratings

Based on our understanding, ESMA’s action, together with the other ESAs, rested on two pillars in terms of addressing overreliance on credit ratings:

- Trying to address regulatory overreliance on credit ratings, and
- Assisting SCAs with reducing market recourse to external ratings.

In terms of (i), the ESAs published their Final Report on Mechanistic references to credit ratings in the ESAs’ guidelines and recommendations in 2014. It identified three sets of guidelines and recommendations which still contain references to ratings which

are considered as sole or mechanistic, namely: the guidelines detailing how CRR/CRD IV should be implemented, the MMF Guidelines and the upcoming Solvency II regulation.

- Is there any action foreseen to remove these remaining references? In terms of (ii), we extensively discussed the discussion paper and the upcoming study.
- Is there any follow up action foreseen based on the results the study? Any other action planned?

Practical help with research

- Any relevant research or work that we could draw upon?
- Any advice on how best to approach regulators / market players based on your experience with similar exercise
- Any contacts you could provide

Discussion topics – Industry associations

Section 1: Current use of external ratings by industry

1. The use of ratings due to legislative requirements

- To what extent is the use of external ratings by market participants still being driven by regulatory requirements and how?
- Please indicate for which legislative obligation you employ external credit ratings?
- Does the legislation allow for alternative approaches to the use of external credit ratings?
- If yes, explain why you choose to employ or not the available alternatives?

2. the use of credit ratings for other purposes:

- To what extent do businesses in your industry use external credit ratings and for what purposes?
 - To make investment/ lending decisions
 - To monitor and manage portfolio risk
 - To determine eligibility and value of collateral
 - To access capital markets
 - To determine haircuts
 - In financial contracts e.g. loan contracts, contractual agreements
 - Other
- To what extent are references to external credit ratings present in financial contracts? What is the nature of these contractual references?
- Where external ratings are used, would it be standard industry practice to also conduct internal analysis of the underlying methodologies of the external ratings? And / or to complement it with other sources of information/additional internal assessment?
- Do businesses in your industry use mechanistic links to external credit ratings in their contracts? If yes, do contracts typically refer to the 'big three' CRAs or do they use generic references to ratings? What are the reasons for such mechanistic links? What do you understand by "sole and mechanistic" reliance?
- Are those external credit ratings mainly produced by the 'Big credit rating agencies (Standard & Poor's, Moody's, and Fitch) or do you also employ credit ratings with a smaller market share?

Section 1bis: efforts to reduce mechanistic reliance on external credit ratings

- What action has been taken by the industry to reduce mechanistic reliance on external credit ratings in contracts over the last few years?
- Have you noticed any material changes in terms of reduction of reliance on external credit ratings among your members over the last few years? Please explain
- What are the main challenges preventing your industry from reducing contractual reliance on external credit ratings?
- Has your supervisor taken any steps to reduce mechanistic reliance on external credit ratings or incentives the use of alternatives?

Section 2: Alternatives to external credit ratings

- What alternatives are currently being used by the industry in lieu of / in complement to external credit ratings? How commonly?
- Are there any alternatives that are currently not used in the market, but have the potential for considerable take-up?
- Feasibility of implementing these alternatives

<p>Technical considerations / Effectiveness</p>	<p>Ease of use/ interpretation Mitigation of negative effects such as pro-cyclicality Does it facilitate comparability/ ranking of different investments Does it provide a common language External transparency Availability to market participants Applicability to different products (corporate debt, sovereign debt, structured finance products) Ability of the alternative to mitigate the conflict of interest problem Reliability Accuracy</p>
<p>Operational considerations</p>	<p>Know-how required to produce the rating What is the incentive to produce quality? How is the rating/assessment evaluated and by whom? Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended</p>
<p>Market acceptance</p>	<p>Market participants' willingness to accept and use the credit rating alternative?</p>
<p>Regulatory considerations</p>	<p>Acceptability of alternative to Regulator</p>
<p>Costs</p>	<p>The costs involved in implementing the alternative</p>

- Have you noticed any material changes in terms of the take-up of alternatives among your members over last few years? Please explain
- What are the main challenges preventing your industry from using alternatives to external credit ratings?

Section 3: Any other comments

- Is there anything else that you would like to add that we have not touched upon?

Section 4: Practical help with research

- Any relevant research or work that we could draw upon?
- Way forward to approach your members

Discussion topics – Market participants (asset owners/ investors)

- For what purposes does your organisation use external ratings? Examples: to set credit risk policy limits in investment mandates / financial contracts?
- To what extent are references to external credit ratings applied in financial contracts by your organisation?
- Do financial contracts contain specific references to ratings produced by the 'big three' (S&P, Moody's, Fitch) or to credit ratings/ credit risk assessment more generally?
- What are the main reasons for using external ratings in contractual agreements? Are there any regulatory drivers obligating / encouraging your sector to rely on external ratings?
- Are there elements in your contractual agreements to prevent sole and mechanistic reliance on external ratings? Examples: the use of dual or multiple credit ratings; use of interval ratings, supplemented by external credit ratings
- Does your organisation encourage asset/ investment managers to make their own credit risk assessment and to perform due diligence?
- Are there elements in your contractual agreements that mitigate the potential risks of sole and mechanistic reliance on external ratings (such as the so called "cliff effects" or widespread sales of downgraded instruments) e.g. introduction of grace periods in trigger clauses
- What in your view are the main advantages and disadvantages of using external ratings in financial contracts?
- Since the financial crisis has your sectoral competent authority / your industry association / your organisation, taken any measures to reduce contractual references to external ratings?
- Does your organisation use or has considered using alternatives to external credit ratings in financial contracts? If so, which ones?
- Feasibility of implementing these "alternatives"

Technical considerations / Effectiveness	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
Operational considerations	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
Market acceptance	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
Regulatory considerations	<ul style="list-style-type: none"> • Acceptability of alternative to Regulator
Costs	<ul style="list-style-type: none"> • The costs involved in implementing the alternative

- Would an increased use of alternatives to external ratings be considered by you as: (i) desirable, (ii) feasible and if so, why?
- What are the main challenges preventing your organisation from (i) further reducing contractual references to external credit ratings? (ii) from further using alternatives to external credit ratings?
- Is there anything else that you would like to add to what we have already discussed?

Discussion topics – Market participants (asset managers /financial intermediaries)

1. About your organisation

1.1 Investment activities of your organisation

1.2 Types of products that your organisation invests in:

- Sovereign debt
- Sub-sovereign debt
- Corporate debt
- Structured finance products

1.3 What proportion of your investment portfolio represents (a) externally rated instruments and (b) unrated instruments?

2. Your organisation's overall approach to assessing and reviewing the credit risk of various financial products and counterparties

2.1 How is the credit risk assessment function organised?

For example, is the credit risk assessment function housed within a dedicated department such as risk management, credit research, or credit risk management or is it integrated within the team managing the investment portfolio?

2.2 Could you please describe your organisation's approach to assessing credit risk of financial products and counterparties?

Examples of different approaches:

- Whether your organisation exclusively uses Credit Rating Agency (CRA) ratings to assess creditworthiness
- Whether your organisation primarily uses CRA ratings to assess creditworthiness, but supplements external ratings with internal analysis.
- Whether your organisation uses CRA ratings, but adjusts these based upon its own internal analysis
- Whether your organisation has fully developed in-house capabilities and technical expertise to assess credit risk and counterparty creditworthiness. External ratings are only used to cross-check the results of the internal analysis
- Whether your organisation has constructed credit risk scoring models by integrating data from various sources (external ratings, publicly available information, market indicators and information gathered through client relationships etc)
- Other

2.3 What is your organisation's approach to credit risk assessment/management at different stages of the investment cycle?

- When making a decision to invest
- When monitoring/ managing investment

2.4 Does your organisation's approach to credit risk assessment vary by product type? If so, could you please explain how?

- Sovereign debt
- Sub-sovereign debt

- Corporate debt
- Structured finance

3. Approach to internal credit risk assessment 3.1 What types of data are used by your organisation for internal credit risk assessment?

- Financial statements/ indicators including balance sheet, cash flow statements, debt servicing capability, capital adequacy and liquidity.
- Historical losses data
- Modelling of expected losses data
- Macroeconomic and microeconomic indicators – e.g. expected interest rates, exchange rate, and economic situation trends, GDP growth rate.
- Market data – e.g. credit default swaps, bond spreads, share prices etc.
- Qualitative information such as
 - management and auditor quality etc.
 - the general business profile, including an issuer's or counterparty's market share, the regulatory environment, competitive position (SWOT analysis)
 - organisational structure
- Other

3.2 Where are the data sourced from?

- Directly from the issuer/ counterparty
- Publicly available sources
- Specialised information sources e.g. Reuters, Dun & Bradstreet
- Client interactions

3.3 Does your organisation uses computational models to assess risk?

- If so, are these
 - Bespoke/ proprietary models?
 - Vendor based solutions?

4. Use of third party assessments

4.1 Which third party assessments/ ratings does your organisation normally use for the different types of financial products that it invests in?

- Ratings/ assessments produced by Central Banks
- Ratings produced by big 3 Credit Rating Agencies (S&P, Moody's, Fitch)
- Ratings produced by smaller/ niche players (explore which ones)
- Others

4.2 Where external ratings are used, would it be standard industry practice to also conduct internal analysis/ due diligence of the underlying methodologies of the external ratings?

4.3 For what purposes are external ratings used?

- To make investment/ lending decisions

- Monitoring and managing portfolio risk
- To determine regulatory capital requirements
- To determine eligibility and value of collateral
- Other

4.4 What weight does your organisation/ department attribute to external (CRA) ratings in its assessment of credit risk of the different types of financial products?

4.5 How does your organisation deal with any differences in results of internal analysis and external ratings?

5. Regulatory references to external ratings

5.1 To what extent is the use of external ratings driven by regulatory requirements? What are the specific requirements imposed by regulators that oblige you to use external ratings?

5.2 Are there any industry standards, laws and/or regulation applicable to your industry that still contain references to external credit ratings that could be viewed as "sole and mechanistic"?

5.3 Based on your knowledge, have sectoral authority responsible for supervising your sector/ relevant regulators taken any action / measure to reduce mechanistic reliance on external credit ratings in contracts over the last few years? Have these been effective on the ground?

6. Contractual references to ratings

6.1 What type of references to ratings exist in

- Investment guidelines/ mandates?
- Other forms of contracts?

6.2 Do contracts specifically refer to external ratings? Are these references specifically to ratings produced by big three?

6.3 Do these contractual references promote "sole and mechanistic" reliance on external ratings?

7. Changes implemented by your organisation since the financial crisis

7.7 Since the financial crisis has your organisation

- Changed its approach to credit risk assessment?
- Taken measures to reduce contractual references to external ratings?

8. Feasibility of alternatives to external ratings

8.1 What is your understanding of alternatives to external credit ratings? Are these internal only or can these alternatives include market based measures?

8.2 Feasibility of implementing alternatives to external ratings

Technical considerations / Effectiveness	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
Operational considerations	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
Market acceptance	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
Regulatory considerations	Acceptability of alternative to Regulator
Costs	<ul style="list-style-type: none"> • The costs involved in implementing the alternative

8.3 What are the main challenges preventing your organisation from (i) further reducing contractual overreliance on external credit ratings? (ii) from further using alternatives to external credit ratings?

e.g Costs, data availability, client preferences etc.

8.4 Would an increased use of these alternatives to external be considered by you as: (i) desirable, (ii) feasible and if so, why?

8.5 Even in the absence of alternatives, what other measures / changes could be introduced to mitigate the risk of contractual over-reliance on external ratings?

- *e.g. introduction of grace periods in trigger clauses*

Closing remarks

Is there anything else that you would like to add to what we have already discussed?

Discussion topics – Central counterparties

Section 1: Credit risk assessment undertaken by your organisation

For which of the following purposes does your organisation conduct credit risk assessments?

- To assess the creditworthiness of members/ counterparties
- To determine eligibility of collateral
- To determine the size of the haircuts / initial margin requirements
- Others – please specify

Section 2: Post-crisis regulatory developments

- We are aware that since end 2012, CCPs are required by EMIR³ and the related Regulatory Technical Standards (RTS⁴) to employ “defined and objective methodologies” based on “adequate internal assessment” and which does not fully or solely “rely on external opinions”.
- What changes have been introduced in your organisation in response to these requirements? Specifically, what methodologies has your organisation developed and how has it changed its practice/ approach to credit risk assessment

What have been the major challenges in implementing these requirements?

What have been the major benefits of the changes introduced?

Sections 3: Role of external ratings

To what extent are external ratings still used in credit risk assessment? How are external ratings used?

For example:

- *External ratings are used as an input to internal credit risk scoring models* which are based on data integrated from various sources (external ratings, publicly available information, market indicators and information gathered through client relationships etc)
- *External ratings are only used as a reference point* and to cross-check the results of the internal analysis
- *External ratings are not used at all*
- Other approach – please describe

What weight is typically assigned to external ratings in the credit risk assessments conducted by your organisation?

Which third party assessments/ ratings does your organisation normally use?

- Ratings/ assessments produced by Central Banks
- Ratings produced by big 3 Credit Rating Agencies (S&P, Moody's, Fitch)
- Ratings produced by smaller/ niche players (explore which ones)
- Others

³ REGULATION (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

⁴ COMMISSION DELEGATED REGULATION (EU) No 153/2013 of 19 December 2013 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties

How does your organisation deal with any differences in results of internal analysis and external ratings?

Section 4: Approach to internal credit risk assessment

What types of data are used by your organisation for internal credit risk assessment?

- Financial statements/ indicators including balance sheet, cash flow statements, debt servicing capability, capital adequacy and liquidity
- Historical losses data
- Modelling of expected losses data
- Macroeconomic and microeconomic indicators – e.g. expected interest rates, exchange rate, and economic situation trends, GDP growth rate.
- Market data – e.g. credit default swaps, bond spreads, share prices etc.
- Qualitative information such as
 - management and auditor quality etc.
 - the general business profile, including an issuer's or counterparty's market share, the regulatory environment, competitive position (SWOT analysis)
 - organisational structure
 - Other

Where are the data sourced from?

- Directly from the issuer/ counterparty
- Publicly available sources
- Specialised information sources e.g. Reuters, Dun & Bradstreet
- Client interactions

Does your organisation uses computational models to assess risk?

- If so, are these
 - Bespoke/ proprietary models?
 - Vendor based solutions?

Section 5: Contractual references to ratings

How are ratings applied in financial contracts? E.g. trigger clauses

Do contracts specifically refer to internal or external ratings? In case of latter, are these references specifically to ratings produced by big three?

Section 6: Feasibility of alternatives to external ratings

What is your understanding of alternatives to external credit ratings? Are these internal only or can these alternatives include market based measures?

What are you views on the feasibility of replacing external ratings with alternative?

<p>Technical considerations / Effectiveness</p>	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
<p>Operational considerations</p>	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
<p>Market acceptance</p>	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
<p>Regulatory considerations</p>	<p>Acceptability of alternative to Regulator</p>
<p>Costs</p>	<ul style="list-style-type: none"> • The costs involved in implementing the alternative

What are the main challenges preventing your organisation from further using alternatives to external credit ratings?

e.g Costs, data availability, market preferences etc.

Would an increased use of these alternatives to external be considered by you as: (i) desirable, (ii) feasible and if so, why?

Even in the absence of alternatives, what other measures / changes could be introduced to mitigate the risk of over-reliance on external ratings?

Closing remarks

Is there anything else that you would like to add to what we have already discussed?

Discussion topics – Association of corporate issuers

Section 1: About your organisation

- Types of products that your members issue:
 - Corporate debt
 - Structured finance products
- Your members' financing needs
 - What proportion of your members' financing needs are covered by (a) banks and (b) the markets? *Explore differences by sector, size, region*
 - To which extent do they depend on ratings? Is the dependency particularly pronounced for certain profiles?

Section 2: Current use of external ratings and cooperation with credit rating agencies

- From how many credit rating agencies do your members typically solicit ratings?
- Do they solicit mainly the 'Big Three' credit rating agencies (Standard & Poor's, Moody's, and Fitch)?
- Are unsolicited ratings related to the products your members issue frequently made available?
- What are the benefits from external credit ratings from an issuer perspective? Do all benefits relate to the following interlinked benefits: reducing the asymmetry of information between issuers and investors, reducing the information costs, increasing the number of potential borrowers and promoting liquid markets?
- Have your members already reported drawbacks from an overreliance on external credit ratings?
- To which extent are hired credit rating agencies provided access to non-public information?
- What determines the extent to which non-public information is shared with the credit rating agency?
- Over the recent years, have your members been subject increased disclosure requirements: (a) towards credit rating agencies? (b) publicly?

Section 3: Feasibility of alternatives to external ratings

- What is your understanding of alternatives to external credit ratings? Are these internal only or can these alternatives include market based measures?
- Feasibility of implementing alternatives to external ratings

Technical considerations / Effectiveness	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
Operational considerations	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
Market acceptance	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
Regulatory considerations	Acceptability of alternative to Regulator
Costs	<ul style="list-style-type: none"> • The costs involved in implementing the alternative

- Would an increased use of these alternatives to external credit ratings be considered by your members as: (i) desirable, (ii) feasible and if so, why?
- Even in the absence of alternatives, what other measures / changes could be introduced to mitigate the risk of contractual over-reliance on external ratings?

Closing remarks

- Is there anything else that you would like to add to what we have already discussed?
- Any relevant research or work that we could draw upon?
- Way forward to approach your members

Discussion topics – US federal agencies

1. Role of the agency

- Which of the following sectors are you supervising/ regulating?
 - credit institutions
 - investment firms
 - insurance / reinsurance undertakings
 - institutions for occupational retirement provision
 - management companies
 - investment companies
 - alternative investment fund managers
 - central counterparties and prospectuses

2. Steps taken following the adoption of the Dodd Frank Act

- Following the adoption of the Dodd Frank Act, have you modified existing regulation or adopted new rules to remove references to credit ratings?
- What is the status of those modifications (e.g. final vs proposed rules)?
- Do some of the references to external credit ratings still remain? In which pieces of legislation? On which criteria have you prioritized your work when removing references?
- Does the modified/ new regulation specify the alternative approaches to be used by market participants in lieu of external credit ratings?
- Have these changes in regulation been effective on the ground? Have market participants changed their approach to creditworthiness assessment as a result? Please explain
- Have those changes had any significant impact for your work as a supervisor (e.g. need to allocate extra resources to monitor the adequacy of the credit risk assessment processes among supervised entities)
- Beyond removing references to external credit ratings in key pieces of legislation, have you taken other steps to reduce over-reliance on credit ratings in your sector over the last few years?

3. The use of external credit ratings by market participants

- To what extent are market participants in your sector using references to CRA ratings in their financial contracts (e.g investment mandates, loan covenants, collateral agreements) and in what ways?
 - Do contracts tend to include specific references to ratings produced by the 'big three' rating agencies (Standard & Poor's, Moody's, and Fitch)?
- What are the main reasons for using external ratings in financial contracts?
- What measures are typically used by supervised entities to limit or mitigate the risk of sole and mechanistic reliance on credit ratings in contracts?
- What are the main challenges preventing your supervised entities from further reducing contractual overreliance on external credit ratings?
- What further actions could be taken to further reduce mechanistic reliance on external credit ratings in contracts? Would those actions be supported by market players? Why?

- For example, would the prohibition of rating triggers be considered as a proportionate option?
- Which good practices could be further promoted?
- Should the emphasis be on implementing measures to reduce mechanistic reliance and/or on the promotion of alternatives?
- In which cases would complete removal of regulatory or contractual references to external ratings not be: (i) desirable, (ii) feasible and why?
- Aside from contracts, for what other purposes do supervised entities in your sector use external ratings e.g. access to capital markets, access to funding from money markets, determine haircuts, to meet capital requirements etc.?

4. Alternatives to external credit ratings

- In your particular sector, which alternatives could potentially replace or reduce the use of external credit ratings?
- What alternatives are currently being used by your sector in lieu of / in complement to external credit ratings? How commonly?
- Feasibility of implementing alternatives:

Technical considerations / Effectiveness	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
Operational considerations	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
Market acceptance	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
Regulatory considerations	Acceptability of alternative to Regulator
Costs	<ul style="list-style-type: none"> • The costs involved in implementing the alternative

- What are the main challenges preventing your industry from using alternatives to external credit ratings
- Are there any specificities of your sector that make it more difficult for market participants to use alternatives to external credit ratings?

5. Any other comments

- Is there anything else that you would like to add that we have not touched upon?

6. Relevant research/ studies and contacts

- Could you please share any relevant research or studies your organisation might have commissioned on the topic
- Relevant contact persons within your organisation/ sector

Discussion topics – US industry associations

Introduction about your organisation

Section 1: US Regulatory context and recent market developments

- Which federal agencies have the responsibility for regulating and supervising your sector?
- Following the adoption of the Dodd Frank Act, how have the federal agencies regulating your sector(s) modified existing regulation or adopted new rules to remove references to, or reliance upon, credit ratings?
- Does the modified/ new regulation specify the alternatives approaches to be used by market participants in lieu of external credit ratings?
- Have you noticed any material changes in terms of the take-up of alternatives as a result? Please explain

Section 2: Market practices: the use of alternatives

- What alternatives are currently being used by the industry in lieu of / in complement to external credit ratings? How commonly?
- Could you please provide us with the following information on the various alternatives that you have just mentioned

Technical considerations / Effectiveness	<ul style="list-style-type: none"> • Ease of use/ interpretation • Mitigation of negative effects such as pro-cyclicality • Does it facilitate comparability/ ranking of different investments • Does it provide a common language • External transparency • Availability to market participants • Applicability to different products (corporate debt, sovereign debt, structured finance products) • Ability of the alternative to mitigate the conflict of interest problem • Reliability • Accuracy
Operational considerations	<ul style="list-style-type: none"> • Know-how required to produce the rating • What is the incentive to produce quality? • How is the rating/assessment evaluated and by whom? • Would the alternative provide for an independent internal control function and what external oversight does the alternative provide to ensure it is working as intended
Market acceptance	<ul style="list-style-type: none"> • Market participants' willingness to accept and use the credit rating alternative?
Regulatory considerations	Acceptability of alternative to Regulator

Costs	<ul style="list-style-type: none">• The costs involved in implementing the alternative
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- Are there any other alternatives that are currently not used in the market, but have the potential for considerable take-up?
- What are the main challenges preventing your industry from using alternatives to external credit ratings?

Section 3: General questions regarding the role of external credit ratings

1. The use of ratings due to legislative requirements

- To what extent is the use of external ratings by market participants still being driven by regulatory requirements and how?
- Please indicate for which legislative obligation you employ external credit ratings?
- Does the legislation allow for alternative approaches to the use of external credit ratings?
- If yes, explain why you choose to employ or not the available alternatives?

2. The use of credit ratings for other purposes:

- To what extent do businesses in your industry use external credit ratings and for what purposes?
 - To make investment/ lending decisions
 - To monitor and manage portfolio risk
 - To determine eligibility and value of collateral
 - To access capital markets
 - To determine haircuts
 - In financial contracts e.g. loan contracts, contractual agreements
 - Other
- To what extent are references to external credit ratings present in financial contracts? What is the nature of these contractual references?
- Where external ratings are used, would it be standard industry practice to also conduct internal analysis of the underlying methodologies of the external ratings? And / or to complement it with other sources of information/additional internal assessment?
- Do businesses in your industry use mechanistic links to external credit ratings in their contracts? If yes, do contracts typically refer to the 'big three' CRAs or do they use generic references to ratings? What are the reasons for such mechanistic links? What do you understand by "sole and mechanistic" reliance?
- Are those external credit ratings mainly produced by the 'Big credit rating agencies (Standard & Poor's, Moody's, and Fitch) or do you also employ credit ratings with a smaller market share?

Section 5: Any other comments

- Is there anything else that you would like to add that we have not touched upon?

Section 6: Practical help with research

- Any relevant research or work that we could draw upon?
- Any other person we should contact?

Online survey of Central banks (collateral framework)

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. ICF Consulting Services is carrying out the above study on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the CRA regulation, to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that all central banks will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 19 questions and we estimate that it will take around 20 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General Information

1. **Your Name:**

2. **Your Role:**

3. **Country:**

- | | | |
|---|---|--|
| <input type="checkbox"/> Austria | <input type="checkbox"/> Belgium | <input type="checkbox"/> Bulgaria |
| <input type="checkbox"/> Cyprus | <input type="checkbox"/> Czech Republic | <input type="checkbox"/> Denmark |
| <input type="checkbox"/> Estonia | <input type="checkbox"/> Finland | <input type="checkbox"/> France |
| <input type="checkbox"/> Germany | <input type="checkbox"/> Greece | <input type="checkbox"/> Hungary |
| <input type="checkbox"/> Iceland | <input type="checkbox"/> Ireland | <input type="checkbox"/> Italy |
| <input type="checkbox"/> Latvia | <input type="checkbox"/> Lithuania | <input type="checkbox"/> Luxembourg |
| <input type="checkbox"/> Malta | <input type="checkbox"/> Poland | <input type="checkbox"/> Portugal |
| <input type="checkbox"/> Romania | <input type="checkbox"/> Slovakia | <input type="checkbox"/> Slovenia |
| <input type="checkbox"/> Spain | <input type="checkbox"/> Sweden | <input type="checkbox"/> The Netherlands |
| <input type="checkbox"/> The United Kingdom | | |

Use of credit ratings in central bank's collateral framework

4. **Are there any references to external credit ratings in your bank's collateral framework? Specifically, are there any references to credit ratings in...**

	Yes	No
...rules governing the eligibility of collateral	<input type="checkbox"/>	<input type="checkbox"/>
...rules governing counterparty eligibility	<input type="checkbox"/>	<input type="checkbox"/>
...rules determining the size of (initial) margin or haircut	<input type="checkbox"/>	<input type="checkbox"/>

(if there are references), does the central bank only accept external credit ratings produced by particular credit rating agencies?

- Yes
- No

Please specify which credit rating agencies

5. We would like to better understand how external ratings are used in your bank's collateral framework. Please tick the boxes that apply

- External ratings are only used as a guide for collateral eligibility; we form our own independent view about collateral eligibility based on internal analysis
- External ratings are used as a hard and fast criterion for eligibility
- External ratings are used as a trigger for a review of collateral eligibility

6. Is there a minimum rating requirement for collateral eligibility?

Please tick if a minimum rating is required for eligibility

Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals)	<input type="checkbox"/>
Securities issued by private sector financial entities	<input type="checkbox"/>
Securities issued by private sector non-financial corporates	<input type="checkbox"/>
Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)	<input type="checkbox"/>

Please describe the rating threshold

Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals) _____

Securities issued by private sector financial entities _____

Securities issued by private sector non-financial corporates _____

Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits) _____

Central bank's approach to credit assessment (for collateral framework)

7. Please indicate your bank's approach to external assessment (eg from credit rating agencies) for each of the following asset-classes

	external assessment (eg from credit rating agencies) plays a relatively big role	in-house assessment by the central bank (may include external ratings, but only as one of many inputs).
Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals)	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector financial entities	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector non-financial corporates	<input type="checkbox"/>	<input type="checkbox"/>
Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)	<input type="checkbox"/>	<input type="checkbox"/>

8. What types of data are used by the central bank for internal credit risk assessment?

	Financial statements / indicators	Historical losses data	Modelling of expected losses data	Macroeconomic and microeconomic indicators	Market data (credit default swaps, bond spreads)	Qualitative information (management /organizational structure, general business profile and environment)	Other
Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector financial entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector non-financial corporates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, Please specify:

Central bank's approach to credit assessment (for collateral framework)

9. Where are the data sourced from? Please tick all that apply

- Directly from the issuer/ counterparty
- Publicly available sources
- Specialised information sources e.g. Reuters, Dun & Bradstreet
- Client interactions

10. Does the central bank use any computational models to assess risk?

- Yes
- No

Are they:

- Bespoke/ proprietary models
- Vendor based solutions

11. Which of the following steps has the central bank taken to reduce reliance on external credit ratings since the financial crisis

- We have lowered the minimum rating requirements for at least some assets (please specify below)
- We now require at least two ratings for collateral being posted
- We have reduced the role that credit ratings play in our collateral framework, with ratings being a guide and trigger for a review of collateral eligibility rather than a hard-edged criterion
- Other

Lower rating requirement, please specify:

Other, please specify:

Analysis of current practices and alternatives

12. What are the main benefits from using external credit ratings?

13. Have you noticed any negative aspects from the bank's usage of external credit ratings when determining collateral eligibility criteria?

Yes

No

Please specify:

14. What is your understanding of alternatives to external credit ratings which can be useful in central banks' collateral frameworks?

15. Are the following alternative considered as viable in your area?

	Yes	No
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions (e.g. OECD country classification)	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

Please explain why or why not:

Internal credit quality assessment _____

Market based indicators _____

Assessments from international institutions (e.g. OECD country classification) _____

Other third part assessments by e.g. Central Banks _____

Automated scorings based on computational models _____

Other _____

Analysis of current practices and alternatives

16. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative market based indicators such as bond spreads, credit default swap spreads on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative assessments from international institutions (e.g. OECD country classification) - for sovereign debt only, on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternatives other third part assessments by e.g. Central Banks on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, please specify:

17. What are the main challenges preventing you from using more alternatives to external credit ratings?

Closing remarks

18. If you have any other comments, please add these here:

19. May we contact you in case of any follow up questions?

- Yes
 No

Please enter your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of Sectoral Competent Authorities

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. The research is being carried by ICF Consulting Services on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the Credit Rating Agencies Regulation (CRA III), to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that all Sectoral Competent Authorities will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 24 questions and we estimate that it will take 30 - 40 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General information

1. Your Name:

2. Your Role:

3. Name of your Organisation:

4. Country:

- | | | |
|---|---|--|
| <input type="checkbox"/> Austria | <input type="checkbox"/> Belgium | <input type="checkbox"/> Bulgaria |
| <input type="checkbox"/> Cyprus | <input type="checkbox"/> Czech Republic | <input type="checkbox"/> Denmark |
| <input type="checkbox"/> Estonia | <input type="checkbox"/> Finland | <input type="checkbox"/> France |
| <input type="checkbox"/> Germany | <input type="checkbox"/> Greece | <input type="checkbox"/> Hungary |
| <input type="checkbox"/> Iceland | <input type="checkbox"/> Ireland | <input type="checkbox"/> Italy |
| <input type="checkbox"/> Latvia | <input type="checkbox"/> Lithuania | <input type="checkbox"/> Luxembourg |
| <input type="checkbox"/> Malta | <input type="checkbox"/> Poland | <input type="checkbox"/> Portugal |
| <input type="checkbox"/> Romania | <input type="checkbox"/> Slovakia | <input type="checkbox"/> Slovenia |
| <input type="checkbox"/> Spain | <input type="checkbox"/> Sweden | <input type="checkbox"/> The Netherlands |
| <input type="checkbox"/> The United Kingdom | | |

5. Which of the following sectors are supervised/ regulated by your organization? Please tick all that apply

- Credit institutions
- Investment firms
- Insurance/ reinsurance undertakings
- Institutions for occupational retirement provision/ pension funds
- Asset management companies
- Investment companies
- Alternative investment fund managers
- Central counterparties and prospectuses
- Others

If other, please specify:

Please list the key pieces of sectoral legislation that falls within the purview of your organisation (please answer this question for each of the sectors supervised by your organisation)

Credit institutions	_____

Investment firms	_____

Insurance/ reinsurance undertakings	_____

Institutions for occupational retirement provision/ pension funds	_____

Asset management companies	_____

Investment companies	_____

Alternative investment fund managers	_____

Central counterparties and prospectuses	_____

Other	_____

Regulatory references to external ratings

7. What steps have been taken by your organisation in recent years to remove references to credit ratings in national sectoral legislation (including national legislation transposing EU legislation)? Please tick one box only

- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from all relevant pieces of sectoral legislation that falls within our competence
- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from most of the sectoral legislation that falls within our competence
- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from some of the sectoral legislation that falls within our competence
- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been partially removed from the sectoral legislation that falls within our competence
- Other

If other, please specify:

Please explain the reasons why references to credit ratings have not been completely removed from all relevant pieces of sectoral legislation:

- 8. In which cases would complete removal of regulatory references to external ratings not be: (i) desirable, (ii) feasible and why?**

- 9. To what extent have the regulatory changes made so far (i.e. removal of references to credit ratings from sectoral legislation as indicated above) been effective in reducing formulaic reliance on credit ratings by market participants?**

Implementation of Article 5a(2) of the CRA Regulation

Article 5a(2) of CRA III requires that Sectoral Competent Authorities shall monitor the adequacy of the credit risk assessment processes being followed the supervised entities, assess the use of contractual references to credit ratings and, where appropriate, encourage them to mitigate the impact of such references, with a view to reducing sole and mechanistic reliance on credit ratings, in line with specific sectoral legislation

10. Please briefly describe the steps taken by your organization in response to the above regulatory requirements.

Steps taken to monitor the adequacy of the credit risk assessment processes among supervised entities _____

Steps taken to monitor contractual references to external credit ratings among supervised entities _____

Steps taken to encourage supervised entities to mitigate the impact of such references, with a view to reducing 'sole and mechanistic' reliance on credit ratings _____

Steps taken to promote alternatives to external credit ratings _____

Contractual references to external ratings

11. Could you please indicate the types of contractual agreements that might contain references to credit ratings? Please tick all that apply

- Investment mandates
- Fund rules
- Loan covenants
- Collateral agreements
- Others
- Not applicable
- Don't know

If other, please specify

12. To what extent are supervised entities using references to credit ratings in the above contractual agreements? Please tick one box only

- To a large extent (i.e. usually)
- To a moderate extent (i.e. sometimes)
- To a limited extent (i.e. rarely)
- Not at all
- Not applicable
- Don't know

13. Where contractual references exist, would it be standard market practice to specifically refer to the ratings produced by the 'big three' rating agencies (Standard & Poor's, Moody's, and Fitch) in contractual agreements? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

Contractual references to external ratings

14. Have you noticed any changes in market practices in recent years with respect to the use of credit ratings in financial contracts? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

If yes, please could you provide an overview of the main changes in market practices

15. Is there any evidence of excessive or formulaic reliance on ratings in contractual agreements? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

If yes, please could you provide an overview of this evidence

16. What are the main challenges that might be preventing your supervised entities from reducing contractual references to credit ratings?

Alternatives to external credit ratings

17. In your particular sector, which alternatives could potentially replace or reduce the use of external credit ratings? Please tick all that apply

- Internal credit quality assessment by market participants
- Market based measures e.g. bond spreads, credit default swap spreads etc.
- Assessments from international institutions (e.g. OECD country classification) - for sovereign debt only
- Other third part assessments by e.g. Central Banks
- Automated scorings based on computational models
- Other

If other, please specify

Alternatives to external credit ratings

To what extent are supervised entities currently using the following alternatives to external credit ratings?

	To a large extent (i.e. usually)	To a moderate extent (i.e. sometimes)	To a limited extent (i.e. rarely)	Not at all	Not applicable	Don't know
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Market based measures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, please specify:

Analysis of current practices and alternatives

19. Please rate Internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Market based indicators on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Assessments from international institutions on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Cost of using the alternative for supervisors

Cost of using the alternative for market participants

Please rate Other third part assessments (by e.g. Central Banks) on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Cost of using the alternative for
market participants



Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Alternatives to external credit ratings

20. What should be the characteristics of a viable alternative to external credit ratings to allow for the effective and efficient supervision of market participants? Please tick all that apply

- Ease of use/ interpretation
- It should facilitate comparability/ ranking of different investments
- It should provide a common language
- External transparency
- Reliability
- Accuracy
- Other

If other, please specify

21. What are the main challenges preventing your supervised entities from using alternatives to external credit ratings?

22. Are there any specificities of your sector that make it more difficult for market participants to use alternatives to external credit ratings?

Any other comments

23. If you have any other comments, please add these here:

24. May we contact you in case of any follow up questions?

- Yes
 No

If yes, please provide us with your contact details

Email: _____

Phone number: _____

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of National treasuries

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. ICF Consulting Services is carrying out the above study on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the CRA regulation, to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that you will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 13 questions and we estimate that it will take around 20 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution

General Information

1. **Your Name:**

2. **Your Role:**

3. **Name of your Organisation:**

Use of external credit ratings

4. **To what extent does a sovereign rating remain an important factor when accessing international capital markets?**

5. **What do you see as the main benefits of using external credit ratings?**

6. **Have you experienced drawbacks from 'mechanistic' reliance on external credit ratings in recent years?**

Yes

No

Please elaborate on which drawbacks you experienced:

Use of external credit ratings

7. Have you seen any benefits from the new transparency requirements to be met when rating sovereign debt, which were introduced with the last revision of the CRA regulation (CRAIII, in its article 8a)?

	Yes	No
Announcement of the calendar for sovereign debt rating	<input type="checkbox"/>	<input type="checkbox"/>
Publication of sovereign ratings outside trading hours	<input type="checkbox"/>	<input type="checkbox"/>
Requirement to complement the credit rating with a research report	<input type="checkbox"/>	<input type="checkbox"/>

Please briefly explain your answer

Announcement of the calendar for sovereign debt rating _____

Publication of sovereign ratings outside trading hours _____

Requirement to complement the credit rating with a research report _____

8. Are there any further regulatory improvements that could be introduced to reduce mechanistic reliance on ratings and to prevent negative effects from such reliance (e.g. cliff effects)?

- Yes
- No

Please elaborate on which improvements could be made:

Feasibility of alternatives to external ratings

9. What is your understanding of alternatives to external credit ratings which could be useful in the area of sovereign debt?

10. Are the following alternative considered as viable in your area?

	Yes	No
Internal credit quality assessment by investors	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators e.g. credit default swap spreads	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions e.g. OECD country risk classification	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Feasibility of alternatives to external ratings

11. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative market based measures on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative assessments from international institutions on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative other third part assessments on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Closing remarks

12. If you have any other comments, please add these here:

13. May we contact you in case of any follow up questions?

Yes

No

Please enter here your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of Credit rating agencies

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. ICF Consulting Services is carrying out the above study on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the CRA regulation, to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that all credit rating agencies will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 17 questions and we estimate that it will take around 20 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

Your answers can be saved at any time and you can return to it later via the URL provided.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General Information

1. Your Name:

2. Your Role:

3. Name of your Organisation:

4. Which types of products do you rate? Please tick all that apply

- Sovereign debt
- Sub-sovereign debt
- Corporate debt/ bonds
- Structured finance
- Other

Please specify:

5. Please indicate your main business model(s) for each of the products selected above: Please tick all that apply

	Issuer pays	Investor pays	Unsolicited ratings
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

The rating process

6. To form your assessment, do you use: Please tick all that apply

	a mix of quantitative and qualitative indicators	solely a quantitative model
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

7. Do you typically request information from the issuer?

- Yes
- No, we rely solely on publicly available information

8. Beyond the information provided by issuer/ counterparty, which other sources of information are typically used? Please tick all that apply

	Financial statements / indicators	Historical data	Modeling of expected losses	Macroeconomic and microeconomic data	Market data (credit and default swaps, bond spread, share prices, etc.)	Qualitative information such as management /organ isation al structure, general business profile and environment	Other
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other

Other, please specify (for sovereign debt):

Other, please specify (for sub-sovereign debt):

Other, please specify (for corporate debt/ bonds):

Other, please specify (for structured finance):

Other, please specify (for other):

9. The computational models used to assess risk are: Please tick one box only

- Bespoke/ proprietary models
- Vendor based solutions
- We do not use computational models

10. Are there any major differences with regards to the rating process by type of products that you rate (Sovereign debt / Sub-sovereign debt / Corporate debt / Structured finance / other)? Please explain

Changes implemented since the financial crisis

11. Do you support the public policy objective of reducing overreliance on external credit ratings and the recent steps taken to achieve that objective?

- Yes
- No

12. Please briefly describe the changes introduced by your organization since the financial crisis

(i) Changes in rating methodology _____

(ii) Steps taken to foster users' understanding of underlying methodologies of the external ratings _____

(iii) Other substantial changes which would build confidence in external ratings _____

13. According to you, which issues remain to be tackled and how could it be done?

14. What is your understanding of alternatives to external credit ratings?

15. Are the following alternatives considered as viable?

	Yes	No
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators such as bond spreads, credit default swap spreads	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions (e.g. OECD country classification) - <i>for sovereign debt only</i>	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

If other, please specify:

Please explain why or why not:

Analysis of current practices and alternatives

16. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

17. Please rate the alternative market based measures on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

18. Please rate the alternative assessments from international institutions (e.g. OECD country classification) on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

19. Please rate the alternative other third part assessment by e.g. Central Banks on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

20. Please rate the alternative automated scoring based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

21. Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Please specify:	<hr/> <hr/>		

Any other comments

22. If you have any other comments, please add these here:

23. May we contact you in case of any follow up questions?

Yes

No

Please enter here your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of Sectoral Competent Authorities

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. The research is being carried by ICF Consulting Services on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the Credit Rating Agencies Regulation (CRA III), to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that all Sectoral Competent Authorities will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 24 questions and we estimate that it will take 30 - 40 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General information

1. Your Name:

2. Your Role:

3. Name of your Organisation:

4. Country:

- | | | |
|---|---|--|
| <input type="checkbox"/> Austria | <input type="checkbox"/> Belgium | <input type="checkbox"/> Bulgaria |
| <input type="checkbox"/> Cyprus | <input type="checkbox"/> Czech Republic | <input type="checkbox"/> Denmark |
| <input type="checkbox"/> Estonia | <input type="checkbox"/> Finland | <input type="checkbox"/> France |
| <input type="checkbox"/> Germany | <input type="checkbox"/> Greece | <input type="checkbox"/> Hungary |
| <input type="checkbox"/> Iceland | <input type="checkbox"/> Ireland | <input type="checkbox"/> Italy |
| <input type="checkbox"/> Latvia | <input type="checkbox"/> Lithuania | <input type="checkbox"/> Luxembourg |
| <input type="checkbox"/> Malta | <input type="checkbox"/> Poland | <input type="checkbox"/> Portugal |
| <input type="checkbox"/> Romania | <input type="checkbox"/> Slovakia | <input type="checkbox"/> Slovenia |
| <input type="checkbox"/> Spain | <input type="checkbox"/> Sweden | <input type="checkbox"/> The Netherlands |
| <input type="checkbox"/> The United Kingdom | | |

5. Which of the following sectors are supervised/ regulated by your organization? Please tick all that apply

- Credit institutions

- Investment firms
- Insurance/ reinsurance undertakings
- Institutions for occupational retirement provision/ pension funds
- Asset management companies
- Investment companies
- Alternative investment fund managers
- Central counterparties and prospectuses
- Others

If other, please specify:

Please list the key pieces of sectoral legislation that falls within the purview of your organisation (please answer this question for each of the sectors supervised by your organisation)

Credit institutions	_____ _____ _____
Investment firms	_____ _____
Insurance/ reinsurance undertakings	_____ _____
Institutions for occupational retirement provision/ pension funds	_____ _____
Asset management companies	_____ _____
Investment companies	_____ _____
Alternative investment fund managers	_____ _____
Central counterparties and prospectuses	_____ _____
Other	_____ _____

Regulatory references to external ratings

7. What steps have been taken by your organisation in recent years to remove references to credit ratings in national sectoral legislation (including national legislation transposing EU legislation)? Please tick one box only

- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from all relevant pieces of sectoral legislation that falls within our competence
- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from most of the sectoral legislation that falls within our competence

- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been completely removed from some of the sectoral legislation that falls within our competence
- References that have the potential to trigger “sole or mechanistic reliance” on credit ratings by market participants, have been partially removed from the sectoral legislation that falls within our competence
- Other

If other, please specify:

Please explain the reasons why references to credit ratings have not been completely removed from all relevant pieces of sectoral legislation:

8. In which cases would complete removal of regulatory references to external ratings not be: (i) desirable, (ii) feasible and why?

9. To what extent have the regulatory changes made so far (i.e. removal of references to credit ratings from sectoral legislation as indicated above) been effective in reducing formulaic reliance on credit ratings by market participants?

Implementation of Article 5a(2) of the CRA Regulation

Article 5a(2) of CRA III requires that Sectoral Competent Authorities shall monitor the adequacy of the credit risk assessment processes being followed the supervised entities, assess the use of contractual references to credit ratings and, where appropriate, encourage them to mitigate the impact of such references, with a view to reducing sole and mechanistic reliance on credit ratings, in line with specific sectoral legislation

10. Please briefly describe the steps taken by your organization in response to the above regulatory requirements.

Steps taken to monitor the adequacy of the credit risk assessment processes among supervised entities _____

Steps taken to monitor contractual references to external credit ratings among supervised entities _____

Steps taken to encourage supervised entities to mitigate the impact of such references, with a view to reducing 'sole and mechanistic' reliance on credit ratings _____

Steps taken to promote alternatives to external credit ratings _____

Contractual references to external ratings

11. Could you please indicate the types of contractual agreements that might contain references to credit ratings? Please tick all that apply

- Investment mandates
- Fund rules
- Loan covenants
- Collateral agreements

- Others
- Not applicable
- Don't know

If other, please specify

12. To what extent are supervised entities using references to credit ratings in the above contractual agreements? Please tick one box only

- To a large extent (i.e. usually)
- To a moderate extent (i.e. sometimes)
- To a limited extent (i.e. rarely)
- Not at all
- Not applicable
- Don't know

13. Where contractual references exist, would it be standard market practice to specifically refer to the ratings produced by the 'big three' rating agencies (Standard & Poor's, Moody's, and Fitch) in contractual agreements? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

Contractual references to external ratings

14. Have you noticed any changes in market practices in recent years with respect to the use of credit ratings in financial contracts? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

If yes, please could you provide an overview of the main changes in market practices

15. Is there any evidence of excessive or formulaic reliance on ratings in contractual agreements? Please tick one box only

- Yes
- No
- Not applicable
- Don't know

If yes, please could you provide an overview of this evidence

16. What are the main challenges that might be preventing your supervised entities from reducing contractual references to credit ratings?

Alternatives to external credit ratings

17. In your particular sector, which alternatives could potentially replace or reduce the use of external credit ratings? Please tick all that apply

- Internal credit quality assessment by market participants
- Market based measures e.g. bond spreads, credit default swap spreads etc.
- Assessments from international institutions (e.g. OECD country classification) - for sovereign debt only
- Other third part assessments by e.g. Central Banks
- Automated scorings based on computational models
- Other

If other, please specify

Alternatives to external credit ratings

To what extent are supervised entities currently using the following alternatives to external credit ratings?

	To a large extent (i.e. usually)	To a moderate extent (i.e. sometimes)	To a limited extent (i.e. rarely)	Not at all	Not applicable	Don't know
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Market based measures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, please specify:

Analysis of current practices and alternatives

19. Please rate Internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Market based indicators on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Assessments from international institutions on the parameters below

Low Medium High

Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty

Ability to compare and rank different instruments /counterparties according to their credit risk

Limitation of negative effects such as pro-cyclicality

Transparency

Suitability of the alternative for supervisory purposes

Acceptability / ease of use for market participants

Cost of using the alternative for supervisors

Cost of using the alternative for market participants

Please rate Other third part assessments (by e.g. Central Banks) on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate Automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Suitability of the alternative for supervisory purposes

Acceptability / ease of use for market participants

Cost of using the alternative for supervisors

Cost of using the alternative for market participants

Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Suitability of the alternative for supervisory purposes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for supervisors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Alternatives to external credit ratings

20. What should be the characteristics of a viable alternative to external credit ratings to allow for the effective and efficient supervision of market participants? Please tick all that apply

- Ease of use/ interpretation
- It should facilitate comparability/ ranking of different investments
- It should provide a common language
- External transparency
- Reliability
- Accuracy
- Other

If other, please specify

21. What are the main challenges preventing your supervised entities from using alternatives to external credit ratings?

22. Are there any specificities of your sector that make it more difficult for market participants to use alternatives to external credit ratings?

Any other comments

23. If you have any other comments, please add these here:

24. May we contact you in case of any follow up questions?

Yes

No

If yes, please provide us with your contact details

Email:

Phone number:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of National treasuries

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. ICF Consulting Services is carrying out the above study on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the CRA regulation, to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that you will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 13 questions and we estimate that it will take around 20 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution

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General Information

1. **Your Name:**

2. **Your Role:**

3. **Name of your Organisation:**

Use of external credit ratings

4. **To what extent does a sovereign rating remain an important factor when accessing international capital markets?**

5. **What do you see as the main benefits of using external credit ratings?**

6. **Have you experienced drawbacks from 'mechanistic' reliance on external credit ratings in recent years?**

Yes

No

Please elaborate on which drawbacks you experienced:

Use of external credit ratings

7. Have you seen any benefits from the new transparency requirements to be met when rating sovereign debt, which were introduced with the last revision of the CRA regulation (CRAIII, in its article 8a)?

	Yes	No
Announcement of the calendar for sovereign debt rating	<input type="checkbox"/>	<input type="checkbox"/>
Publication of sovereign ratings outside trading hours	<input type="checkbox"/>	<input type="checkbox"/>
Requirement to complement the credit rating with a research report	<input type="checkbox"/>	<input type="checkbox"/>

Please briefly explain your answer

Announcement of the calendar for sovereign debt rating _____

Publication of sovereign ratings outside trading hours _____

Requirement to complement the credit rating with a research report _____

8. Are there any further regulatory improvements that could be introduced to reduce mechanistic reliance on ratings and to prevent negative effects from such reliance (e.g. cliff effects)?

Yes

No

Please elaborate on which improvements could be made:

Feasibility of alternatives to external ratings

9. What is your understanding of alternatives to external credit ratings which could be useful in the area of sovereign debt?

10. Are the following alternative considered as viable in your area?

	Yes	No
Internal credit quality assessment by investors	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators e.g. credit default swap spreads	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions e.g. OECD country risk classification	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Feasibility of alternatives to external ratings

11. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative market based measures on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative assessments from international institutions on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative other third part assessments on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative for market participants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify:

Closing remarks

12. If you have any other comments, please add these here:

13. May we contact you in case of any follow up questions?

- Yes
 No

Please enter here your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Online survey of Credit rating agencies

Introduction

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Your answers can be saved at any time and you can return to it later via the URL provided.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General Information

1. Your Name:

2. Your Role:

3. Name of your Organisation:

4. Which types of products do you rate? Please tick all that apply

- Sovereign debt
- Sub-sovereign debt
- Corporate debt/ bonds
- Structured finance
- Other

Please specify:

5. Please indicate your main business model(s) for each of the products selected above: Please tick all that apply

	Issuer pays	Investor pays	Unsolicited ratings
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

The rating process

6. To form your assessment, do you use: Please tick all that apply

	a mix of quantitative and qualitative indicators	solely a quantitative model
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

7. Do you typically request information from the issuer?

- Yes
- No, we rely solely on publicly available information

8. Beyond the information provided by issuer/ counterparty, which other sources of information are typically used? Please tick all that apply

	Financial statements / indicators	Historical data / losses	Modeling of expected losses data	Macroeconomic and microeconomic data	Market data (credit and default swaps, bond spread, etc.)	Qualitative information (credit and default rates, etc.)	Other such as management /organizational structure, general business profile and environment
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other

Other, please specify (for sovereign debt):

Other, please specify (for sub-sovereign debt):

Other, please specify (for corporate debt/ bonds):

Other, please specify (for structured finance):

Other, please specify (for other):

9. The computational models used to assess risk are: *Please tick one box only*

- Bespoke/ proprietary models
- Vendor based solutions
- We do not use computational models

10. Are there any major differences with regards to the rating process by type of products that you rate (Sovereign debt / Sub-sovereign debt / Corporate debt / Structured finance / other)? *Please explain*

Changes implemented since the financial crisis

11. Do you support the public policy objective of reducing overreliance on external credit ratings and the recent steps taken to achieve that objective?

- Yes
- No

12. Please briefly describe the changes introduced by your organization since the financial crisis

(i) Changes in rating methodology _____

(ii) Steps taken to foster users' understanding of underlying methodologies of the external ratings _____

(iii) Other substantial changes which would build confidence in external ratings _____

13. According to you, which issues remain to be tackled and how could it be done?

14. What is your understanding of alternatives to external credit ratings?

15. Are the following alternatives considered as viable?

	Yes	No
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators such as bond spreads, credit default swap spreads	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions (e.g. OECD country classification) - <i>for sovereign debt only</i>	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>
If other, please specify:		

Please explain why or why not:

Analysis of current practices and alternatives

16. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

17. Please rate the alternative market based measures on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

18. Please rate the alternative assessments from international institutions (e.g. OECD country classification) on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

19. Please rate the alternative other third part assessment by e.g. Central Banks on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

20. Please rate the alternative automated scoring based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

21. Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Please specify:	<hr/> <hr/>		

Any other comments

22. If you have any other comments, please add these here:

23. May we contact you in case of any follow up questions?

Yes

No

Please enter here your contact details:

Thank you

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2. Your Role:

3. Name of your Organisation:

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- Sovereign debt
- Sub-sovereign debt
- Corporate debt/ bonds
- Structured finance
- Other

Please specify:

5. Please indicate your main business model(s) for each of the products selected above: Please tick all that apply

	Issuer pays	Investor pays	Unsolicited ratings
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

The rating process

6. To form your assessment, do you use: Please tick all that apply

	a mix of quantitative and qualitative indicators	solely a quantitative model
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>
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Structured finance	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

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	Financial statements / indicators	Historical data / losses	Modeling of expected losses data	Macroeconomic and microeconomic data	Market data (credit and default swaps, bond spread, etc.)	Qualitative information (credit information and default rates such as management /organizational structure, general business profile and environment)	Other
Sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sub-sovereign debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate debt/ bonds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Structured finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other

Other, please specify (for sovereign debt):

Other, please specify (for sub-sovereign debt):

Other, please specify (for corporate debt/ bonds):

Other, please specify (for structured finance):

Other, please specify (for other):

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11. Do you support the public policy objective of reducing overreliance on external credit ratings and the recent steps taken to achieve that objective?

- Yes
 No

12. Please briefly describe the changes introduced by your organization since the financial crisis

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If other, please specify:		

Please explain why or why not:

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Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

17. Please rate the alternative market based measures on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

18. Please rate the alternative assessments from international institutions (e.g. OECD country classification) on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

19. Please rate the alternative other third part assessment by e.g. Central Banks on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

20. Please rate the alternative automated scoring based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

21. Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Applicability to different products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Please specify:	<hr/> <hr/>		

Any other comments

22. If you have any other comments, please add these here:

23. May we contact you in case of any follow up questions?

Yes

No

Please enter here your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Survey of Central banks (collateral framework)

Introduction

This survey is being organised in the context of a **Study on the Feasibility of Alternatives to Credit Ratings**. ICF Consulting Services is carrying out the above study on behalf of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

The study will map alternatives to external credit ratings and assess the feasibility of implementing the identified alternatives in a European context. The study will also examine the extent to which external ratings are used in financial contracts and look into measures that could be implemented to reduce contractual over-reliance on credit ratings.

The results of the study will feed into the report the European Commission shall submit, as per Articles 5c and 39(5)(g) of the CRA regulation, to the European Parliament and the Council regarding alternatives to credit ratings and the potential need to propose measures to address contractual over-reliance on credit ratings.

This survey is a voluntary exercise. However, we hope that all central banks will find the time to look at the questionnaire and to answer as many of the questions as possible. The survey provides an important opportunity to provide your inputs to future EU policy in this area. Your contribution is, therefore, both valuable and important

The survey consists of 19 questions and we estimate that it will take around 20 minutes to complete. We would be grateful if you would complete the survey by **Friday, 16 October, 2015**.

All individual answers and comments will be treated as **strictly confidential** and **non-attributable**.

In case of any technical issue, please contact Melanie Dubuis at Melanie.Dubuis@icfi.com

We thank you in advance for your contribution.

General Information

1. Your Name:

2. Your Role:

3. Country:

- | | | |
|---|---|--|
| <input type="checkbox"/> Austria | <input type="checkbox"/> Belgium | <input type="checkbox"/> Bulgaria |
| <input type="checkbox"/> Cyprus | <input type="checkbox"/> Czech Republic | <input type="checkbox"/> Denmark |
| <input type="checkbox"/> Estonia | <input type="checkbox"/> Finland | <input type="checkbox"/> France |
| <input type="checkbox"/> Germany | <input type="checkbox"/> Greece | <input type="checkbox"/> Hungary |
| <input type="checkbox"/> Iceland | <input type="checkbox"/> Ireland | <input type="checkbox"/> Italy |
| <input type="checkbox"/> Latvia | <input type="checkbox"/> Lithuania | <input type="checkbox"/> Luxembourg |
| <input type="checkbox"/> Malta | <input type="checkbox"/> Poland | <input type="checkbox"/> Portugal |
| <input type="checkbox"/> Romania | <input type="checkbox"/> Slovakia | <input type="checkbox"/> Slovenia |
| <input type="checkbox"/> Spain | <input type="checkbox"/> Sweden | <input type="checkbox"/> The Netherlands |
| <input type="checkbox"/> The United Kingdom | | |

Use of credit ratings in central bank's collateral framework

4. Are there any references to external credit ratings in your bank's collateral framework? Specifically, are there any references to credit ratings in...

	Yes	No
...rules governing the eligibility of collateral	<input type="checkbox"/>	<input type="checkbox"/>
...rules governing counterparty eligibility	<input type="checkbox"/>	<input type="checkbox"/>
...rules determining the size of (initial) margin or haircut	<input type="checkbox"/>	<input type="checkbox"/>

(if there are references), does the central bank only accept external credit ratings produced by particular credit rating agencies?

- Yes
- No

Please specify which credit rating agencies

5. We would like to better understand how external ratings are used in your bank's collateral framework. Please tick the boxes that apply

- External ratings are only used as a guide for collateral eligibility; we form our own independent view about collateral eligibility based on internal analysis
- External ratings are used as a hard and fast criterion for eligibility
- External ratings are used as a trigger for a review of collateral eligibility

6. Is there a minimum rating requirement for collateral eligibility?

Please tick if a minimum rating is required for eligibility

Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supnationals)

Securities issued by private sector financial entities

Securities issued by private sector non-financial corporates

Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)

Please describe the rating treshold

Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supnationals) _____

Securities issued by private sector financial entities _____

Securities issued by private sector non-financial corporates _____

Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits) _____

Central bank's approach to credit assessment (for collateral framework)

7. Please indicate your bank's approach to external assessment (eg from credit rating agencies) for each of the following asset-classes

	external assessment (eg from credit rating agencies) plays a relatively big role	in-house assessment by the central bank (may include external ratings, but only as one of many inputs).
Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals)	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector financial entities	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector non-financial corporates	<input type="checkbox"/>	<input type="checkbox"/>
Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)	<input type="checkbox"/>	<input type="checkbox"/>

8. What types of data are used by the central bank for internal credit risk assessment?

	Financial statements / indicators	Historical losses data	Modelling of expected losses data	Macroeconomic and microeconomic indicators	Market data (credit default swaps, bond spreads)	Qualitative information (management /organizational structure, general business profile and environment)	Other
Securities issued by public sector entities (eg government of all levels, central bank, public agencies, supranationals)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector financial entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Securities issued by private sector non-financial corporates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other issuer types that cannot fit in the above, or assets that are not securities (eg non-marketable credit claims, deposits)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, Please specify:

Central bank's approach to credit assessment (for collateral framework)

9. Where are the data sourced from? Please tick all that apply

- Directly from the issuer/ counterparty
- Publicly available sources
- Specialised information sources e.g. Reuters, Dun & Bradstreet
- Client interactions

10. Does the central bank use any computational models to assess risk?

- Yes
- No

Are they:

- Bespoke/ proprietary models
- Vendor based solutions

11. Which of the following steps has the central bank taken to reduce reliance on external credit ratings since the financial crisis

- We have lowered the minimum rating requirements for at least some assets (please specify below)
- We now require at least two ratings for collateral being posted
- We have reduced the role that credit ratings play in our collateral framework, with ratings being a guide and trigger for a review of collateral eligibility rather than a hard-edged criterion
- Other

Lower rating requirement, please specify:

Other, please specify:

Analysis of current practices and alternatives

12. What are the main benefits from using external credit ratings?

13. Have you noticed any negative aspects from the bank's usage of external credit ratings when determining collateral eligibility criteria?

Yes

No

Please specify:

14. What is your understanding of alternatives to external credit ratings which can be useful in central banks' collateral frameworks?

15. Are the following alternative considered as viable in your area?

	Yes	No
Internal credit quality assessment	<input type="checkbox"/>	<input type="checkbox"/>
Market based indicators	<input type="checkbox"/>	<input type="checkbox"/>
Assessments from international institutions (e.g. OECD country classification)	<input type="checkbox"/>	<input type="checkbox"/>
Other third part assessments by e.g. Central Banks	<input type="checkbox"/>	<input type="checkbox"/>
Automated scorings based on computational models	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>

Please specify

Please explain why or why not:

Internal credit quality assessment _____

Market based indicators _____

Assessments from international institutions (e.g. OECD country classification) _____

Other third part assessments by e.g. Central Banks _____

Automated scorings based on computational models _____

Other _____

Analysis of current practices and alternatives

16. Please rate the alternative internal credit quality assessment on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative market based indicators such as bond spreads, credit default swap spreads on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative assessments from international institutions (e.g. OECD country classification) - for sovereign debt only, on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternatives other third part assessments by e.g. Central Banks on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate the alternative automated scorings based on computational models on the parameters below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please rate any other alternative on the parameters below and specify the alternative below

	Low	Medium	High
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to compare and rank different instruments /counterparties according to their credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Limitation of negative effects such as pro-cyclicality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Acceptability / ease of use	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost of using the alternative	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If other, please specify:

17. What are the main challenges preventing you from using more alternatives to external credit ratings?

Closing remarks

18. If you have any other comments, please add these here:

19. May we contact you in case of any follow up questions?

- Yes
 No

Please enter your contact details:

Thank you

Thank you very much for taking the time to respond to this survey;
your response is important to us.

Please press 'submit' below.

Annex 4 Workshop notes

Workshop Report: alternatives to external credit ratings

Friday, 30 October 2015, 10.00 – 16.30

ICF International, 146 Rue Royale, Brussels – 1000

3rd floor meeting room

Introduction

Within the framework of the **Study on the feasibility of alternatives to credit ratings**, ICF organised a workshop in Brussels to test the first findings of their research and to explore some of the emerging issues in further detail. This report summarises the workshop discussion. It reflects the best efforts of note-takers to capture a wide range of comments and observations made by the participants. Any additions and corrections to the report would be most welcome.

The remainder of the document is structured as follows:

- Section 1 outlines the main uses of credit ratings by regulators, central banks and market participants;
- Section 2 presents our findings on the role that external ratings play in credit risk assessment;
- Section 3 summarises the main regulatory drivers of the use of external ratings;
- Section 4 reflects upon the use of ratings in financial contracts;
- Section 5 provides an initial mapping of alternatives and provides a comparative assessment of the identified alternatives vis-à-vis external ratings.

A list of workshop participants is provided in Annex 1.

Section 1: The use of credit ratings

The discussion confirmed that credit ratings are used for a variety of purposes by regulators, central banks and market participants.

Several additions were made to the initial table (presented in the background paper for the workshop), notably with regards to the use of external ratings in the insurance sector (capital requirements, value and eligibility of collateral, derivative covenants/ OTC derivatives contracts).

It was also discussed that the use of ratings is quite widespread in the non-financial sector. For example:

- Ratings are an input into corporate decision making such as M&A decisions;
- Ratings are also taken into account when governments provide guarantees to corporates.

The question of whether CCPs use external ratings in determining their capital requirement was raised by the audience. After referring to the EBA FINAL draft Regulatory Technical Standards on Capital Requirements for Central Counterparties

under Regulation (EU) No 648/2012⁵, it appears that indeed, at least for some exposures, the RTS refer to regulations which themselves allow the use of external ratings. For example, for the calculation of the risk-weighted exposure amounts for non-covered credit risk, it says that a CCP shall apply the Standardised Approach described in the Directive (EU) No 2006/48/EC, which itself mentions in its Article 30 that "Credit quality may be determined by reference to the credit assessments of External Credit Assessment Institutions ('ECAIs')".

The importance of several specific uses was also highlighted:

- In the structured finance segment, ratings are instrumental in structuring the transaction. It was mentioned that the best structure for a securitisation transaction is determined through an iterative process between the CRA and the originator. The pricing of these transactions ultimately depends on their ratings.
- For banks and insurers, the main drivers for using ratings are to comply with regulatory requirements (Liquidity Coverage Requirements and capital requirements are major economic factors for banks) and for accessing finance.
- Banks and insurance companies use external ratings to set up and/or calibrate their internal models. It does not mean that banks design their models to mimic the ratings, but they map the internal ratings against the external ratings, to assess what a particular internal rating means if translated into an external rating. In the asset management sector, ratings are used for two primary purposes:
 - a) Defining the investment universe (to reflect investors' expectations, and also because investors use external ratings as a control tool).
 - b) Benchmarking i.e the performance of portfolios or funds is assessed against so called benchmarks that are defined in terms of ratings (investment grade benchmarks, high yield benchmarks).
- There is also the use of ratings by MMFs (to attract investment) which has been highlighted as carrying the risk of sole and mechanistic reliance in the recent IOSCO report.
- In collateral frameworks, as in repo transactions, ratings are very important because of the common language function they fulfil. The list of eligible collateral is often mapped against external ratings.
- Auditing firms are also users of ratings. As per IFRS 9, impairment rules will be triggered by change in credit – and external ratings will be a source of information.

Table 1 overleaf provides an overview of the main uses of credit ratings by various stakeholder groups - it has been updated to reflect the comments and feedback provided by the market participants.

⁵ https://www.eba.europa.eu/documents/10180/105101/EBA-DraftRTS-2012-01--Draft-RTS-on-capital-requirements-for-CCPs---WITH-CORRECTED-TYPOS_1.pdf

Table 1: The use of ratings by regulators, central banks and market participants

Type of use		Types of users							
		Asset Managers / Investment funds / Hedge funds	Insurance/ Re-insurance companies	Credit Institutions/ Banks	Pension Funds	Non - financial corporations	CCPs	Central banks	Government (national/ sub-national)
Borrowing and lending activities	To access finance (by demonstrating creditworthiness)		✓	✓	✓	✓ (bonds)		✓	
	Making investment/ lending decisions (i.e. to assess creditworthiness)	✓	✓	✓	✓	✓ (in the case of M&A)			
	Offering trade credit					✓			
	Credit enhancement through structured finance transactions	✓	✓	✓	✓				
	Monitoring and managing credit risk	✓	✓	✓	✓				
	Disclosure, communication and reporting portfolio risk	✓	✓	✓	✓				
	Defining the investment universe	✓			✓				
Collateral frameworks	Value and eligibility of collateral	✓	✓	✓			✓	✓	
	Haircuts						✓	✓	
Contractual uses (investor protection)	Investment mandates/ guidelines	✓	✓	✓	✓				
	Reinsurance arrangements		✓	✓	✓				
	Loan agreements, guarantees, letters of credit			✓	✓	✓			
	Derivative covenants/ OTC derivatives contracts		✓	✓	✓		✓		
	Prospectuses (bonds, funds)	✓		✓	✓	✓			✓
	Fund rating	✓							
	Repo transactions		✓	✓					
Regulatory uses	Monitoring of systemic risk/ stress tests		✓	✓				✓	✓
	Determining capital requirements		✓	✓			✓	✓	✓
	Determining securitisation exposures		✓	✓				✓	✓
	Liquidity		✓	✓	✓				✓
most common uses of external ratings									

Section 2: The role that external ratings play in credit risk assessment

Participants generally agreed that external ratings are rarely used in isolation and that various approaches co-exist depending on the sector, on the market participant, on the asset class, etc, especially when it comes to investment decisions as opposed to the determination of capital requirements, where the use of external ratings is mechanistic under the standardised approach / the standard formula (via the mapping of external ratings to credit quality steps).

The consequences of differences between external ratings and internal risk assessments were discussed. It was highlighted that the discrepancies are what people pay attention to, since it is where money is made or lost. Market participants will strive to understand the reasons behind the discrepancies, to figure out who is making the correct judgement.

The question of knowing whether the internal assessment will prevail is not a yes/no answer. In the asset management sector, it is possible not to divest in such instances, provided that there is trust in the internal analysis. But it will depend on the context: an investment fund (unless it is a rated fund) generally has more flexibility than an asset manager working under predefined mandates and meeting institutional investors' requirements.

In the banking / insurance sector, the players using the standardised approach/standard formula will be less flexible / the external ratings will play a bigger role. Indeed, for them, calculating capital requirements and making investment decisions are not completely disconnected from each other, as the foreseen capital requirements influence the investment decisions and investment positions determine capital requirements.

On a separate note, the participants agreed that use of small agencies was limited. Several reasons were cited for this:

- Ratings produced by smaller agencies are often not yet accepted for regulatory purposes, as the mapping of external ratings to credit quality steps is still ongoing (for the insurance sector)
- Ratings produced by smaller agencies are often not accepted by central banks e.g. the ECB only accepts ratings produced by four CRAs
- Differential treatment of ratings by regulators and market participants e.g. 'AAA' by smaller agency is often not treated as a 'AAA' by the big three

It was mentioned that new CRAs could have an incentive to produce inflated ratings (to attract issuers). A counter argument which was raised is the reputation factor. Besides, in the draft mapping of credit quality steps against credit assessments of External Credit Assessment Institutions, a high rating by a new CRA does not equate to a high rating by a Big 3 agency (which means there are provisions in place against possible gains in terms of capital requirements should rating inflation happen).

On the other hand, the fact that, in the draft mapping, the ratings by newer CRAs and Big 3 agencies are not treated equally has indeed been reported by a few market participants during the interviews as detrimental for smaller agencies – market participants will not opt for smaller agencies if it penalises them in terms of capital requirements.

With the mapping of credit quality steps against credit assessments of External Credit Assessment Institutions not yet finalised, the ratings by smaller agencies cannot yet be used to determine capital requirements. The expected date for the final mapping (initially set in June 2014) cannot yet be confirmed – it is possible that the final mapping is not available by January 2016, when Solvency II comes into force.

Section 3: Regulatory drivers of the use of external ratings

The audience confirmed that regulation remains a key driver behind the use of external ratings by market participants in several sectors – Table 2.

Table 2: Drivers of the use of external ratings by market participants (investors/intermediaries and issuers)

Drivers of the use of external ratings	Asset Managers	Insurance/ Re-insurance companies	Credit Institutions/ Banks	Other Institutional Investors	Non-financial corporations	Government (national/sub-national)
Own sectoral regulation	Low	High** (determining capital requirements)	High (determining capital and liquidity requirements)	Medium*	N/A	N/A
Sectoral regulation from other sectors	High (Regulation applicable to investors)	Low (To a minor extent, for financial conglomerate)	Low (To a minor extent, for financial conglomerate)	N/A	N/A	N/A
Investor preferences	High (internal policies of investors)	High (ratings are necessary to access capital markets)	High (ratings are necessary to access capital markets)	High (internal policies of investors)	High (ratings are necessary to access capital markets and important to determine the interest rate with banks)	High (ratings are necessary to access international capital markets)

* In some countries, there are regulatory provisions stipulating minimum rating requirements or investment limits (defined with reference to external ratings) for pension funds – CRAIII had the ambition to reduce overreliance in the pension fund sector.

** Under Solvency I, insurance companies in many countries had investment limits for specific asset classes defined in terms of ratings. This reference to ratings will disappear in 2016 when Solvency II will be applied.

In the asset management sector, the only sectoral piece of regulation making references to ratings is the MMF Guidelines⁶. They have now been revised – there is no more threshold below which money market instruments are automatically excluded from the investment universe but references to external ratings remain, whereby “a downgrade below the two highest short-term credit ratings by any agency registered and supervised by ESMA that has rated the instrument should lead the manager to undertake a new assessment of the credit quality of the money market instrument to ensure it continues to be of high quality”.

⁶ http://www.esma.europa.eu/bg/system/files/10-049_cesr_guidelines_mmfs_with_disclaimer.pdf

In the asset management sector, if the vehicle (fund) is rated, CRAs will sometimes impose strict requirements to maintain an AAA rating. CRAs will maintain 'AAA' of a fund only if the fund invests in 'AAA' as rated by the Big 3 agencies.

In terms of the overview of references to external ratings in key EU sectoral legislation, it was only highlighted that the provisions mitigating risks of overreliance in Solvency II should be mentioned (see amended Table 3).

Table 3: References to external ratings in EU sectoral legislation

Sector	Key references to external ratings
Banking sector	<p>Under the Basel II standardised approach, the Capital Requirement Directive (CRD) refers to credit ratings for measuring capital requirements.</p> <p>CRR/CRD IV still rely to a large extent on external ratings under the standardised approaches (to determine credit risk, counterparty credit risk and market risk, and for large exposures).</p> <p>The credit risk framework establishing capital requirements contains references to credit quality steps in order to determine risk weights. Through EBA binding technical standards, the credit quality steps are mapped to ratings of CRAs.</p> <p>Moreover, CRR goes beyond capital requirements by notably including specific provisions related to liquidity. These liquidity provisions rely to some extent on CRA ratings.</p>
Insurance sector	<p>With Solvency II, new references to ratings are introduced in the sectoral legislation, to calculate capital requirements under the standard formula. This results from the introduction of a risk based approach, similar to what exists in the banking sector. However, references to ratings that were common in regulatory investment limits under Solvency I will disappear.</p> <p>Solvency II also contains provisions specifying that sole and mechanistic reliance is forbidden. It foresees that insurers have to use additional assessments whenever practically possible, and it is necessary for large and complex exposures.</p>
Asset management sector	<p>There are no regulatory incentives to use ratings in the asset management sector.</p>
Investors (e.g. pension funds)	<p>The extent to which eligible investments or permissible asset concentrations are defined in terms of external credit ratings varies by jurisdiction.</p>

Another possible area with references to external ratings in the banking sector was mentioned. Credit institutions can post collateral to secure their payment commitment amount to deposit guarantee schemes and in that context, the question was raised of

whether there could be references to credit ratings in the eligibility criteria for accepting collateral. After verification, the criteria for eligibility and management of collateral in the EBA Guidelines on payment commitments under Directive 2014/49/EU on deposit guarantee schemes⁷ specify that the criteria used can be those of the European Central Bank (ECB) or national central banks of the European Union.

Section 4: Contractual references to external ratings

The audience broadly shared the SCA's views expressed in the survey that, in certain types of financial contracts, references to external ratings are widespread. It was highlighted that with the benefit of hindsight, it would have been beneficial to ask the SCAs in a close ended question to which extent the references to external rating have the potential to trigger sole and mechanistic reliance.

The participants agreed that the list provided below reflects the main contractual uses of ratings (with small additions)

- Rating constraints and guidelines in investment mandates/ asset manager contracts.
 - For example, asset managers are sometimes constrained to only invest or retain issues that are investment grade, according to the ratings given by specific agencies (typically the Big 3).
 - Similarly, fund rating (more precisely the rating agency rating a fund) has a dramatic influence on the eligible investments of the fund itself (permitting to invest only in the instruments rated by itself at a particular grade).
- *Rating triggers are often used in loan and bond covenants.* These triggers are contractual provisions that give counterparties and lenders the right to terminate credit availability, accelerate credit obligations or have the borrower post additional collateral in the event of specified rating actions.
- *Collateral agreements/ frameworks, including for OTC derivatives.* Lenders impose minimum rating standards on securities accepted as collateral for a loan. This can be the result of voluntary lending policy guidelines or regulatory references to ratings. Similarly, central banks do not accept securities below investment grade as collateral for commercial bank borrowing.
- *Other contractual references* include prospectuses, re-insurance agreements and letters of credit.
 - Another example of contractual use was quoted and taken from the news: in the documentation related to hybrid instruments, there are often provisions allowing the issue redemption before the maturity in case of a Rating Methodology Event. With S&P's recent decision to consider hybrids as 100 per cent debt when calculating credit ratios, this type of contractual provision might prove useful for the issuer⁸.

In terms of the mitigating factors, one factor which was added to the list is the use of multiple ratings as well as the use of ratings by smaller agencies.

⁷ <https://www.eba.europa.eu/documents/10180/1089310/EBA-GL-2015-09+Guidelines+on+DGS+payment+commitments.pdf>

⁸ See for instance <http://www.ft.com/intl/cms/s/0/204edd8c-7e30-11e5-a1fe-567b37f80b64.html#axzz3rBzx66gz>

Box 1 List of mitigating factors quoted

The use of internal credit risk assessment systems (which are supposed to be ahead of ratings)
 Introduction of grace periods in contracts
 Inclusion of a small high yield / unrated bucket in the mandate
 Negotiable character of contractual provisions
 Rating requirements which do not need to hold throughout the investment cycle
 Defining investment grade in terms of internal rating
 Possibility to overrule the external rating
 Use of multiple ratings and use of ratings by smaller agencies.

The relevance of those mitigating factors across the different sectors was also discussed. It was first highlighted that these mitigating factors relate to the contractual uses of external ratings – not to the determination of capital requirements. Besides it was explained that the extent to which insurance companies will be prone to use such mitigating factors will depend on several factors: whether the availability of own funds is a constraint for them, whether they use an internal model or not.

The study team clarified that this list of mitigating factors, drawn from qualitative research, represents the range of existing practices without assessing quantitatively the prevalence of each mitigating factor.

Section 5: Mapping and feasibility of alternatives

Market participants agreed Table 4 represents the range of possible approaches to credit analysis, not forgetting the automated scorings by companies such as D&B and Van Dijk. As such, the alternatives are not mutually exclusive and cannot be used in isolation.

There was consensus that the holy grail of alternatives does not exist.

The table maps both full alternatives, i.e. in house analysis which is the expression of an opinion on creditworthiness like an external credit rating by a CRA, and pieces of information / approaches which may feed into the formation of such an opinion.

Table 4: Classification of different approaches to credit analysis

Type	Sub-category	Description	Input data / sources of information	Asset class for which alternative may be suitable
Internal	In-house credit analysis (judgmental)	The bulk of the analytical work is performed by the investor through a combination of model generated outputs and own analysis	A variety of data is used Market-based measures Accounting-based measures Third party assessments Default statistics etc.	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt • Structured products •
	In-house credit analysis (fully automated)	Standard models are used to generate statistical scoring or probability of default	Proprietary models or vendor solutions generating model based probability assessments, indexes and implied ratings	

Type	Sub-category	Description	Input data / sources of information	Asset class for which alternative may be suitable
External	Market- based measures	Credit default swap spreads	Market data in used as proxy measure of risk	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt • Structured products
		Bond pricing information	Market data in used as proxy measure of risk	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt •
	Accounting based measures	Financial ratios	Data collected from sources such as Dun & Bradstreet, Amadeus etc. is analysed by investor	<ul style="list-style-type: none"> • Corporate debt
	Third party assessment (non-commercial)	OECD country risk classification	Data collection and analysis is carried out by the OECD	<ul style="list-style-type: none"> • Sovereign debt
		Scoring by central bank based on central credit registers (CCRs) and central financial statements databases (CFSDs)	Data collection and analysis is carried out by the Central Bank	<ul style="list-style-type: none"> • Corporate debt
	Third party assessment (commercial)	Scorings	Data collection and analysis is carried out by commercial entities (data providers, consultancies)	<ul style="list-style-type: none"> • Corporate debt •
		Ratings produced by rating agencies or other similar entities (which may call themselves rating agencies or not)	Data collection and analysis is carried out by rating agencies	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt • Structured products

One approach which was discussed is the added value of promoting the availability of more data in the public domain / of promoting a tool organising available data, so that investors can make their own assessment.

- It was put forward that the problem today is that there is an abundance of data, but that it is expensive to collect, process and analyse information when it is fragmented. Data is not being organised and structured for functional purposes. Only academics, CRAs and large entities actually access the data published by e.g. central banks. The abundance of information creates entry barriers for smaller players. The idea of a public body, e.g. the EC, getting involved in organising the information was highlighted as a way forward. Under this approach, the competition / market forces would play a role only in the "generating opinion" part of the rating process. No consensus was however

found on that point, as it was mentioned that many private players are already active in standardising the available information and in this case, the problem is more a cost issue for smaller players wanting to source the data already standardised. A cautionary note on standardisation was flagged – it can be counter-productive if the wrong standards are created; it can be hard to change and adapt standards (standards can create path dependency).

- Initiatives such as the simple standardised securitisation (STS) and the European Data Warehouse are steps which go into that direction, but are not yet comprehensive enough. Often, one problem is that the data is not organised in a functional manner, as the general public use was not the original aim of such initiatives (the European Data Warehouse was initially designed for the ECB itself)
- There are cost implications of asking FIs to provide more and more data. Solutions should therefore focus on how the data that is already available can be organised a more effective way and be made available to a broader circle of users/investors.

Of the various approaches identified, participants generally agreed that the only fully credible alternative to external ratings is internal credit assessment processes. Several comments were made on the internal system, including:

- One point which was flagged is that among the mapped approaches, only internal analysis is fit as an alternative for determination of capital requirements purposes. If used for regulatory purposes, an alternative should be risk sensitive enough. The BCBS approach was, for instance, considered as too simplistic (two risk drivers) compared to the CRA methodology.
- From a regulatory point of view, reliance on internal systems comes with an additional burden for regulators. It is important to ensure internal system produce reliable estimations for capital needs – regulators have very expectations in this area. It is therefore often more difficult for smaller entities to bear the cost of an application for the use of internal ratings/models. If the entity is too small, it makes more sense for that entity to rely on a third party assessment and convince the regulator that the third party in question is well placed to undertake the assessment. Then, for entities using the standardised approach, internal assessments which would be produced cannot overrule external ratings, unless where the internal assessment indicates that the external ratings expresses a too high credit quality.
- It was highlighted that, in practice, a minority of the credit institutions (in terms of number of institutions – the picture might be different in terms of market share) have obtained an approval for the use of the Foundation Internal Ratings Based approach (FIRB) or of the Advanced Internal Ratings Based approach (AIRB) – see the recent ESMA technical report⁹. The main reasons for that are cost and resources, according to the participants.
- There was a discussion with regards to the actual resources needed to build and maintain an internal model but it was difficult for a clear picture to emerge as many factors play a role, including the scope of the internal model and the staffing level of the internal department, which itself depends on the size of the institution. In Europe, there are many banks and insurers which operate with 20 members of staff, or even 2-3 people (overall). For banks, even small banks, assessing credit risk is at the core of their business (although it is evolving with the new services banks now provide). Other cost influencing

⁹ ESMA. 2015. Technical Advice on reducing sole and mechanistic reliance on external credit ratings. Available at: https://www.esma.europa.eu/system/files/esma-2015-1471_technical_advice_on_reducing_sole_and_mechanistic_reliance_on_external_credit_ratings.pdf

factors were quoted including the fact that if the portfolio is “straightforward”, the costs should be reasonable, but on the other hand, factors which increase the cost are the fragmentation of available information and the incentives to diversify. For the initial development of internal models, development costs can be of the following order of magnitude: high single digit million euros. A survey to banks by an auditing firm on the cost of an internal model for banks showed that many banks declared the costs to be superior to 50 million euros, or 5 million euros.

- One way forward for small organisations lacking resources could be to pool resources to build common internal systems or to outsource the analysis to a qualified third party.
- When comparing the reliability of external vs internal ratings, the academic literature¹⁰ suggests that with internal ratings, the capital requirements for banks tend to be lower, while risks and losses increase.
- Other works e.g. by the EBA confirm that different internal models come with different conclusions – but diversity per se is valued.
- In terms of knowing whether there are incentives to get the internal models right, there must be diverging perspectives within a same institutions (and therefore the internal systems of check of balance). Also it depends on the function of the internal model. There are many internal models within the same institutions and while banks certainly have incentives to make the right investment decisions, they could at the same time be focussing on lowering capital requirements.
- The reliability of an internal system will never reach 100% - since an internal system, like a CRA, produces an *opinion*.

On the ability of alternatives to limit negative effects such as pro-cyclicality: it was mentioned that 0 does not reflect the intrinsic characteristics of alternatives per se but the rather the ability of alternatives to limit pro-cyclicality because of the use / potential use which is made of the alternative. Per se, all approaches based on judgment (internal analysis, external ratings by CRAs) are less procyclical but in the case of external ratings by CRAs, pro-cyclical effects derive from mechanistic reliance on a limited pool of opinions.

On a separate note, some amendments were suggested to assessment criteria.

- Ease of use for market participants was considered as very similar to cost for market participants
- Acceptability should be broken down per different uses.

Table 5 presents an overview of alternatives and of their feasibility integrating the comments made during the workshop.

¹⁰ Behn, Markus and Haselmann, Rainer F. H. and Vig, Vikrant, The Limits of Model-Based Regulation (November 30, 2014). SAFE Working Paper No. 75. Available at SSRN: <http://ssrn.com/abstract=2523383> or <http://dx.doi.org/10.2139/ssrn.2523383>

Table 5: Preliminary comparative assessment of the different approaches to credit risk assessment

Criteria \ Alternative	In house analysis	Market based measures	Accounting based measures	OECD country risk	Scoring / assessment by CB	Other third party scoring	External ratings
Applicability	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt • Structured products • 	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt (for highly liquid instruments) • Structured products (for highly liquid instruments) 	<ul style="list-style-type: none"> • Corporate debt • 	<ul style="list-style-type: none"> • Sovereign debt 	<ul style="list-style-type: none"> • Corporate debt • Structured products • 	<ul style="list-style-type: none"> • Corporate debt • 	<ul style="list-style-type: none"> • Sovereign debt • Corporate debt (of large companies) • Structured products •
Coverage	<ul style="list-style-type: none"> • Based on needs of FI 	<ul style="list-style-type: none"> • Instruments that are traded 	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> • Corporate-mainly cover big companies
A functioning alternative according to market participants	Yes	No	No (only in specific cases e.g. loan covenant)	Yes (with some limitations)	Yes where available and accessible	No (except for small and mid caps)	N/A

Criteria \ Alternative	In house analysis	Market based measures	Accounting based measures	OECD country risk	Scoring / assessment by CB	Other third party scoring	External ratings
Reliability & accuracy of the alternative in signalling the credit quality of the instrument / of the counterparty	High	Low – high levels of volatility	Medium	High	Medium	Medium	High for corporates Low/ Medium for sovereigns and structured finance
Ability to compare and rank different instruments /counterparties according to their credit risk	High within the same internal system Medium across systems	Medium	Medium Low across countries	High	Medium Low across countries	Medium	Perceived as high by market participants, but challenged by the academic literature ¹¹
Limitation of negative effects such as pro-cyclicality	High	Low	Medium	Medium	Medium	Medium	Low
Transparency	Low to the outsider, Medium to the supervisor	High	Medium	High	Medium	Medium	High
Suitability of the alternative for supervisory purposes	Medium	Medium	Medium	Medium	Medium	Medium	High

¹¹ See for instance: Cornaggia, Jess and Cornaggia, Kimberly Rodgers and Hund, John, Credit Ratings across Asset Classes: A Long-Term Perspective (November 10, 2015). Available at SSRN: <http://ssrn.com/abstract=1909091> or <http://dx.doi.org/10.2139/ssrn.1909091>

Criteria \ Alternative	In house analysis	Market based measures	Accounting based measures	OECD country risk	Scoring / assessment by CB	Other third party scoring	External ratings
Acceptability	High for regulatory purposes High investment decisions Low in contracts	Low for regulatory purposes Low for investment decisions Low in contracts	Low for regulatory purposes Low for investment decisions High in contracts	High for regulatory purposes (US experience) Medium for investment decisions Medium in contracts	Medium for regulatory purposes Medium for investment decisions Medium in contracts	Low for regulatory purposes Low for investment decisions (large caps), medium for investment decisions (small and mid caps) Medium in contracts	High for regulatory purposes High for investment decisions High in contracts
Cost of using the alternative for supervisors	High- supervisors have to approve internal approaches	Low	Low	Low	Low	Low	Low
Cost of using the alternative for market participants	High – duplication of effort across participants	Low	Low	Low	Low	Low	Low

Concluding remarks

There are several contexts within which external ratings are used, mainly when making an investment decision, for contractual uses and for regulatory purposes. The problematic area, where it seems more difficult to reduce sole and mechanistic reliance on external credit ratings, is the prudential use of ratings.

There is a need to find actions to reduce sole and mechanistic reliance resulting from regulatory references to ratings. The US experience¹² and BCBS work could maybe be further explored to learn on that point. In addition, the current framework used to calculate capital charges could be revised. One could, for instance, question the fact that unrated instruments automatically require high capital charges. There would also be a case to introduce more granularity (i.e. introduce more quality steps) and / or to smoothen the scale (closer capital charges across steps, no big jumps). Besides the mapping of credit quality steps against external ratings could maybe integrate other elements / inputs.

There is no silver bullet alternative. Of all approaches mapped, internal analysis is the one with most potential and the one which should be further incentivized. Regulatory concerns, however, need to be addressed (standards cannot be lowered; using an internal model for regulatory purposes necessarily need a supervisory approval) and cost issues should also be taken into consideration. Regulators and FI need to find the right balance between the cost for implementation and approval of internal models and the benefit of their use.

Availability of data – in an organized manner – is also a priority which can facilitate internal analysis. It could be considered as a public good.

Acting on the state of the CRA market, increasing competition, favouring the entry of new players (maybe specialized in sectors) is complementary to promoting alternatives. In terms of regulating the CRA market, however, much has already been introduced and constraints created, which also mean that in some cases (e.g. Mergers & Acquisitions), the CRAs cannot react as quickly as the sell side players. As it was shown in the case of the securitization market, especially in the US, competition among CRAs (securitization markets were the area where CRAs were competing the most) does not automatically mean valuable information is brought to the market– there needs to have provisions in place to make sure own judgement is not impaired / there are no flaws in the methodologies.

¹² On the impacts of the changes made in the US for the insurance sector, see:

Hanley , Kathleen Weiss and Nikolova, Stanislava, The Removal of Credit Ratings from Capital Regulation: Implications for Systemic Risk (July 1, 2014). Available at SSRN: <http://ssrn.com/abstract=2357145> or <http://dx.doi.org/10.2139/ssrn.2357145>

Becker, Bo and Opp, Marcus M., Regulatory Reform and Risk-Taking: Replacing Ratings (September 2, 2014). Swedish House of Finance Research Paper No. 13-03. Available at SSRN: <http://ssrn.com/abstract=2294416> or <http://dx.doi.org/10.2139/ssrn.2294416>

List of participants

Name	Organisation
Ms Natasha Cazenave	IOSCO Committee 5 / AMF France
Ms Melania Dinescu	Commission de Surveillance du Secteur Financier (CSSF)
Mr Dieter Hendrickx	National Bank of Belgium (NBB)
Mr Stephane Herndl	Amundi / French Asset Management Association (AFG)
Mr Bernhard Reisecker	Vienna Insurance Group (VIG)
Mr Robert Hintze	Insurance Europe
Mr Marco Mancino	European Association of Co-operative Banks (EACB)
Mr Casey Campbell	CreditUtility
Dr Dion Bongaerts	Rotterdam School of Management
Mr Philippe Caluwaerts	DG FISMA
Mr Paul Fraix	DG FISMA
Mr Paolo Fucile	DG FISMA
Dr Pedro Gomes	Universidad Carlos III de Madrid
Prof Lawrence White	New York University's Stern School of Business
Prof John Ryan	London School of Economics
Ms Charu Wilkinson	ICF
Ms Juliette Mathis	ICF

Annex 5 Additional research findings

Main survey results

Four online surveys were designed to collect inputs from the following stakeholder groups: (i) Sectoral Competent Authorities; (ii) Credit rating agencies; (iii) National central banks; (iv) National treasuries. Table 1 indicates the number of responses received.

Table 6 Answers to the survey to date

	Number of responses received
Sectoral Competent Authorities (SCAs)	29
Credit rating agencies	8
Central banks	0
National treasuries	14

Main results of these surveys are presented below.

SCA survey

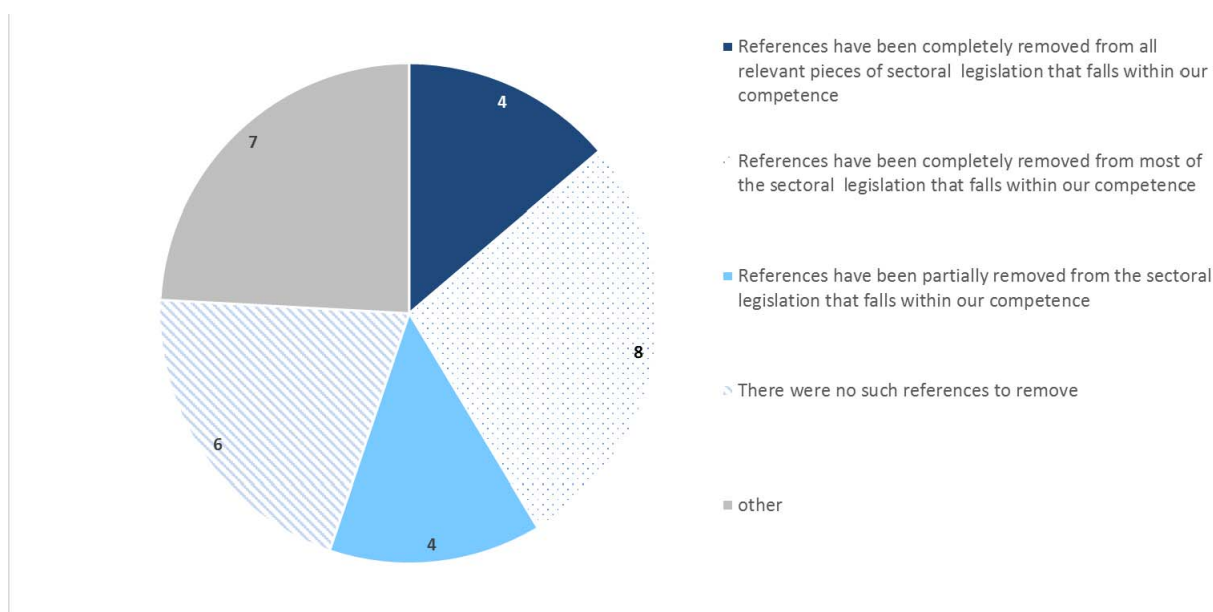
Profile

In terms of the sectors covered by SCAs, there was a balanced representation. All listed sectors (Credit institutions, Investment firms, Insurance/ reinsurance undertakings, Institutions for occupational retirement provision/ pension funds, Asset management companies, Investment companies, Alternative investment fund managers, Central counterparties and prospectuses) gathered 12-15 respondents (multiple choice of sector possible).

Regulatory references to external ratings

SCAs were first asked about the steps taken by their organisation over the recent years to remove references to credit ratings in national sectoral legislation. Four SCAs indicated that references that have the potential to trigger "sole or mechanistic reliance" on credit ratings have been completely removed from all national sectoral legislation falling under their competence. Six SCAs highlighted there were no such references to begin with. In eight cases, the references had been removed from most of the relevant legislation, and in four cases, the references had partially been removed. The remaining SCAs are still in the process of assessing the current situation or put forward that the remaining references come from EU legislation.

Figure 1 Steps taken to remove references that have the potential to trigger "sole or mechanistic reliance" on credit ratings in national sectoral legislation



Source: ICF survey of SCAs; n=29

Question: What steps have been taken by your organisation in recent years to remove references to credit ratings in national sectoral legislation (including national legislation transposing EU legislation)? Please tick one box only

EU legislation (in the banking and insurance sector) is also the main reason given for not removing all references to credit ratings, followed by the advantages of external credit ratings and the lack of alternatives. To some extent, the complete removal of regulatory references to external ratings is not seen as desirable and/or feasible for the same reasons.

In terms of the extent to which the regulatory changes made so far have been effective in reducing formulaic reliance on credit ratings by market participants, SCAs have given mixed opinions. On the one side, for some SCAs, changes were too recent for impacts to be assessed, or the relevant legislation were still to be implemented. On the other side, others expressed the view that sole and mechanistic reliance on credit rating had effectively been reduced and made the link to an increase in the take up of the internal ratings based approach.

Implementation of Article 5a(2) of the CRA Regulation

Steps taken to monitor the adequacy of the credit risk assessment processes among supervised entities

SCAs were first asked to explain which steps they had taken to monitor the adequacy of the credit risk assessment processes among supervised entities.

Most of them indicated that monitoring the adequacy of the credit risk assessment processes is part of their routine monitoring and surveillance activities (on-site and off-site supervision, audits, review of credit risk management documentation).

Some SCAs highlighted they had taken steps (via information campaigns, updates of the national legislation) to draw the attention of their supervised entities to the need to adapt, where necessary, their credit risk assessment procedures and their financial documentation (e.g. their investment principles).

Some SCA answers seemed to indicate they focused their efforts on monitoring the adequacy of the processes to determine regulatory capital requirements (use of the

Standardised Approach or of the Internal Rating based approach), rather than on the wider issue of credit risk assessment processes.

Some SCAs had not yet taken specific steps (too recent regulatory changes / not yet implemented), although this could be the case in the future (one SCA indicated that it could be the subject a thematic review in the future but that it had not yet been the case).

Steps taken to monitor contractual references to external credit ratings among supervised entities

Secondly, SCAs were asked to explain which steps they had taken to monitor contractual references to external credit ratings among supervised entities.

To some extent, monitoring contractual references is also part of regular activity: part of the audit / risk assessment processes, on-site supervision and thematic reviews.

Some SCAs indicated the use of external ratings in contracts is not monitored systematically, but rather on a case by case basis. For instance, the impact of ratings changes in specific contracts or transactions may be investigated if considered as relevant for the supervised entity. One SCA indicated how implementing a systematic monitoring approach is not feasible, considering the sheer number of various contractual arrangements and contractual freedom considerations.

In the asset management / investment companies sectors, a few SCAs have put in place a system whereby they approve the commercial documents / prospectuses before disclosure, to ensure there is no sole and mechanistic reliance on external ratings.

In this area as well, some SCAs indicated it is too early to have taken action, while for a few others contractual references to external credit ratings among supervised entities is not considered as an area meriting attention (because of the low scale of the problem).

Steps taken to: (i) encourage supervised entities to mitigate the impact of such references, with a view to reducing 'sole and mechanistic' reliance on credit ratings and (ii) promote alternatives to external credit ratings

Apart from those having not yet taken action, most SCAs consider they encouraged supervised entities to mitigate the impact of such references to external rating and promote alternatives via legal changes as well as surveillance, monitoring and enforcement actions.

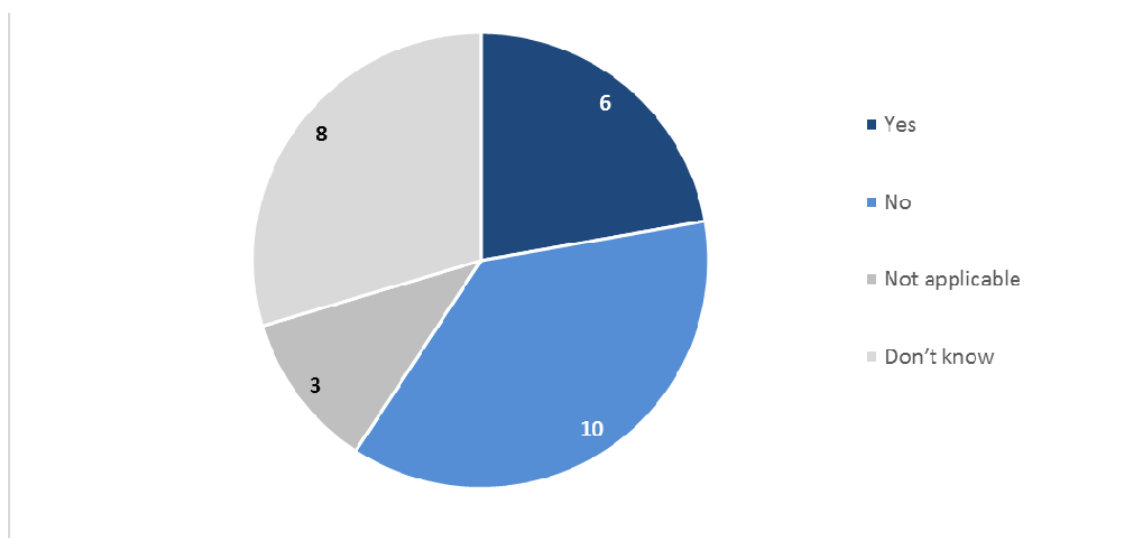
While some SCA answers seem to indicate that they have not taken any further steps on the basis that the law is regarded as sufficient, some SCAs went beyond. Activities undertaken comprised: dialogue with supervised entities, recommendations to companies and industry associations, press releases about CRAIII, issue of thematic publications, organisation of workshop with market participants.

Changes over the recent years in terms of contractual references to ratings

SCAs were asked whether they noticed any changes in market practices in recent years with respect to the use of credit ratings in financial contracts.

Most respondents indicated that they either did not notice any change (10 SCAs) or did not know (8 SCAs). Only six SCAs indicated that they noticed a change (reduced sole and mechanistic reliance).

Figure 2 Changes in market practices in recent years with respect to the use of credit ratings in financial contracts



Source: ICF survey of SCAs; n=27

Question: Have you noticed any changes in market practices in recent years with respect to the use of credit ratings in financial contracts? Please tick one box only

As answer to the next question, SCAs were invited to convey main challenges that might be preventing their supervised entities from reducing contractual references to credit ratings.

In their qualitative answers, no less than ten SCAs mention the lack of empirically tested, transparent and comparable alternatives. Some SCAs reminded the advantages of external ratings and the cost of developing internal or alternative credit assessment methodologies. In addition, it was underlined that in the context of contractual relations, assessments by third parties, having no stake in the transaction, is valued (including because it prevents conflict of interest). Another quoted factor is the pressure from investors' side.

National treasuries' survey

Use of external credit ratings

Extent to which a sovereign rating remains an important factor when accessing international capital markets

National treasuries widely believe that sovereign ratings remain an important factor when accessing international capital markets (two respondents have highlighted an important factor amongst other). The main reasons are that external ratings, especially produced by the big three CRAs, are important criteria for the investment decisions and risk management policies of investors and for the ECB collateral framework. Sovereign ratings allow reaching a wide and diversified investor base.

Main benefits of using external credit ratings

The main benefits of using external credit ratings from a national treasury's point of view include: comparability (standardised ranking which is internationally recognized), wider investor base (it allows investors to outsource or compare their own assessments), recognition (especially for new entrants), lower borrowing costs, simplicity, transparency, objective and neutral judgement, reliability.

Experience with drawbacks from 'mechanistic' reliance on external credit ratings in recent years

Eight responding National Treasuries indicated that they experienced drawbacks from 'mechanistic' reliance on external credit ratings in recent years.

Many referred to the time of the financial / sovereign debt crisis, when they experienced successive downgrades. Mechanistic reliance on external credit ratings is believed to have forcefully accelerated sell-offs of the downgraded assets (because of the strict rating mandates of the investors or in case investors relied on sovereign benchmark indexes - of which the downgraded bond dropped out). The same effect of reduced investor base was observed in case of securities which were no longer rated. Another detrimental effect for the national treasuries in such situations was the funding cost.

Regulatory improvements

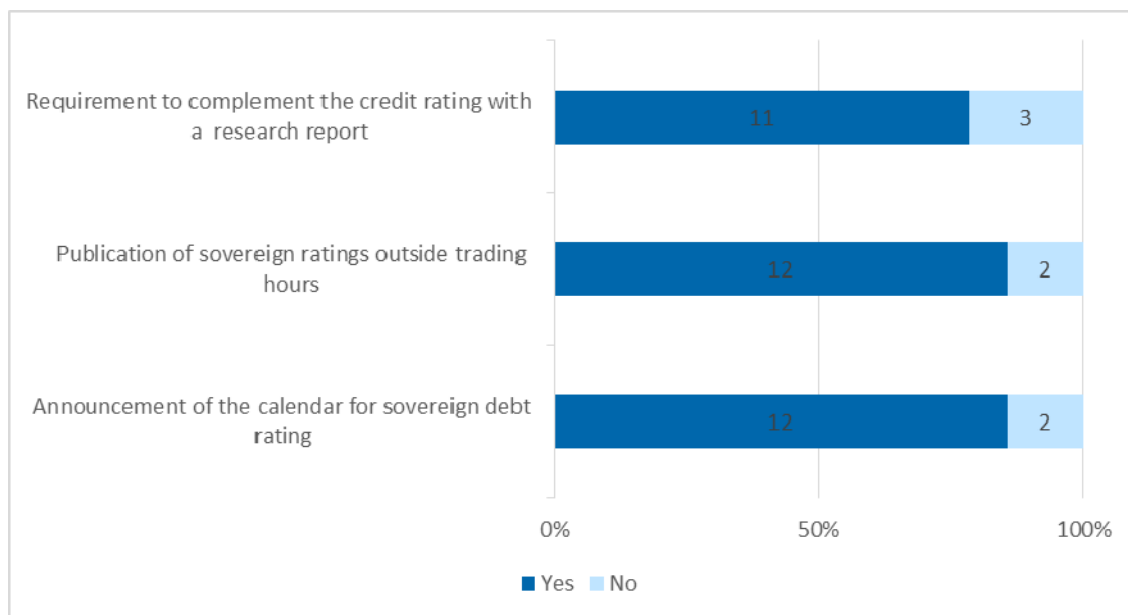
Many of responding National Treasuries did see benefits from all three new transparency requirements introduced by article 8a of the CRAIII regulation.

According to respondents, the **announcement of the calendar for sovereign debt rating** has made the rating process more transparent and predictable. It allows them to better prepare the briefing and announcements. It is also useful to manage the timeline of issuances, ensuring international debt issues are not made on the same date than a rating publication date. Overall it reduces financial instability which used to arise from speculation about credit rating moves. That said, a few National Treasuries regretfully highlighted that event-driven rating changes (outside the calendar) are still possible and made. One respondent highlighted that the calendar should be made available in the year, to allow for a better anticipation of the first trimester rating reviews.

As far as **publication of sovereign ratings outside trading hours** is concerned, the main advantages highlighted by National Treasuries is that it prevents the market from disruptions and large fluctuations. It gives times to market participants to digest the news and fosters more measured consideration (rather than immediate reactions to headlines). There is less risk that debt issues get disrupted due to rating changes.

The **requirement to complement the credit rating with a research report** is also welcome by National Treasuries. They appreciate it gives more transparency on the underlying rating factors and more credibility towards the rating change. It also lowers the risk of arbitrary decisions.

Figure 3 Benefits from the new transparency requirements



Source: ICF survey of NTs; n=14

Question: Have you seen any benefits from the new transparency requirements to be met when rating sovereign debt, which were introduced with the last revision of the CRA regulation (CRAIII, in its article 8a)?

In terms of potential further regulatory improvements, about half of the respondents had suggestions to make. They each concern different areas and are summarised below:

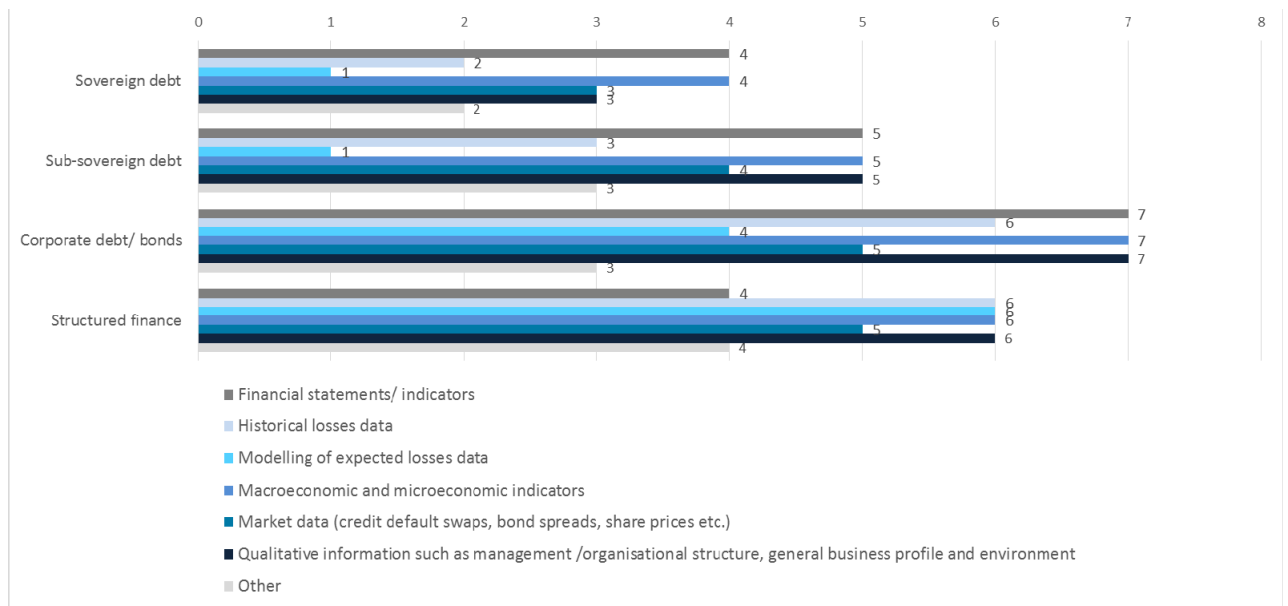
- All remaining references to credit ratings in EU and national legislations could be removed.
- Institutions such as the ECB could also update their policies so as to avoid taking decisions solely on the
- Accompanying research reports could be made mandatory even when there is no rating action (when the rating remains unchanged)
- Significant investors could have an obligation to have their own credit-assessment /-research department for investors
- The use of multi-period/ multi-agency averages could be encouraged and generalised to prevent cliff-effects and reduce the impact of a change in rating by a single agency.

Survey of Credit Rating Agencies

The rating process

All responding CRAs use a mix of quantitative and qualitative indicators to form their assessments. All but one typically request information from the issuer. Information sources are varied and their relevance varies across product type (see Figure 5). These differences in relevant sources of information implies that each product type has its own methodology even if the overall process remains similar. For example, the rating of structured finance instruments relies more on modelling of portfolio cash flows and running sensitivity analysis based on several cash flow scenarios. All computational models used by CRAs are bespoke/ proprietary models.

Figure 4 Sources of information used by product type



Source: ICF survey of CRAs; n=7

Question: Beyond the information provided by issuer/ counterparty, which other sources of information are typically used? Please tick all that apply

Changes implemented since the financial crisis

All but one responding CRA support the public policy objective of reducing overreliance on external credit ratings and the recent steps taken to achieve that objective.

In terms of the changes introduced by CRAs since the financial crisis, few changes in rating methodology were reported. CRAs stress a continuous improvement in the robustness of their methodologies, with some more substantial changes in the methodologies to rate structured finance products and banks.

There were however steps taken to foster users' understanding of underlying methodologies of the external ratings. Respondents reported focusing on transparency. This starts with publishing the methodology on the website and also includes meetings with companies and investors to explain the methodologies, outreach programmes, greater education of policy makers and regulators, providing more information to the market on what credit ratings mean, enhancing documentation.

Other changes which were reported by the respondents include: changes to the approval structure and governance system of the CRA (including e.g. the setting up of an independent model validation group for models used in the rating process) , enhanced staffing levels and trainings, studies about the actual performance of ratings such as actual / expected loss studies and more granular transition and default studies.

Remaining issues to be addressed

Many of the remaining issues responding (smaller) CRAs would like to see addressed related the state of the CRA market, to its oligopolistic market structure and lack of competition. It also related to the acceptance of small CRAs by institutions such as the ECB (which should reportedly abandon or revise its Eurosystem Credit Assessment Framework) and their treatment in the ongoing EBA mapping.

Other issues which have been quoted include inter alia: (i) the need to better educate the users of credit ratings; (ii) the need to have provisions to avoid rating shopping, (iii) the need for international consistency regarding the regulation of CRA activities,

(iv) the need to reduce regulatory overreliance on credit ratings (avoiding rating thresholds and references to specific CRAs), and (v) the need to introduce more information disclosure requirements in the structured product segment.

Aggregated results regarding respondents' view on alternatives to credit ratings

All survey respondents were asked to express their views about potential alternatives to external credit ratings.

While SCAs were asked to tick which particular alternatives could potentially replace or reduce the use of external credit ratings for SCAs, national treasuries and CRAs were asked to indicate whether, yes or no, particular alternatives were viable alternatives to external credit ratings. The given list of alternatives comprised: Internal credit quality assessments; Market based measures; Assessments from international institutions (e.g. OECD country classification); Assessments by e.g. Central Banks; and Automated scorings based on computational models.

SCAs, national treasuries and credit rating agencies were then asked to develop their assessment across nine criteria. For instance, the first criterion invited them to rate the reliability and accuracy of each identified alternative (e.g. internal credit quality assessment) in signalling the credit quality of the instrument / of the counterparty on a three-modality scale (low / medium / high).

Aggregated results are reported below, by alternative, after the presentation of some key messages.

Key messages

The key message, aggregating all respondent types, is that internal credit quality assessments is seen as the most promising alternative overall (75% of positive answers). National treasuries is the exception category which favoured assessments by e.g. the OECD over internal credit quality assessments.

The three next alternatives (Market based measures; Assessments from international institutions e.g. OECD country classification and assessments by e.g. Central Banks) perform equally well (50% of positive answers).

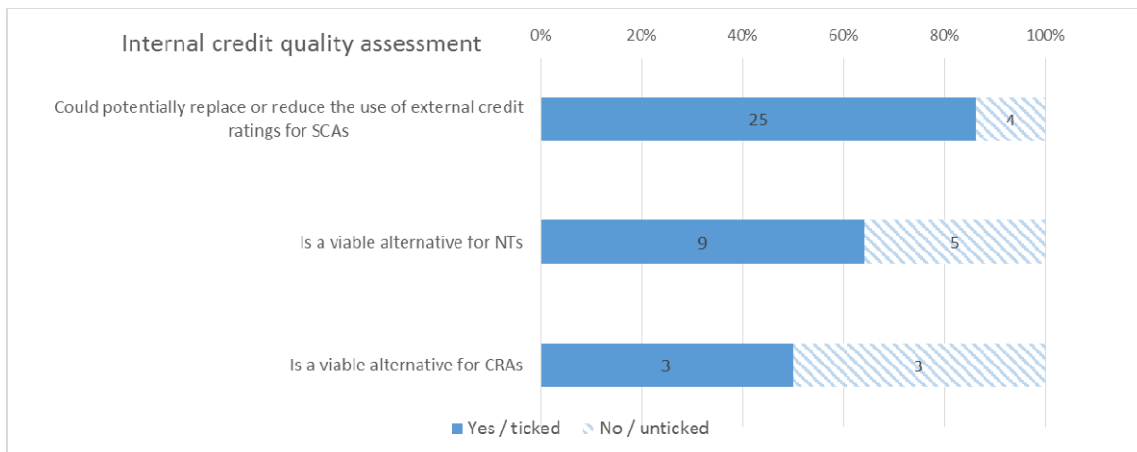
Automated scorings based on computational models is a less convincing alternative according to the respondents (35% of positive answers).

Of all respondents, CRAs were the group rating the alternatives in a less favourable way (25% of positive answers against 55-60% for the other two groups).

Internal credit quality assessments

Internal credit quality assessments is the most convincing alternatives across all stakeholder types.

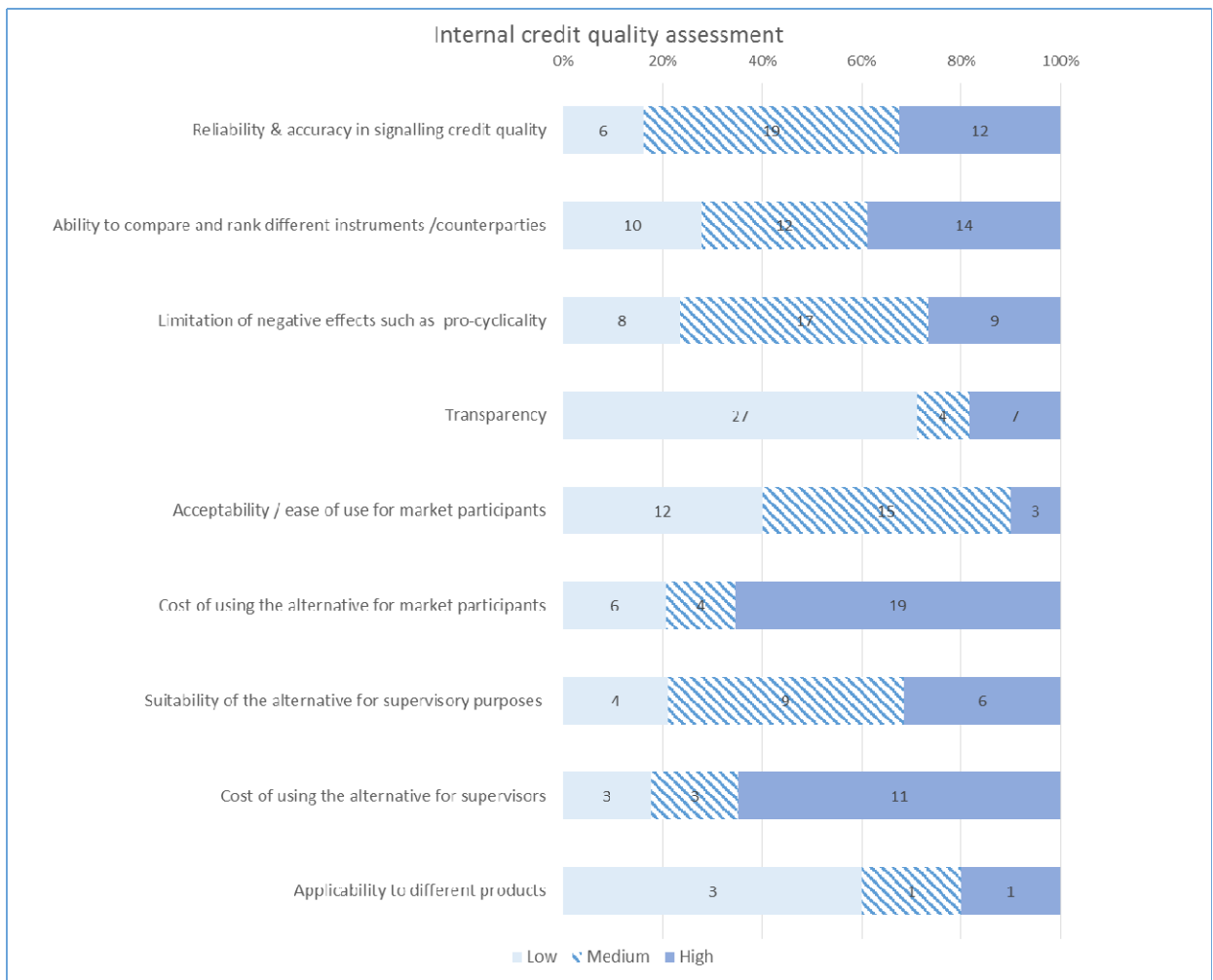
Figure 5 Overall assessment of the alternative



Source: ICF survey of SCAs (N=29); NT (N=14); CRAs (N=6)

The alternative Internal credit quality assessments performs especially well in terms of reliability and accuracy, ability to compare and rank; limitation of negative effects and suitability for supervisory purposes. The downside is the cost.

Figure 6 Assessment of the alternative across nine criteria

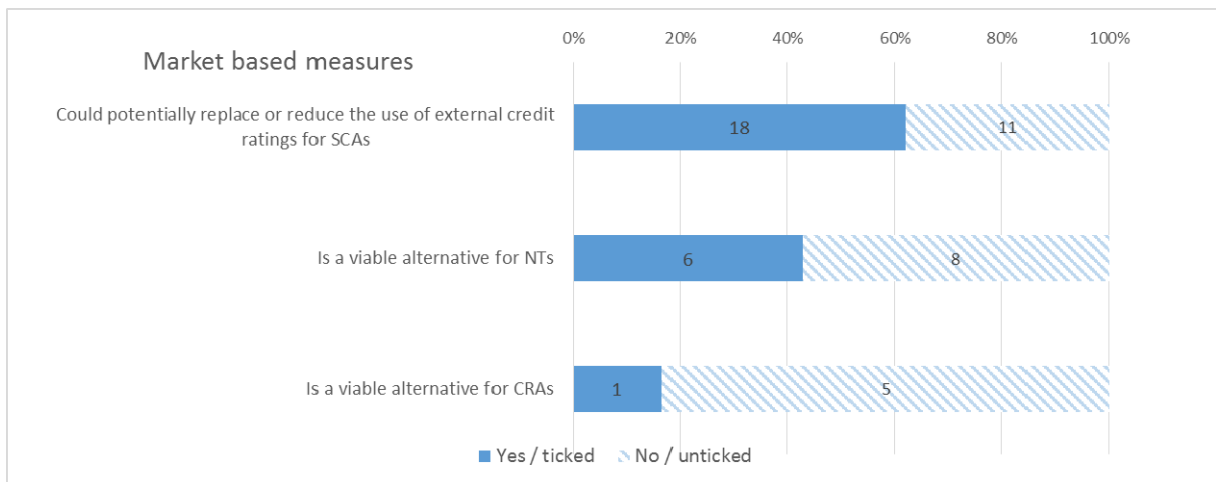


Source: ICF survey of SCAs; CRAs and NT. N varies by criterion, between 5 and 38 (not all types of respondents have been asked to rate all criteria)

Market based measures

Market based measures receives average support and seems a potential alternative especially for SCAs.

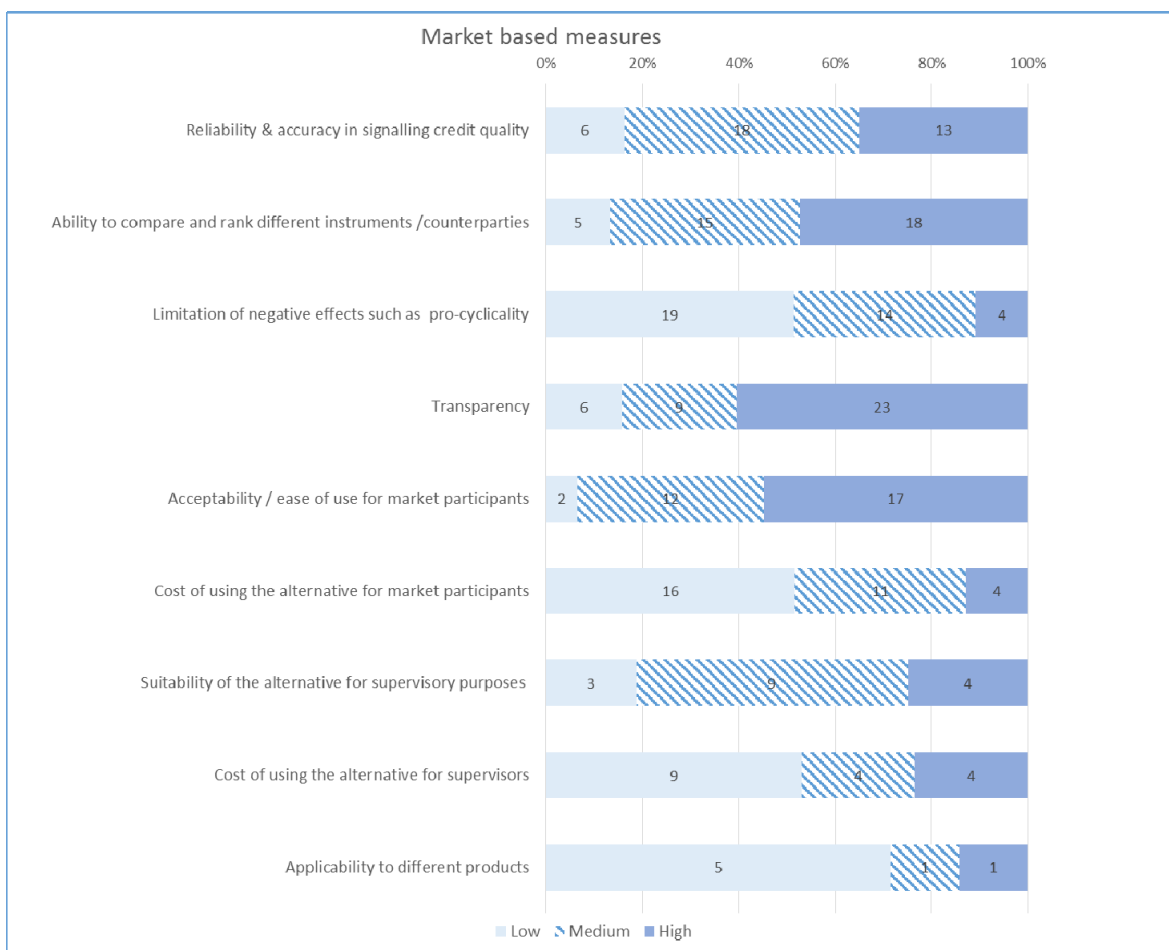
Figure 7 Overall assessment of the alternative



Source: ICF survey of SCAs (N=29); NT (N=14); CRA (N=6)

Market based measures perform well across almost all criteria. Importantly, they are however rated poorly in terms of limiting negative effects such as pro-cyclicality. It is the alternative receiving the lowest ratings on this criterion.

Figure 8 Assessment of the alternative across nine criteria

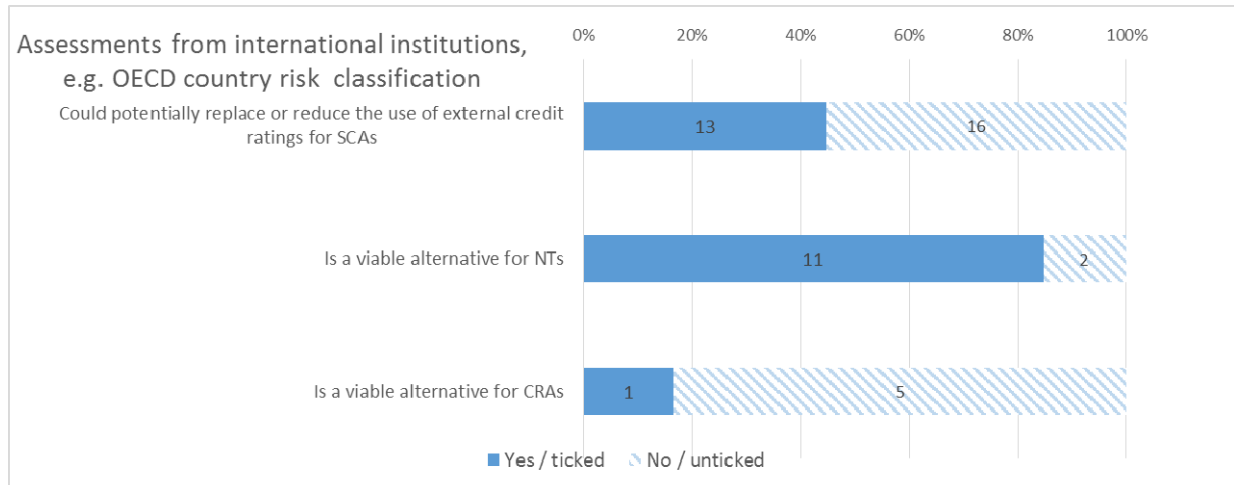


Source: ICF survey of SCAs; CRAs and NT. N varies by criterion, between 7 and 38 (not all types of respondents have been asked to rate all criteria)

Assessments from international institutions (e.g. OECD country classification) - for sovereign debt only

Assessments from international institutions (e.g. OECD country classification) receives average support overall and is the alternative gathering most support among National treasuries.

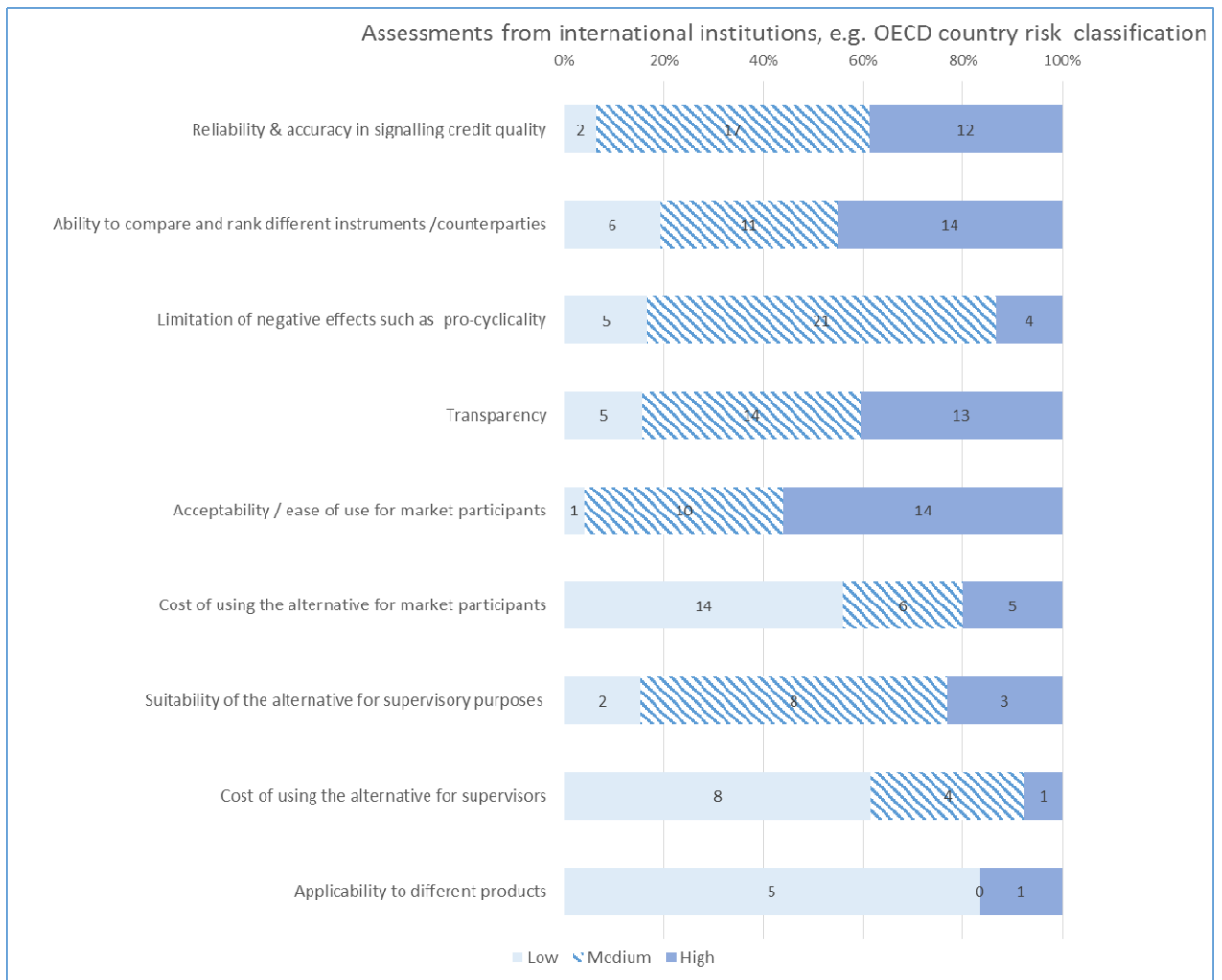
Figure 9 Overall assessment of the alternative



Source: ICF survey of SCAs (N=29); NT (N=13); CRAs (N=6)

The alternative Assessments from international institutions (e.g. OECD country classification) performs especially well in terms of cost, reliability and accuracy, ability to compare and rank; and transparency and acceptability/ease of use by market participants.

Figure 10 Assessment of the alternative across nine criteria

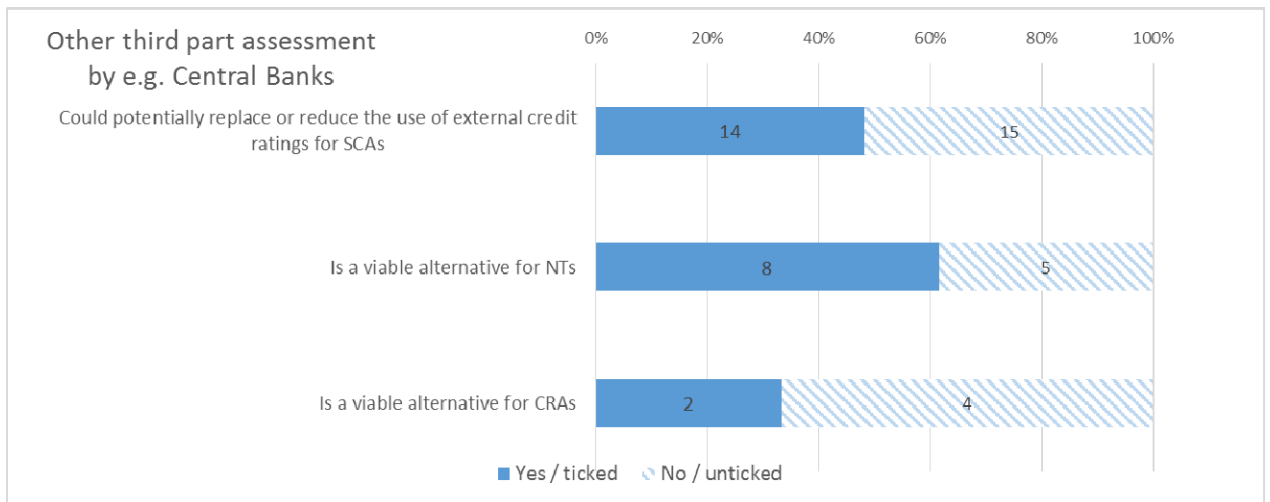


Source: ICF survey of SCAs; CRAs and NT. N varies by criterion, between 6 and 32 (not all types of respondents have been asked to rate all criteria)

Other third part assessments by e.g. Central Banks

Other third part assessments by e.g. Central Banks receives average support overall.

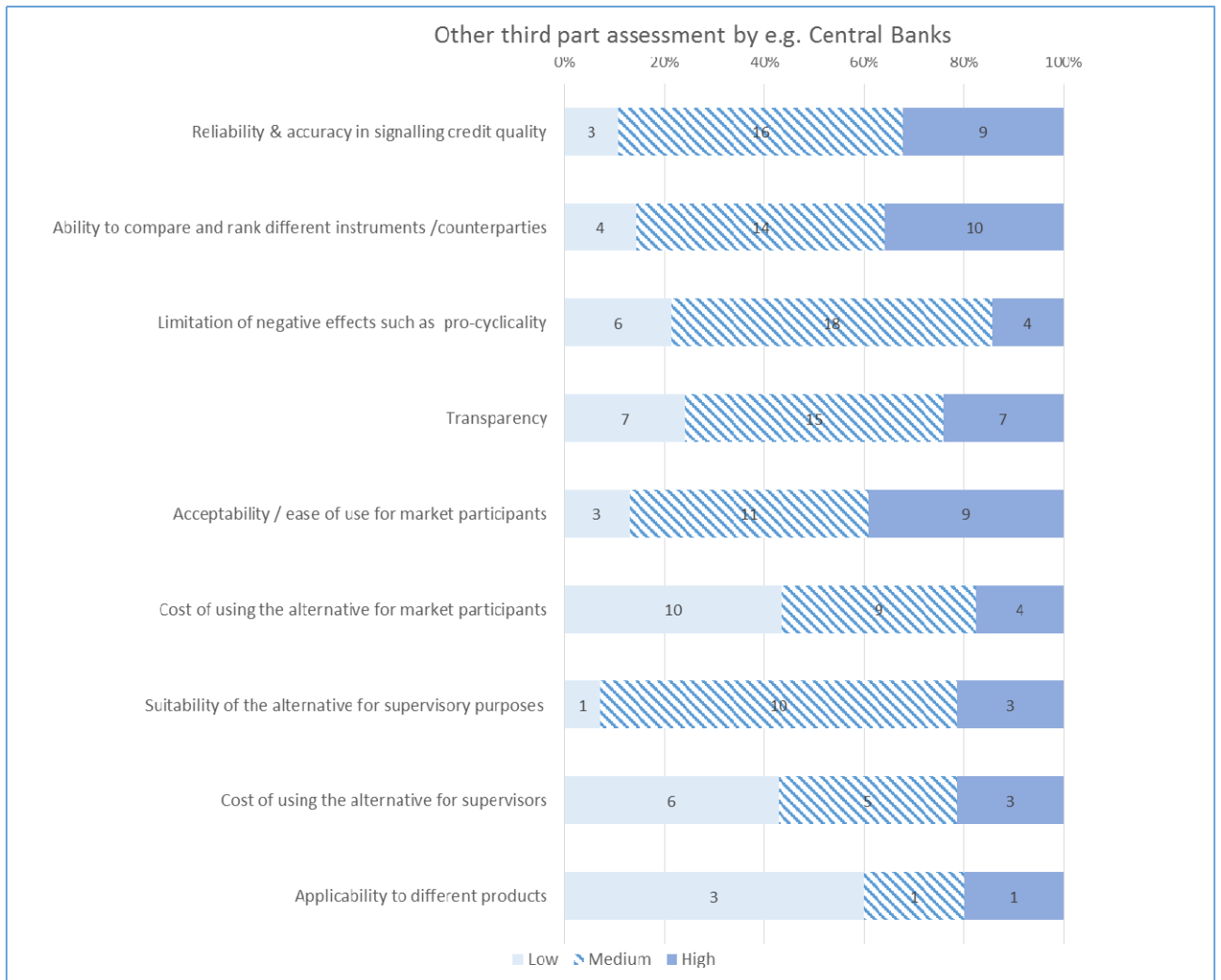
Figure 11 Overall assessment of the alternative



Source: ICF survey of SCAs (N=29); NT (N=13); CRA (N=6)

All criteria receive average assessments.

Figure 12 Assessment of the alternative across nine criteria

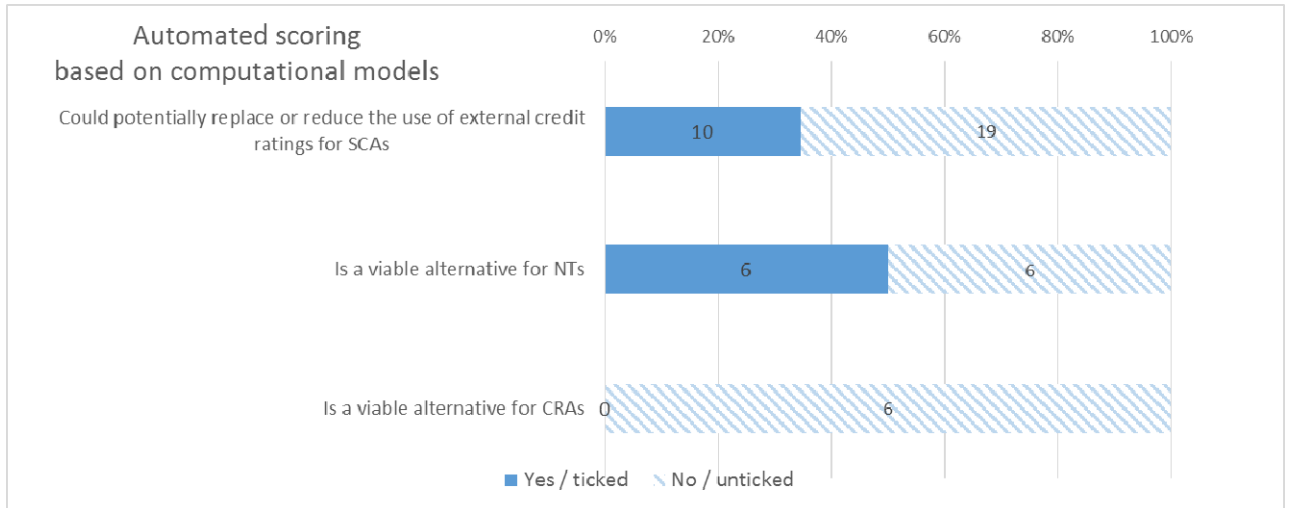


Source: ICF survey of SCAs; CRAs and NT. N varies by criterion, between 5 and 29 (not all types of respondents have been asked to rate all criteria)

Automated scorings based on computational models

Automated scorings based on computational models is the alternative gathering the lowest levels of support, especially among CRAs and SCAs.

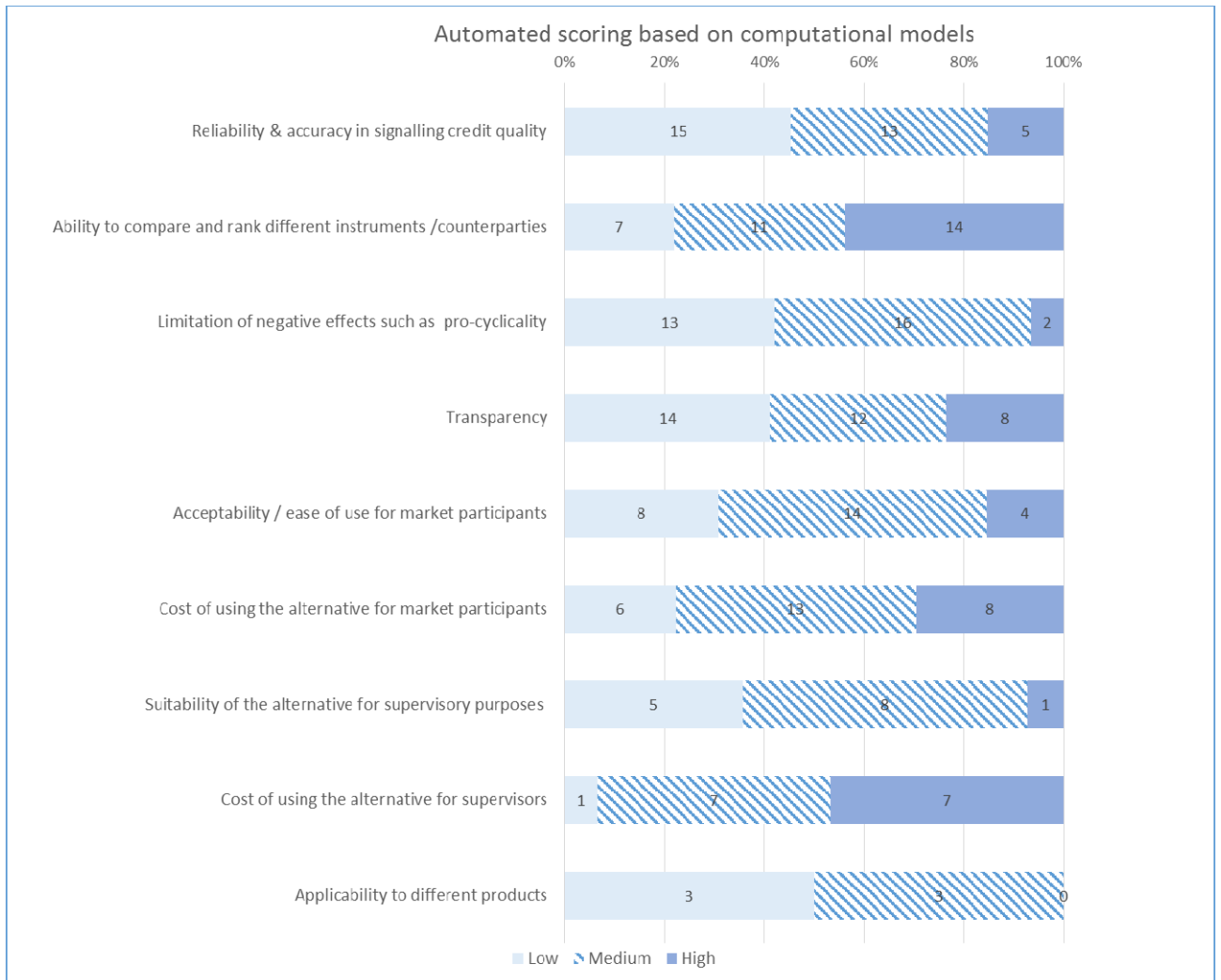
Figure 13 Overall assessment of the alternative



Source: ICF survey of SCAs (N=29); NT (N=12); CRA (N=6)

Automated scorings based on computational models performs poorly especially in terms of reliability and accuracy, limitation of negative effects and transparency.

Figure 14 Assessment of the alternative across nine criteria



Source: ICF survey of SCAs; CRAs and NT. N varies by criterion, between 6 and 34 (not all types of respondents have been asked to rate all criteria)

Additional messages from interviews regarding credit assessment processes and the role that external credit ratings play

As the *raison d'être* of external ratings is to reduce information asymmetries between borrowers and lenders, we explored the following issues with financial intermediaries, investors and asset managers in considerable detail:

- Organization of the credit risk assessment function within the firm;
- The role of external ratings in the organisation's approach to credit risk assessment;
- The use of computational models in credit risk assessment processes of the organisation concerned;
- The weight placed on external ratings;
- Handling of discrepancies between internal risk assessment and external ratings;
- Sources of information used for internal credit risk assessment.

A synthesis of the information collected from stakeholder interviews is presented below.

Organisation of credit risk assessment function

There are different approaches to organising the credit risk assessment function, depending on factors such as sector, size, sophistication of the market participant.

Asset management companies do not necessarily have a dedicated credit risk department. The credit risk assessment function is often integrated with portfolio management. In such cases, the portfolio manager and the credit analyst work hand in hand: the portfolio manager is primarily responsible for making investment decisions, while the credit analyst assesses the risk. It can also be that the same team of professionals is in charge of both portfolio management and credit risk assessment tasks.

Alternatively, the credit risk assessment function can be separated from portfolio management. Credit risk analysts produce an internal rating / an internal analysis and make it available to investment team. Credit risk analysts can be specialists by sector / geographical location.

Both models (a separated credit risk assessment function or integrated with portfolio management) are regarded as valid by the associations in the sector, who valued diversity of approaches. That said, associations also put forward the proportionality principle: the more complex the investments (e.g. in structured finance) and the higher the risks, the greater the rationale for a dedicated team, with different lines of reporting. If the market participant only invests in high quality sovereign bonds, there is less need for in-depth research and it can more easily be done by the portfolio manager.

The credit assessment function can also be integrated within a research department, doing both credit and equity research to create synergies. The research can also go beyond economic and financial factors to integrate extra financial criteria (notably environmental, social and governance criteria).

The interviewees highlighted that after the first assessment by the credit risk assessment function, there is another layer of scrutiny: the risk management function. The credit risk team can, in some cases, be located within the risk department.

The risk management department focuses on analyzing relevant positions only (knowing that there is no standard definition of what a relevant position is, it varies from one asset management company to another, it can be calculated within a single fund or for the whole company). It means also that for certain positions fulfilling some

predefined criteria the risk management department does not need to be further involved / delegate its authority. For other positions, it might be the case needs to be made by credit risk analyst and investment team before an appropriate risk management committee.

This second level assessment can have a more portfolio driven approach, compared to the initial level assessment. It typically looks at both market and credit risk, with ratings potentially playing a role in the credit risk part.

Asset owners (e.g. pension funds) who outsource the management of their assets also have teams monitoring the credit quality of their portfolio, teams which can be located in various departments.

Role of external ratings in the credit assessment process

There was a list of five modalities to describe the assessment process which was suggested to interviewees, ranging from pure reliance on external ratings to fully-fledged internal models.

Many of the interviewees assessed themselves as rather sophisticated in terms of assessment process. The interviewees highlighted that the same company does not necessarily has one approach but rather can implement differentiated approaches depending on the asset class, for example.

The first modality stating "your organisation exclusively uses Credit Rating Agency (CRA) ratings to assess creditworthiness" was not chosen by the interviewees in the asset management sector. One association reminded that this would go against the law as this is prohibited by CRAIII and not in line with the provisions foreseen by the UCITS and AIFMD regulations. It is their understanding this model had never been prevalent in the asset management sector and was quickly abandoned after the crisis. One interviewee admitted that indeed they rely solely on external ratings only, but only for monitoring of below threshold positions.

Within the insurance sector however, it was reported that it is possible that smaller firms totally rely on ratings. There was one example of a larger firm who developed and used its internal rating system only for the unrated positions, and otherwise relied primarily on ratings. It can also be the case for small and medium-sized credit institutions, who only have ancillary investment services to help diversify risks, but limit their investments to securities issued by governments, banks and large industrial companies.

Another possible scenario is that the first level of assessment, by the investment team is made purely on the external rating, but the risk management team then uses its own internal model.

The second modality read "your organisation primarily uses CRA ratings to assess creditworthiness, but supplements external ratings with internal analysis" and the third, described by some interviewees as very similar to the second, was "your organisation uses CRA ratings, but adjusts these based upon its own internal analysis".

One association indicated that these two options were favoured to some extent when the credit risk is remote (e.g. for highly rated sovereigns), although the analysis would at a minimum be supplemented by an analysis of other factors beyond credit risk, including investment limits of the fund (individual exposure limits, sectoral limits).

Many interviewees (asset managers, insurance companies, and banks) answered they had "fully developed in-house capabilities and technical expertise to assess credit risk and counterparty creditworthiness". They also agreed with the second part of the statement saying that "external ratings are only used to cross-check the results of the

internal analysis". However, in some cases external ratings are used when no internal analysis is available and when allowed by regulation.

Many interviewees (asset managers, insurance companies, and banks) also indicated that they had "constructed credit risk scoring models by integrating data from various sources (external ratings, publicly available information, market indicators and information gathered through client relationships etc.)".

Interviewees could not necessarily chose amongst the fourth and fifth option. For instance, they would have credit risk model but would still use ratings to cross check. Some interviewees preferred the fourth to the fifth option because their internal processes were more qualitative in nature than what is implied by credit risk scoring model (associated to the prediction of probabilities of default).

Within the insurance sector, with regards to the use of ratings, there is a difference between the life and non-life insurance sector, who have different business models. Schematically, property and casualty insurance companies use ratings more predominantly, compared to the life insurance sector. The reason behind that is that life insurance companies have very long duration contracts with relatively certain cash outflows. Managing the assets adequately, having one's own investment strategy, to match the cash outflow, is a key part of the business, where the competitive advantage comes from. In comparison, non-life insurance companies have more uncertain cash outflows and therefore need to invest more conservatively.

The CCP interviewed declared being totally independent of external ratings and using its own rating system. For financial institutions, it uses a system based on the CAMELS rating system (originally developed by banking supervisors in the US). The six rated dimension in the CAMELS rating system are as follows:

- (C)apital adequacy
- (A)sset quality
- (M)anagement Capability
- (E)arnings
- (L)iquidity
- (S)ensitivity (sensitivity to market risk, especially interest rate risk)

By and large, interviewees said external ratings are only "one factor amongst others", "one parameter considered", "one complementary source of information", "one component of the whole process", "one of the input factors - but never the sole input"; albeit an important one. Ratings are not taken at face value. Other reference points, used to complement the internal analysis which play a dominant role, include comparison with peer groups or spreads, but the sources of information are much wider (see sources of information section). It was reminded that market players need to do their own evaluation, or at least quality check the external ratings they are using, and that this is currently a common practice. Despite the availability of ratings and their usefulness, market participants reminded they are aware they need to understand the sectors/ products in which they are investing.

The only exceptions are when market participants (small insurance companies and banks) use external ratings for activities which are peripheral to the core of their business, or when banks and insurance companies need to use external ratings for the purpose of determining regulatory capital requirements.

Externally rated instruments represent a large proportion of the investment portfolio of the interviewees, irrespective of the sector. Unrated instruments typically represent a few percentage points.

That said, the mere fact that a security is unrated does not prevent investment, unless the manager acts according to a mandate specifying limited or no exposure to non-

rated asset. Another case was an investment investing in asset backed securities, who avoided those asset backed securities which are not rated because of the "very punitive" capital treatment they are subject to.

Also, the extent to which non-rated assets are invested in depends on several criteria including the nature of the business, the fund profile, clients' preferences and jurisdiction. For example, banks lending to SMEs or municipal/ local government/ public health institutions typically have strong internal capacities as this type of counterparties are typically not externally rated. In the asset management sector, AIF will often invest in instruments with less rating coverage compared to UCITS. Some asset classes, e.g. infrastructure projects, are typically not rated. The same is true for real estate funds (except for investments in residential mortgage backed securities). In the corporate bond market, non-rated assets can be issued by companies too small to be rated or by companies who refused to be rated (e.g. family owned companies who do not see the need for a rating).

Most interviewees could not assign a formalised weight to the rating (in many cases, the decisions are not based on quantitative models with a weight attached to each variable and external ratings are used only for comparison purposes). That said, the weight can vary by asset class (see differences across asset classes). Also in case the rating has major implications in terms of capital requirements, it can become a decisive criteria for the investment decision. One asset management company was able to provide an overall estimate of 20 to 25% weight applied for credit rating.

It was reported that the output of the internal analysis can also take several forms. In one case, the analyst assigned a rating using a similar scale than that of the rating agencies but ranging from one to four. In another case, the system was evaluating two dimensions: the intrinsic characteristics at present and perspectives for the future, each dimension having three modalities (positive/ neutral/ negative). In that second case, the risk level per se is not qualified and there is a need to present that information with some sort of credit quality measure.

Use of computational models by market participants

Market participants were asked whether they use computational models. There were cases where the interviewees did not have such quantitative models, or at least not sophisticated statistical models as they explained the analysis was extensively based on subjective factors.

The ones who do have computational models can have vendor based solutions, or both vendor based solutions and proprietary models (with the proprietary model more or less developed). Vendor model are usually based on the big three. Some internal add-ins can also be attached to the vendor based solutions. The internal models can be available for certain asset classes and not for others and can be different depending on the asset class or, for corporates, on the sector of activity or accounting standards used. In addition, some asset management companies use computational models background looking only to calculate what were the risks and relative performance however, they do not use it forward looking.

The internal model can also be calibrated against / back-tested against external ratings or other indicators.

Banks and insurance companies who do use the internal based approach to calculate their capital requirements do necessarily have an internal model.

The extent to which the underlying methodologies of the external ratings are assessed

The general idea emerging from the interviews is that market participants have a good understanding of the methodologies used by the CRAs. Analysts understand the nuances in the methodologies used by the 'big three', which may lead them to have some preferences for one agency or another. Regular exchanges with the CRAs to discuss changes in methodologies were reported in a few cases. It was highlighted as well that there might have a case to dig more into the methodology for riskier asset classes (notably structured finance, compared to high quality sovereign bonds). Furthermore, analysts are well placed to understand the logic behind ratings because their internal processes used to produce internal ratings / assessments are similar to the ones used by CRAs.

That said, some interviewees highlighted that they would not typically challenge the methodologies of the CRAs, and certainly not try to assess all ratings produced by the CRAs. They would verify the ratings look consistent overall but would not try to question particular ratings (especially as producing ratings is not an exact science). They give a limited importance to ratings, but take them at face value.

Discrepancies between internal and external ratings

Discrepancies are generally monitored as part of an alert system, a crosscheck point. Discrepancies between internal and external ratings can occur from time to time and can stem from the fact that internal analysis can be more forward looking for example.

When there is a discrepancy, this calls for a second analysis (quantitative and/or qualitative, possibly, but not in all cases, undertaken by a separate team, e.g. the risk management team).

If the difference cannot be explained, the internal rating would generally prevail. These differences however can also point out good investment opportunities: if the CRA rating is high while the internal system indicates the quality is in fact lower, it might be the good moment to sell at a good price (in the opposite situation, it would be a good time to buy).

Assessment process across different stages of the investment cycle

In terms of market participants' approach to credit risk assessment/ management at different stages of the investment cycle, there is naturally a more thorough analysis of credit risk when initiating an investment as compared to the monitoring stages.

The update to the analysis for monitoring purposes would typically be made every 6/12/18 months, and more frequently in case of there is a new piece of information to analyse, or a change in key indicators (some market participants mentioned a watch list procedure, which implies more frequent updates).

For monitoring purposes, one asset management company highlighted how external ratings are not supposed to be the signal to which asset managers react: asset managers are supposed to be ahead of the ratings. The success of asset managers is based on the ability to produce adequate internal ratings, gauge if the spread level (CDS, bonds or loans) reflects the risk appropriately and starting from there, make a decision.

On the side of investors, they perform their monitoring thanks to the monthly/ quarterly investor reports they receive from managers.

Assessment process across product type

Some companies have approaches which remain the same across product types (even though the sources of information can vary) but many differentiate their approach to credit risk assessment by product type.

- For instance, for sovereign bonds, the use of third party assessments is typically more prevalent and the analysis lighter than for other classes. Building

one's internal model for that asset class was seen as too costly considering the amount of information which needs to be analysed, for little added value, especially since it is accepted by the regulators to rely on ratings for sovereigns. In the few cases where companies reported doing a proper internal analysis on the sovereign debt, it was reported that the judgmental part in the analysis process is even more important than for other asset classes.

- For corporates, the internal analysis was generally described as more thorough than for sovereigns. That said, one interviewee highlighted that the added value of the ratings was particularly important for that asset class – because of the insider information CRAs have in case of solicited ratings.
- For structured finance, for those companies where this type of investments are material, the internal analysis can go further than for other asset classes because there is a need to understand the quality of the underlying assets, the structure of the transaction and the different levels of subordination. Internal analysis can include simulations on how the products would perform under different economic scenarios. It was reported that market participants not in a position to internally assess these products have not maintained their positions in that area after the crisis.

The differences in assessment processes can also be a matter of ratings coverage. One company for instance reported that the internal analysis is more developed for emerging markets where there is less rating coverage.

Generally, the following principle applies: the riskier the investment, the deeper the analysis. Beyond the asset class, the credit quality (as assumed ex-ante) can condition the assessment process opted for. One company reported that for high yield/ unrated assets, own internal analysis is a prerequisite while for high credit quality, investment can be made prior to a formal internal assessment being made.

Types of data used for internal risk assessment

Interviewees confirmed the use of the following types of data for internal risk assessment:

- Financial statements/ indicators including balance sheet, cash flow statements, debt servicing capability, capital adequacy and liquidity.
- Historical losses data
- Modelling of expected losses data
- Macroeconomic and microeconomic indicators – e.g. expected interest rates, exchange rate, and economic situation trends, GDP growth rate.
- Market data – e.g. credit default swaps, bond spreads, share prices etc.
- Qualitative information such as:
 - management and auditor quality etc.
 - the general business profile, including an issuer's or counterparty's market share, the regulatory environment, competitive position (SWOT analysis)
 - organisational structure, ownership structure

It was added that when a relative value analysis is carried out, there is a need to collect data on similar bonds (peer group comparisons). Some interviewees additionally mentioned financial projections (e.g. cash flow generation) as a forward looking element that they use in their internal credit risk assessment approaches.

The relevance of the above mentioned data varies by product type. For sovereign and sub-sovereign debt, macro factors will typically be more important; for corporate debt, the focus will be on the financial accounts and for structured finance, the analysis will concentrate on the underlying assets and will include loan level data. Market data are

only relevant to the extent that the counterparties are active on the capital markets (not necessarily the case for SMEs and sub-sovereigns, but more relevant for large corporations and financial institutions).

Some interviewees also highlighted the importance of the qualitative side/ judgmental part in the analysis process (forecasting, scenario building, talking to issuers) and associated sources of information, especially in the retail and SME business lines. On the other hand, in cases where the investments are made only in listed companies, there is typically no access to the management board and therefore the use of qualitative information is limited. The use of qualitative data is also more prevalent with emerging markets where quantitative information are not as widely available.

Some interviewees highlighted that historical losses data and modelling of expected losses data were not relevant for them, as this data would be used to calculate probabilities of defaults, which they do not do. They would either source the probabilities of default directly from specialist providers since they do not have the data to produce them themselves and would in any case need to source the input data; or they prefer to focus for their own analysis on the fundamentals, rather than on the probabilities of default (to have a different angle from CRAs).

Sources of information

In terms of where data is sourced from, all four presented sources were assessed as relevant, namely

- Directly from the issuer/ counterparty
- Publicly available sources
- Specialised information sources e.g. Reuters, Dun & Bradstreet
- Client interactions

Some interviewees highlighted that it is particularly important to them to have direct contacts with the issuers / clients. One interviewee however stressed that, in the asset management sector, the extent to which direct information is sourced is a matter of size. There would be no client interaction / no information from issuer for small asset managers, unless it is a "very specialised boutique".

It was highlighted that private information plays a bigger role in case of non-frequent issuers who are below investment grade, compared to listed companies and financial institutions where the information is public. It was also mentioned that for risk management (second level assessment), no data is typically sourced from the issuer.

The use of third party assessments

As far as the external credit ratings are concerned, the ones coming from the big three Credit Rating Agencies (S&P, Moody's, Fitch) were reported to be most commonly used by the interviewees. Market participants recognise and appreciate that each of the big 3 has a slightly different focus. It was highlighted that this situation is not due to an industry preference towards these agencies, but rather that it reflects the market reality. Market players use the ratings they have at their disposal. There is a question of path dependency as well for the users, who prefer avoiding to create breaks in series. Beyond that, the big 3 ratings are also the ones investors expect to see, they have a brand name and a track record. One interviewee reminded that beyond the ratings themselves, the accompanying research reports are also used.

For some asset classes / geographies (especially where the big 3 do not have a good rating coverage), smaller players can be used. But generally speaking, smaller players do not seem to be widely used. Interviewees raised the issue that smaller agencies do

not have enough coverage / are focused on niches; that they can have political bias; they can have difficulties in attracting high quality analysts and that they lack historical data services. Last but not least, some interviewees drew attention to the fact that the mapping between ratings and credit quality step (not yet finalized)¹³ treats differently the higher notes from big 3 and from smaller agencies: smaller agencies 'AAA are' considered as credit quality step 3 vs credit quality step 1 for Big 3 'AAA'. It means that if a rating by one of the Big3 is available, there is an incentive to use it; otherwise it would translate into higher capital requirements. It means that implicitly, these regulatory provisions still increase the Big 3's market position.

Ratings/ assessments produced by Central Banks were not found to be widely used. Interviewees mentioned that in many countries, they are not available. Even in France where it is available, not all market participants actually have access to it. Until recently the use of the FIBEN database was restricted to banks only. Although the government has decided to give access to other players (Macron law)¹⁴, this is not yet implemented. This wider access is generally seen as a positive development, especially in the context of the emergence of Euro PP. Besides, concerns were also expressed regarding the potential bias of these estimates

Other third party assessments were not spontaneously quoted as a source of information, except specific, independent research.

Recent changes since the crisis

When prompted specifically about the changes market participants have implemented during the recent years, the interviewees generally conveyed the message that their approach to credit risk assessment has not changed since the crisis, that their processes were in place before that, that they never relied solely on ratings when making their investment decisions. In particular, those who, prior to the crisis, did not invest in structured finance products (which they see as responsible for the crisis), highlighted they did not feel the need for a change.

There was however, some kind of confidence crisis (especially regarding the rating of sovereign bonds, financial institutions and structured finance products): some market players realized that CRAs could have it wrong and consequently, are now less inclined to take ratings at face value.

Some improvements and strengthening of capacities have reportedly been made. For example:

- Some reported they increased the number of analysts to build up the internal risk assessment function.
- Some said they monitoring is done more regularly and actions are taken on that basis.
- Some reported having subscribed to specialized information sources or independent research while other mention they are taking more care to analyse any references there may be.
- Others have put in place procedures in case of inconsistencies between CRA ratings and market data, do a more thorough analysis, especially for particular asset classes such as structured finance or give more importance to credit risks within all investment criteria.

¹³

<http://www.eba.europa.eu/documents/10180/1006707/JC+CP+2015+001+%28Joint+CP+on+draft+ITS+on+mapping+of+ECAIs+under+SII%29.pdf> (mapping table on page 7)

¹⁴ See e.g. <http://www.argusdelassurance.com/acteurs/le-fichier-fiben-bientot-accessible-au-monde-de-l-assurance.89188>

- The internal models were further developed, one bank mentioned that robustness and consistency tests were developed.
- The internal processes are also better documented; although some market participants acknowledged the need to expand their internal processes to cover areas where reliance on ratings is particularly high. On that basis reporting guidelines were created.
- One CCP explained how its internal processes and methodologies, although pre-existing, now need to be approved by the regulator.
- In terms of risk management, there is an increased focus on concentration limits and market risk (as the credit spreads are widening even for high quality products).
- Another notable change since the crisis is that there is much more dialogue between asset managers and CRAs, e.g. to find out the reasons behind a downgrade.
- The conservative policy on liquidity, encouraging banks to hold safer and more liquid assets, lower the needs for thorough analysis or reliance on ratings – since all holdings are of high quality by definition.
- Some investors reported that credit risk or the rating are not necessarily the main area of their attention; there is an increased interest in the social and environmental impact of investments since the crisis.

Summing up of key messages

Generally speaking, market participants use external ratings as an input into or as a reference point for complementing/ cross-checking their own internal credit risk assessment. External ratings are rarely used in isolation and that various approaches co-exist depending on the sector, on the market participant, on the asset class, etc, especially when it comes to investment decisions as opposed to the determination of capital requirements, where the use of external ratings is mechanistic under the standardised approach / the standard formula (via the mapping of external ratings to credit quality steps). The weight placed on external ratings depends on the sector, size and sophistication of the market participant and the types of products that they invest in.

For example, in the insurance sector (where credit risk assessment is not the core purpose of these undertakings), the use of external ratings is relatively common as it is not considered feasible for insurance/ reinsurance undertakings (except perhaps for the larger ones) to invest in internal credit risk analysis.

Similarly, smaller players –particularly, in the asset management sector and those investing in 'plain vanilla' products- tend to rely more on external ratings rather than invest too much resources into internal analysis.

Many market participants differentiate their approach to credit risk assessment by product type. Generally, the following principle applies: the riskier the investment, the deeper the analysis.

- For sovereign bonds, the use of third party assessments is typically more prevalent and the analysis lighter than for other classes. Building one's internal model for that asset class was seen as too costly considering the amount of information which needs to be analysed, for little added value. Since investing in high-quality sovereign debt is seen as 'safe', the need to conduct own analysis is perceived as low. In the few cases where companies reported doing a proper internal analysis on the sovereign debt, it was reported that the

judgmental part in the analysis process is even more important than for other asset classes.

- For corporates, the internal analysis was generally described as more thorough than for sovereigns. That said, the insider information CRAs have in case of issuer paid ratings is valued.
- For structured finance, for those companies where this type of investments are material, the internal analysis can go further than for other asset classes because there is a need to understand the quality of the underlying assets, the structure of the transaction and the different levels of subordination. It was reported that market participants who are not in a position to internally assess these products have not maintained their positions in that area after the crisis.

Annex 6 Implementation of the Dodd Franck Act in the US

This annex provides a detailed overview of the federal regulatory changes made to implement Article 939A of the Dodd-Frank Act, rule by rule.

The Office of the Comptroller of the Currency - Alternatives to the Use of External Credit Ratings in the Regulations of the OCC, Final rule, Federal Register / Vol. 77, No. 114 (June 13, 2012)

The Office of the Comptroller of the Currency (OCC) regulates national banks and federal savings associations in the US¹⁵. As per OCC regulations, national banks and Federal savings associations (hereafter banks) are required, amongst other things, to adequately manage the credit risk of their portfolio investments and, prior to a purchase, determine whether or not a security is "investment grade", as the attribution of "investment grade" status conditions the right to purchase the security.

The changes to the regulation, made in June 2012 and effective as of January 1, 2013, modify the rules on how to determine whether particular securities are "investment grade"¹⁶. Before the "investment grade" status was conditioned upon external credit ratings, where available. Now, the banks will need to make their own assessments of a security's creditworthiness, along the same lines that what is already currently required for the purchase of unrated securities.

The OCC issued a guidance note to assist the banks in their due diligence process¹⁷. The OCC indicates that the depth of the analysis required will depend on the risk characteristics of the considered security. The risk itself will be determined by the credit quality, the complexity of the structure and the size of the investment. For example, structured securities will imply more due diligence efforts as assessing their creditworthiness, which depends on the cash flows and collateral of the underlying assets, and not on the financial capacity of the issuer for repayment, is more complex. The OCC further indicates that the analytical work can be undertaken internally or by a third party (in the latter case, without delegating responsibility for the decisions taken).

Table 6 shows the list of indicative "factors" that the OCC recommends considering as alternatives to external credit ratings.

¹⁵ <http://www.occ.gov/about/what-we-do/mission/index-about.html>

¹⁶ OCC (2012) Alternatives to the Use of External Credit Ratings in the Regulations of the OCC, Final rule. Federal Register / Vol. 77, No. 114 / Wednesday, June 13, 2012 / Rules and Regulations. Available at: <http://www.occ.gov/news-issuances/federal-register/77fr35253.pdf>

¹⁷ OCC (2012) Alternatives to the Use of External Credit Ratings in the Regulations of the OCC, Final guidance. Federal Register / Vol. 77, No. 114 / Wednesday, June 13, 2012 / Rules and Regulations. Available at: <http://www.occ.gov/news-issuances/federal-register/77fr35259.pdf>

Table 7: Key factors to analyse credit worthiness as a replacement of credit ratings

	Corporate bonds	Municipal government general obligations	Revenue bonds	Structured securities
Confirm spread to U.S. Treasuries is consistent with bonds of similar credit quality	x	x	x	x
Confirm risk of default is low and consistent with bonds of similar credit quality	x	x	x	x
Confirm capacity to pay and assess operating and financial performance levels and trends through internal credit analysis and/or other third party analytics, as appropriate for the particular security	x	x	x	x
Evaluate the soundness of a municipal’s budgetary position and stability of its tax revenues. Consider debt profile and level of unfunded liabilities, diversity of revenue sources, taxing authority, and management experience		x		
Understand local demographics/economics. Consider unemployment data, local employers, income indices, and home values		x	x	
Assess the source and strength of revenue structure for municipal authorities. Consider obligor’s financial condition and reserve levels, annual debt service and debt coverage ratio, credit enhancement, legal covenants, and nature of project			x	
Understand the class or tranche and its relative position in the securitization structure				x
Assess the position in the cash flow waterfall				x
Understand loss allocation rules, specific definition of default, the potential impact of performance and market value triggers, and support provided by credit and/or liquidity enhancements				x
Evaluate and understand the quality of the underwriting of the underlying collateral as well as any risk concentrations				x

	Corporate bonds	Municipal government general obligations	Revenue bonds	Structured securities
Determine whether current underwriting is consistent with the original underwriting underlying the historical performance of the collateral and consider the affect of any changes				x
Assess the structural subordination and determine if adequate given current underwriting standards				x
Analyze and understand the impact of collateral deterioration on tranche performance and potential credit losses under adverse economic conditions				x

Securities and Exchange Commission - Security Ratings Release No. 33-9245; 34-64975; File No. S7-18-08 (September 2, 2011)

The US Securities and Exchange Commission is a US Federal Agency, which was created to enforce federal with the intention to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC thus requires public companies to disclose meaningful financial and other information to the public in order to create a public knowledge pool for investors to judge whether to buy, sell, or hold a particular security. Hence, enabling the public to have access to comprehensive, accurate information for making sound investment decisions.¹⁸

The rule, effective from September 2011, aims to replace rule and form requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 for securities offering or issuer disclosure rules that rely on, or make special accommodations for, security ratings with alternative requirements.¹⁹

The instructions to Forms S-3 and F-3 will no longer refer to security ratings by an NRSRO as a transaction requirement to permit issuers to register primary offerings of non-convertible securities for cash. Instead, these forms are available to register primary offerings of non-convertible securities other than common equity if:

- The issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least \$1 billion in non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act, over the prior three years; or
- The issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least \$750 million of non-convertible securities, other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act; or
- The issuer is a wholly-owned subsidiary of a well-known seasoned issuer (WKSI) as defined in Rule 405 under the Securities Act; or
- The issuer is a majority-owned operating partnership of a real estate investment trust (REIT) that qualifies as a WKSI; or
- The issuer discloses in the registration statement that it has a reasonable belief that it would have been eligible to register the securities offerings proposed to be registered under such registration statement pursuant to General Instruction I.B.2 of Form S-3 or Form F-3 in existence prior to the new rules.²⁰

Securities and Exchange Commission - Removal of certain references to credit ratings under the Securities Exchange Act Of 1934. Release No. 34-71194 (Jan. 8, 2014)

On 8 January 2014²¹, the SEC introduced amendments to its Rule 15c3-1 under the Securities Exchange Act of 1934 relating to minimum regulatory capital requirements applicable to broker-dealers. The amendments have become effective on July 7, 2014.

The amendments maintain the right of broker-dealers to apply lower haircuts to certain classes of securities (commercial paper, nonconvertible debt, and preferred debt), but the eligibility of asset classes for haircuts but are no longer based on credit ratings. Haircuts are designed to reflect the market risk and create a buffer of liquidity. Prior to the amendments, highly rated securities had lower haircuts. Now, broker-dealers are invited to consider a number of factors as alternatives to credit ratings to determine the amount of credit risk. For indicative purposes, the SEC

¹⁸ SEC. 2013. The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation. Available at: <http://www.sec.gov/about/whatwedo.shtml>

¹⁹ Federal Register. 2011. Vol. 76, No. 149. Available at: <http://www.sec.gov/rules/final/2011/33-9245fr.pdf>

²⁰ Federal Register. 2011. Vol. 76, No. 149. Available at: <http://www.sec.gov/rules/final/2011/33-9245fr.pdf>

²¹ SEC (2014) Release No. 34-71194, Op. Cit.

included a non-exhaustive and non-mutually exclusive list of factors which can be taken into account. These include²²:

- Credit spreads (i.e., whether it is possible to demonstrate that a security is subject to a particular amount of credit risk based on the spread between the security's yield and the yield of Treasury or other securities);
- Securities-related research (i.e., whether providers of securities-related research believe the issuer of the security will be able to meet its financial commitments, generally or specifically, with respect to the securities held by the credit union);
- Internal or external credit risk assessments (i.e., whether credit assessments developed internally by the credit union or externally by a credit rating agency, irrespective of its status as an NRSRO, express a view as to a particular security's credit risk);
- Default statistics (i.e., whether providers of credit information relating to securities express a view that specific securities have a probability of default consistent with other securities with a particular amount of credit risk);
- Inclusion on an index (i.e., whether a security, or issuer of the security, is included as a component of a recognized index of instruments that are subject to a specific amount of credit risk);
- Priorities and enhancements (i.e., the extent to which a security is covered by credit enhancements, such as overcollateralization and reserve accounts);
- Price, yield, and/or volume (i.e., whether the price and yield of a security are consistent with other securities that the credit union has determined are subject to a particular amount of credit risk and whether the price resulted from active trading); and
- Asset class-specific factors (e.g., in the case of structured finance products, the quality of the underlying assets).

Thus, these include objective factors such as credit spreads and default statistics as well as subjective factors such as securities-related research.

Securities and Exchange Commission - Removal of Certain References to Credit Ratings Under the Investment Company Act Release Nos. 33-9506; IC-30847 (February 7, 2014)

This rule made amendments to a rule and three forms under the Investment Company Act of 1940 ("Investment Company Act") and the Securities Act of 1933 ("Securities Act") in order to implement a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The amendments replace a reference to required NRSRO credit ratings in rule 5b-3 for certain securities held by funds as collateral for repurchase agreements with an alternative standard that is designed to retain a similar degree of credit quality. The amendment also eliminate the use of NRSRO in Forms N-1A, N-2, and N-3 for funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings.²³

The SEC is adopting a credit quality standard to be applied. The standard is not directly described in the regulation but it includes that i) each acquisition must be an

²² The description of the factors is directly taken from NCUA (2013) Corporate Credit Union Guidance Letter. Available at: <http://www.ncua.gov/Resources/Documents/LCCU2013-01.pdf>

²³ Federal Register. (2014). Vol. 79, No. 5. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-01-08/pdf/2013-31425.pdf>

eligible security and ii) each acquisition, as determined by the fund's board, presents minimal credit risks to the fund.²⁴

Securities and Exchange Commission - Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule. Release No. IC-31828 (Sept. 16, 2015)

The 2014 proposal essentially repropose the 2011 amendment of rule 2a-7 while responding and making necessary modifications due to comments mentioned concerning the 2011 proposal rather than adopting said proposal directly. The final adopted amendments include provisions which would remove references to credit ratings and establish the eligibility of a security as one that has been determined to have minimal risk. The definition of said security eligibility shall be uniform and create a standard that includes objective factors, while retaining a similar degree of credit quality in the money portfolios as it would under the previously established references to credit ratings.²⁵

The Commodity Futures Trading Commission - Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 FR 78776 (Dec. 19, 2011) and Removing any reference to or reliance on Credit Ratings in Commission Regulations; Proposing alternatives to the use of credit ratings, 76 FR 44262 (July 25, 2011)

Created in 1974, The Commodity Futures Trading Commission is an independent agency of the US government that was created to regulate futures and options. The overarching goal was creating a transparent and competitive market, while protecting customers from fraud, and unscrupulous practices associated with derivatives and other products associated with the "Commodity Exchange Act".²⁶

The first regulation includes several elements which attempt to control the exposure to credit, promote prompt liquidity, and reduce the market risks associated with these types of investments. "The amendments address: certain changes to the list of permitted investments (including the elimination of in-house transactions), a clarification of the liquidity requirement, the removal of rating requirements, and an expansion of concentration limits including asset-based, issuer-based, and counterparty concentration restrictions".²⁷

The second regulation was made effective September 23, 2011, in accord with Title IX of the Dodd-Frank Act, and applies to futures commission merchants (FCMs), derivatives clearing organizations (DCOs), and commodity pool operators (CPOs). This regulation removes the requirement of reliance on credit rating agencies in favour of requiring the .agencies to create their standard of credit worthiness based on the proposed regulation by federal agencies. Subsequently, federal agencies should establish "uniform standards of credit worthiness" for use by the respective agencies.²⁸

²⁴ Ropes and Gray LPP. 2015. SEC removes credit-rating references and amends issuer diversification requirements in money fund rules. Available at: <http://www.lexology.com/library/detail.aspx?g=c40e40c0-36cc-4f29-863b-098cf9bbcfde>

²⁵ SEC. 2015. Release No. IC-31828; File No. S7-07-11. Available at: <https://www.sec.gov/rules/final/2015/ic-31828.pdf>

²⁶ CFTC. Mission and responsibilities. Available at: <http://www.cftc.gov/About/MissionResponsibilities/index.htm>

²⁷ CFTC. 2011-31689. Available at: <http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2011-31689>

²⁸ Federal Register. (2011). Vol. 76. No 142. Available at: <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2011-18777a.pdf>

The National Credit Union Administration - Alternatives to the Use of Credit Ratings, 77 FR 74103 (Dec. 13, 2012)

The National Credit Union Administration (NCUA) is the independent federal agency of the United States which is tasked with regulating, chartering, and supervising credit unions. In addition the NCUA manages the National Credit Union Share Insurance Fund which is responsible for insuring the deposits of approximately 100 million credit union account holders at the federal level as well as the majority of account holders at state – chartered institutions.²⁹

The goal of this rule, which was made effective on June 11, 2013, is to remove credit ratings as a source of determining credit worthiness and implement alternative and appropriate standards of determining credit worthiness in accordance with title IX of the Dodd- Frank Act. The NCUA Board issued a Notice of Proposed Rulemaking (NPRM) which required that a credit institution (formal or corporate) conduct and document internal and external credit analyses to determine that an issuer of financial instruments holds a certain capacity to meet its financial requirements. This will replace the previous reliance on National Recognized Statistical Rating Organizations (NRSRO) as the source for credit ratings of credit unions. In determining the credit worthiness of a security, a credit union may consider any of the following factors as deemed appropriate: credit spreads, securities related research, default statistics, inclusion of an index, priorities and enhancements, price, yield, and volume, as well as asset class-specific factors.³⁰ The alternatives are the same than those proposed by the SEC and are listed in further detail in section 5.3.4.

The Federal Housing Finance Agency - Removal of References to Credit Ratings in Certain Regulations Governing the Federal Home Loan Banks, 78 FR 30784 (May 23, 2013)

The Federal Housing Finance Agency (FHFA) is an independent regulatory agency responsible for strengthening the secondary mortgage markets by providing effective supervision, sound research, reliable data, and relevant policies. More specifically, their mission is to “ensure that the housing government sponsored enterprises operate in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment.”³¹

The FHFA proposed to remove a number of references and requirements in regulations affecting the Federal Home Loan Banks and to adopt new provisions that require the Banks to apply internal analytic standards and criteria to determine creditworthiness of a security or obligation. Further to this, FHFA will undertake separate rulemakings to remove references and requirement related to credit rating agencies contained in the capital regulations applicable to the Banks.³²

FHFA considered replacing the current reference to credit rating agencies by requiring that banks determine that a security has a level of credit risk that is equivalent to or less than that of outstanding consolidated obligations before the security can be used to fulfil the negative pledge requirement. Under this alternative approach, the determination would be based on credit standards collectively developed by the Banks in consultation with the Office of Finance. FHFA believed that each Bank would have a

²⁹ NCUA. About NCUA. Available at: <http://www.ncua.gov/about/Pages/default.aspx>

³⁰ Federal Register. (2012). Vol 77. No 240. Available at: <http://www.ncua.gov/Legal/Documents/Regulations/FIR20121214CreditRatings.pdf>

³¹ FHFA. (2015). Who we are and what we do. Available at: <http://www.fhfa.gov/AboutUs>

³² Federal Register. (2013). Vol. 78. No 100. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-12333.pdf>

strong interest in seeing that the other Banks maintain the conservative risk profile of assets used to fulfil the negative pledge requirement.³³

In addition the FHFA requires Bank to maintain a rating of at least the second highest from an NRSRO. These requirements were adopted as a means of enhancing protections afforded holders of consolidated obligations by requiring Banks either collectively or individually to take actions to maintain the required ratings.³⁴

Further, Banks, individually and collectively, should operate in such manner and take any actions necessary, including reducing leverage, to ensure that consolidated obligations maintain the highest level of acceptance by financial markets and are generally perceived by investors as presenting a very low level of credit risk.³⁵

Office of the Comptroller of the Currency (OCC) and Board of Governors of the Federal Reserve System (FED) - Regulatory Capital Rules: Final Rule. Federal Register / Vol. 78, No. 198 (October 11, 2013)

The Office of the Comptroller of the Currency (OCC) and Board of Governors of the Federal Reserve System (Board), adopted a final rule that revises their risk-based and leverage capital requirements for banking organizations. The rule consolidates three separate notices of proposed rulemaking with selected changes. The notices are the following:

- The Basel III Notice of Proposed Rulemaking
- The Standardized Approach Notice of Proposed Rulemaking
- The Advanced Approaches Notice of Proposed Rulemaking³⁶

The Standardized Approach NPR proposed changes to the agencies' and the FDIC's general risk-based capital rules for determining risk-weighted assets and propose alternative standards to credit rating agencies for certain assets, consistent with section 939A of the Dodd-Frank Act.³⁷

As far sovereign bonds are concerned, the OCC and the Federal Reserve Board introduced the use of the Organisation for Economic Cooperation and Development (OECD) Country Risk Classifications (CRC) as a basis for new risk-based capital requirements, instead of sovereign ratings³⁸. The CRC methodology classifies countries into one of eight risk categories (0–7), the zero category grouping countries having the lowest possible risk assessment and the 7 category grouping countries having the highest possible risk assessment³⁹. Although the proposed change is not seen as ideal in terms of risk sensitivity, it is still considered as an improvement compared to the current situation.

³³ Federal Register. (2013). Vol. 78. No 100. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-12333.pdf>

³⁴ Federal Register. (2013). Vol. 78. No 100. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-12333.pdf>

³⁵ Federal Register. (2013). Vol. 78. No 100. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-12333.pdf>

³⁶ OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

³⁷ OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

³⁸ OCC and FED (2013) Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Riskweighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule. Final Rule. Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

³⁹ For more information on the OECD country risk classification methodology, see OECD, "Country Risk Classification," available at: <http://www.oecd.org/tad/xcred/crc.htm>

For certain Supranational Entities and Multilateral Development Banks FDIC proposed to apply a zero percent risk weight to exposures (instead of 20 per cent). This due to their high-credit quality, their strong shareholder support, and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness.⁴⁰

In terms of corporate exposure, both agencies examined market-based alternatives including the use of credit default and bond spreads, as well as the use of particular indicators to differentiate between relative levels of credit risk. However, the agencies judge these alternatives as having significant drawbacks, such as operational complexity, or insufficient development. Therefore, the final rule retains a 100 percent risk weight for all corporate exposures.⁴¹

The percentage risk weight (haircut) for other financial asset was also determined. For instance, there is 100 percent risk weight for securities firms. Also, exposures to a non-U.S. public sector entity in a country that does not have a CRC and is not an OECD member receive a 100 percent risk weight, while exposures to a non-U.S. public sector entity in a country that has defaulted on any outstanding sovereign exposure or that has defaulted on any sovereign exposure during the previous five years receive a 150 percent risk weight.⁴²

Under the Advance Approaches Notice, portfolios subject to IRB risk-based capital formulas must disclose certain information, including explanation and review of the structure of internal rating systems and relation between internal and external ratings; use of risk parameter estimates other than for regulatory capital purposes; process for managing and recognizing credit risk mitigation; and control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review.⁴³

The Federal Deposit Insurance Corporation (FDIC) - Permissible Investments for Federal and State Savings Associations: Corporate Debt Securities Federal Register /Vol. 77, No. 142 (July 24, 2012)

The FDIC is an independent agency of the federal government created in 1933 following the financial crisis. The aim of the FDIC is to preserve and promote public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least \$250,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.⁴⁴

The regulation prohibits insured savings associations from acquiring or retaining a corporate debt security unless the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. The issuer would satisfy this requirement if it presents a low risk of default and is likely to make full and timely repayment of principal and interest.⁴⁵

Federal and state savings associations are allowed to invest only in corporate debt securities that meet creditworthiness standards established by the FDIC. FDIC expects

⁴⁰ OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

⁴¹ OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

⁴² OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

⁴³ OCC and FED (2013) Federal Register / Vol. 78, No. 198 / Friday, October 11, 2013 / Rules and Regulations. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>

⁴⁴ FDIC. (2014). Who is the FDIC? Available at: <https://www.fdic.gov/about/learn/symbol/>

⁴⁵ Federal Register. (2012). Vol. 77, No. 142. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-07-24/pdf/2012-17860.pdf>

savings associations to take into account a number of factors. Although savings associations are allowed to consider an external credit assessment, they must supplement it with due diligence processes and analyses that are appropriate for the size and complexity of the security.⁴⁶

In addition to the rule, the FDIC published a guidance on Due Diligence Requirements for Savings Associations in Determining Whether a Corporate Debt Security Is Eligible for Investment. The guidance aims to help saving associations in determining whether a corporate debt security is permissible for investment, and to further explain the FDIC's expectations with regard to regulatory due diligence requirements. The guidance includes factors to consider when evaluating the creditworthiness of an issuer.

The Federal Deposit Insurance Corporation (FDIC) - Regulatory Capital Rules FIL-18-2014 (April 25, 2014)

The change in the Regulatory Capital Rules relates to the risk-based and leverage capital requirements for FDIC-supervised institutions. The Rule was effective January 1, 2014, with mandatory compliance beginning January 1, 2014, for FDIC-supervised institutions that are subject to the advanced internal ratings-based approaches.

The changes included in the rule are technical revisions designed to ensure that the rule conforms to the final rules issued by the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency described above.⁴⁷ This includes amendment to the methodologies for determining risk-weighted assets for all FDIC-supervised institutions and it the adoption of changes to the FDIC's regulatory capital requirements that meet the requirements of section 171 and section 939A of the Dodd-Frank Act.⁴⁸

The Department of Labor - Proposed Amendments to Class Prohibited Transaction Exemptions to Remove Credit Ratings Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 78 FR 37572 (June 21, 2013)

The United States Department of Labor (DOL) is department of the U.S. government. The DOL is responsible for occupational safety, wage and hour standards, unemployment insurance benefits, reemployment services, and some economic statistics. The mission of the DOL is "To foster, promote, and develop the welfare of the wage earners, job seekers, and retirees of the United States; improve working conditions; advance opportunities for profitable employment; and assure work-related benefits and rights."⁴⁹

The Amendments to Class Prohibited Transaction Exemptions to Remove Credit Ratings which were proposed in June 2013, requires the Department to remove any references to or requirements of reliance on credit ratings and use appropriate alternatives to determine creditworthiness.⁵⁰ The changes affect the employee benefit plans including participants and beneficiaries, fiduciaries, financial institutions that engage in transactions with, or provide services or products to, the plans.⁵¹

⁴⁶ Federal Register. (2012). Vol. 77, No. 142. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-07-24/pdf/2012-17860.pdf>

⁴⁷ FDIC. (2014). Financial Institution Letter. Available at: <https://www.fdic.gov/news/news/financial/2014/fil14018.pdf>

⁴⁸ Federal Register. 2013. Vol. 78 No. 175. Available at: https://www.fdic.gov/news/board/2013/2013-07-09_notice_dis_a_res.pdf

⁴⁹ DOL. Our Mission. Available at: <http://www.dol.gov/opa/aboutdol/mission.htm>

⁵⁰ Federal Register. 2013. Vol. 78, No 120. Page 37573. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-06-21/pdf/2013-14790.pdf>

⁵¹ Federal Register. 2013. Vol. 78, No 120. Page 37573. Available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-06-21/pdf/2013-14790.pdf>

The DOL recognises that numerous factors should be considered when conducting when assessing the creditworthiness of a financial instruments or establishments. The DOL proposed alternatives, following the recommendations of the Securities and Exchange Commission (SEC).

Based on the Securities and Exchange Commission (SEC), the alternative to establish creditworthiness are: : credit spreads, securities related research, default statistics, inclusion of an index, priorities and enhancements, price, yield, and volume, as well as asset class-specific factors (see section 5.3.4 for more details)⁵².

⁵² Federal Register. (2012). Vol 77. No 240. Available at:
<http://www.ncua.gov/Legal/Documents/Regulations/FIR20121214CreditRatings.pdf>

Study on the Feasibility of Alternatives to Credit Ratings

EV-04-15-588-EN-N

doi:10.2874/345030

ISBN: 978-92-79-57553-2