



BANK OF MAURITIUS

Guideline on The Recognition and Use of External Credit Assessment Institutions

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INTRODUCTION

The Standardised Approach to Credit Risk requires banks to use credit assessments provided by external credit assessment institutions (ECAIs) that are recognised by national supervisors as eligible for regulatory capital purposes, to determine the risk-weights on their credit exposures.

Purpose

The purpose of this guideline is to outline the Bank's approach to the recognition process of ECAIs and the use by banks of eligible ECAIs.

Authority

This guideline is issued under the authority of Section 100 of the Banking Act 2004 and Section 50 of the Bank of Mauritius Act 2004.

Scope of application

This guideline applies to all banks licensed under the Banking Act 2004.

Effective date

This guideline is effective as from 31 March 2008.

Interpretation

'Export Credit Agency' or ECA means an institution which, inter alia, provides export credit insurance facilities and publishes consensus country risk scores;

'External Credit Assessment Institution' or ECAI means an entity, other than an Export Credit Agency (ECA), that issues external credit assessments.

Structure of this guideline

This guideline is divided into three parts:

Part I – Recognition of External Credit Assessment Institutions;

Part II – Use of External Credit Assessment Institutions; and

Part III – Use of Export Credit Agencies.

PART I – RECOGNITION OF EXTERNAL CREDIT ASSESSMENT INSTITUTIONS

An eligible External Credit Assessment Institution (ECAI) is an entity that has been recognised by the Bank to meet the eligibility criteria set out in this guideline. Only the credit assessments of eligible ECAIs shall qualify for the Standardised Approach to Credit Risk.

Methods of recognition

Two methods of recognition are proposed:

Direct recognition

1. Under the direct recognition method, the Bank shall conduct an evaluation of an ECAI's compliance with the recognition criteria as set out in this guideline based on the information provided by the ECAI. The ECAI shall meet the six eligibility criteria set out in paragraphs 11 to 31, and the Bank shall conduct the mapping process.

Indirect recognition

2. Under the indirect recognition method, the Bank shall recognise an ECAI based on the recognition criteria of another jurisdiction provided that the criteria comply with the requirements of the Basel Committee on Banking Supervision (BCBS).
3. The Bank shall publish a list of all eligible ECAIs for which it has granted recognition. The list shall include a description of the market segments¹ for which recognition has been granted and the assigned risk weights that correspond to their ratings categories.

The recognition process

4. The recognition process aims at identifying ECAIs that produce consistent, robust and high quality credit assessments to be used by banks for regulatory capital purposes under the Standardised Approach to Credit Risk.
5. The Bank shall grant recognition to an ECAI in one or more market segment(s) provided the ECAI meets the recognition criteria in each market segment it intends to operate. However, the ECAI shall provide separate information in respect of rating methodologies and procedures for each market segment where credit risk assessments differ.
6. A locally incorporated subsidiary may be granted recognition at the level of the group provided the ECAI group demonstrates that the subsidiary for which it is seeking recognition strictly adheres to the procedures and methodologies set up at group level. The same rating has to be applied to a rated entity regardless of

¹ Market segment refers to the various classes of assets, e.g. claims on sovereigns, claims on banks, claims on corporates, etc.

the geographical location of the subsidiary. However, separate application for recognition shall be required where the subsidiary uses credit assessments, procedures and methodologies that are materially different from those of the group. Further, for a newly formed subsidiary, the credit assessment methodology must be established for a minimum of one year (preferably three years) before recognition is sought.

7. When an ECAI group seeks recognition for its local affiliate, associate or joint venture, recognition shall be treated separately. Even if the local affiliate, associate or joint venture uses the same methodologies or complies with the same code of conduct as the group it is associated with, some of its characteristics may differ from those of the group under consideration. For instance, its ownership structure may differ from that of the ECAI group.

Application process

Direct recognition

8. An application to recognise an ECAI may be initiated by a bank intending to use its ratings under the Standardised Approach to Credit Risk, or by an ECAI itself but the latter should demonstrate that at least a bank intends to use its ratings under the Standardised Approach to Credit Risk. This requirement is meant to ensure that only applications of ECAs whose ratings would genuinely be used for prudential risk-weighting purposes are considered.
9. Applications for direct recognition should be supported by relevant information as set out in Annex 1 of this guideline. However, the Bank may call for additional information if deemed necessary. Based on the information provided, the Bank shall verify whether the ECAI meets the six eligibility criteria, and thereafter conduct the mapping.

Indirect recognition

10. Applications for indirect recognition shall be treated on a case-by-case basis. The Bank shall not perform its own evaluation of an ECAI's compliance with the six eligibility criteria but instead shall rely on the assessment of the foreign supervisor to conduct the mapping. However, evidence that the foreign supervisor has granted recognition to the ECAI and that the recognition criteria are in line with the BCBS framework should be provided.

Six eligibility criteria

This section sets out the minimum requirements for each of the six eligibility criteria, namely objectivity, independence, international access/transparency, disclosure, resources, and credibility.

Objectivity

Principle

11. The Bank shall verify whether the credit assessment methodology adopted by the ECAI encompasses the four elements of the objectivity criterion² in each market segment for which it seeks recognition.

Methodology

12. To satisfy the objectivity criterion, the ECAI should demonstrate for each market segment for which it seeks recognition that:
 - (a) the credit assessment methodology analyses all major features of an issuer's/issue's credit quality and covers all major types of debt of an issuer;
 - (b) the credit assessment methodology is conservative, and has been established for a minimum of one year and preferably three years before it seeks recognition;
 - (c) the credit assessment methodology has been applied thoroughly, consistently and comprehensively such that two identical companies rated by the ECAI would have equivalent credit assessment; and different analysts or rating committees within the ECAI would assign equivalent credit assessment to any given entity;
 - (d) the credit assessment methodology incorporates factors known to be relevant in determining an entity's creditworthiness, and these should be supported by statistical evidence that the methodology has produced accurate credit assessments in the past;
 - (e) it has the capabilities
 - (i) to monitor credit assessments on an ongoing basis such that all material changes in the financial or economic environment of an assessment are reflected promptly; and
 - (ii) to review credit assessments at least annually regardless of whether a reassessment has already been undertaken in response to changes in financial condition;
 - (f) it has backtested its credit assessment methodology using historical data for each market segment for which it seeks recognition. It shall demonstrate that it has adequate systems and statistical capabilities to conduct assessments, performance and reliability checks through backtesting. It shall also be required to demonstrate and certify that its backtesting has been in place for at least one year; and

² The credit assessment methodology must be rigorous, systematic, subject to some form of validation based on historical experience, and subject to on-going review and responsive to changes in financial conditions. The assessment methodology for each market segment, including rigorous backtesting, must have been established for at least one year and preferably three years.

- (g) it has the capability to support its credit assessments by default and recovery studies and generate transition matrices.

Independence

Principle

- 13. The Bank shall verify whether the ECAI has processes to safeguard its ratings such that actual or potential internal or external conflicts of interest may not impair the integrity of its credit assessments.

Methodology

- 14. To satisfy the independence criterion, the ECAI shall demonstrate that:
 - (a) it has processes to ensure that internal conflicts do not undermine the integrity of the credit assessments, in particular with respect to the following:

Ownership

- (i) its ownership structure and composition of the Board promote objective rating processes;
- (ii) it has adequate processes and safeguards in place to ensure that its credit assessments are independent when shareholders, subsidiaries, or other entities belonging to the group are rated. However, a bank shall not be allowed to nominate an ECAI which is its subsidiary or associate for its own capital adequacy requirements;
- (iii) it has procedures to manage and/or limit potential conflicts of interest when its board of directors may be involved with rated entities;

Corporate governance

- (iv) its corporate governance framework promotes independent credit assessments;
- (v) its code of conduct adheres to market standards and internationally recognised principles (e.g. International Organization for Securities Commissions (IOSCO) Code of Fundamentals for Credit Rating Agencies);
- (vi) it has mechanisms to manage, prevent and eliminate conflicts of interest to ensure that the ECAI's rating assessments are independent from its major clients and issuers; and that its staff and their relationship with rated entities are regularly monitored;

Organisation structure

- (vii) the ECAI should structure its businesses to ensure that its ratings have been thoroughly analysed, reviewed, and approved by independent

persons;

- (viii) its remuneration policy for staff involved in credit assessments does not affect the making of independent and objective credit assessments;
 - (ix) decisions are made by an independent rating committee composed of qualified and experienced individuals in accordance with the ECAI's established methodology; and
 - (x) it has an independent internal audit function or a similar function that periodically reviews the effectiveness of its internal procedures and processes, credit assessment methodology and credit assessments; and makes commensurate recommendations;
- (b) it has robust financial resources and adequate safeguards in place to ensure that its credit assessments are not subject to commercial pressures. In particular, it must be demonstrated that:
- (i) the ECAI's core rating service is independent – operationally, financially and legally - from any complementary businesses it may develop (e.g. consulting and risk management services);
 - (ii) it has a written fees policy; and
 - (iii) its income from a single issuer does not represent more than 5 per cent of its total revenue such that no issuer may influence its credit assessments; and
- (c) it has adequate processes to ensure independence from ownership, and prevent external pressures or constraints – either political or economic – from jeopardising the objectivity of its credit assessments.

International access/transparency

Principle

15. The Bank shall verify whether an ECAI allows access to credits assessments on equal terms and makes its general methodology available publicly to both domestic and foreign institutions with legitimate interest.

Methodology

16. An ECAI shall demonstrate that it allows access to its credit assessments to all domestic and foreign users with legitimate interest on equal terms.
17. In this context,
- (a) "legitimate users" refers to all banks that intend to use the credit assessments of the ECAI for risk weighting purposes under the Standardised Approach to Credit Risk; and
 - (b) "equal terms" means the terms on which an ECAI allows access to its credit assessments should not be based on discriminating factors, such as

restricting access to firms or participants located in specific geographical areas or imposing higher fees for some services on some categories of customers. However, access can be restricted provided the restriction applies to all in the same way.

18. The ECAI shall demonstrate that its credit assessments and general methodology are available to all legitimate domestic and foreign users to ensure transparency of information.
19. An ECAI that permits only paying subscribers to access its credit assessments shall ensure that its general methodology is available to all paying subscribers on equal terms.
20. An ECAI that does not charge subscribers for access to its credit assessments shall ensure that its general methodology is easily accessible to the public. The ECAI shall make available a full list of its credit assessments in the public section of its website, and ensure that the list is regularly updated.
21. An ECAI shall ensure that all material changes in its general methodology are promptly disclosed to market participants and the Bank.

Disclosure

Principle

22. The Bank shall verify whether the ECAI discloses information relating to its assessment methodologies and transition of the assessments.

Methodology

23. The ECAI shall disclose as a minimum, a general description of its credit assessment methodology, its definition of default, its time horizon, its rating definitions, its actual default rates and its transition matrices to all legitimate users.
24. The Bank shall ensure that information disclosed by the ECAI is understandable and sufficient to allow all users to make knowledgeable decisions.

Resources

Principle

25. The Bank shall verify whether the ECAI has sufficient human and technical resources to carry out high quality credit assessments and maintain ongoing contact with senior and operational levels within the entities assessed.

Methodology

26. The ECAI shall demonstrate that its credit assessments are based on methodologies that incorporate both qualitative and quantitative factors.

Qualitative factors: human resources

- (a) The ECAI shall have adequate staff with the necessary skills and requisite experience;
- (b) it shall have in place recruitment and training policies that ascertain that its staff are able to carry out reliable and consistent credit assessments thoroughly and competently while maintaining ongoing contact with assessed entities;
- (c) it shall ensure that the size of its staff is sufficient to allow the use of established procedures for credible, reliable and consistent credit assessments and ongoing contact with the rated entities; and

Quantitative factors: technical resources

- (d) the ECAI should have the necessary quantitative techniques and models that can process and analyse large quantity of data that enable the conduct of default studies and generation of transition matrices.
27. The ECAI shall demonstrate that it has the capability to invest in the necessary technological infrastructure to ensure speedy acquisition and processing of data/information and timely release of reliable and credible ratings.

Credibility

Principle

28. The Bank shall verify whether the ECAI meets the five previous eligibility criteria and whether it is perceived to be credible by its users.

Methodology

29. The ECAI shall satisfy the five previous eligibility criteria.
30. The ECAI shall demonstrate that independent parties rely on its credit assessments. This can be assessed by:
- (a) its market share;
 - (b) its degree of acceptance by predominant users in the market (e.g. issuers, investors, bankers, etc); and
 - (c) statistical evidence that shows market reliance on the ECAI's ratings.
31. The ECAI shall demonstrate that it has internal procedures to prevent the misuse of confidential information.

On going review of eligibility

32. The Bank shall ensure that, on an ongoing basis, a recognised ECAI meets the

six eligibility criteria and the assigned risk weights reflect the level of credit risk. The Bank shall, among others:

- (a) evaluate all material changes in the credit assessment methodology as reported by an eligible ECAI and prompt changes to the recognition process including mapping if it deems necessary;
 - (b) verify whether the corporate governance framework is sound and conducive to good practices;
 - (c) verify the capabilities of an eligible ECAI to review and monitor its credit assessments on an ongoing basis; and
 - (d) verify whether an eligible ECAI has procedures to ensure that credit assessments capture economic cycles.
33. The Bank shall conduct a review of the continuing eligibility of an ECAI where there are indications of conspicuous weakening in performance and/or market acceptance of the ECAI, and shall take such action as it deems necessary.
34. Where there is evidence that the Cumulative Default Rates³ (CDRs) of an eligible ECAI do not conform to the CDR benchmarks⁴, the Bank may proceed in accordance with paragraphs 36 to 42.
35. The Bank shall undertake an in-depth review of the eligibility criteria of an ECAI every five years and shall take such action as it deems necessary.

Suspension or revocation of recognition

36. Subject to paragraph 37 below, the Bank may, by notice in writing, inform an ECAI of its intention to revoke a recognition granted to it where
- (a) an eligible ECAI fails to meet the recognition criteria set out in this guideline;
 - (b) an eligible ECAI which has been recognised by the Bank under the indirect recognition method is no longer recognised as such by the foreign supervisor.
37. The Bank may, in its own deliberate judgment, prior to or instead of revoking the recognition granted to an ECAI, decide to suspend its recognition.
38. Any suspension imposed under paragraph 37 shall be for such period of time as the Bank may deem fit.
39. Where the Bank decides to suspend or revoke a recognition, it shall serve on

³ CDR is defined as the sum of all defaults that have occurred in a given period for all rated items belonging to the same bucket.

⁴ The CDR benchmarks have been set by BCBS as guidance based on its observations of the default experience reported by major rating agencies internationally.

the ECAI, a notice of its decision to do so, specifying a date, which shall be no less than 14 days of the date of the notice, on which the suspension or revocation shall take effect.

40. The ECAI may, within 7 days of service of a notice under paragraph 39 above, make representations to the Bank.
41. The Bank shall, after considering representations made under paragraph 40 above, take a final decision on the suspension or revocation of the recognition and notify the ECAI accordingly.
42. The Bank shall inform an ECAI in writing of the revocation or suspension of its recognition.

The mapping process

43. The Bank shall map eligible ECAs' assessments to the supervisory risk weights under the Standardised Approach to Credit Risk using the guidance provided by BCBS. The CDR shall be used to determine the associated supervisory risk weights.
44. In conducting the mapping process, the Bank shall assign supervisory risk weights to each rating category such that the probability of default (PD) associated with each rating category is consistent with the level of risk reflected in the supervisory risk weights of the Standardised Approach to Credit Risk.
45. Where there are more rating scales than supervisory risk weights, rating categories shall be bunched together and the Bank shall assign supervisory risk weights such that all rating categories which have PDs falling within a given range attract the same risk weight.
46. The Bank shall consider a variety of qualitative and quantitative factors to differentiate between the relative degrees of risk expressed by each rating category.

Qualitative factors

47. Where an ECAI uses methodologies other than those used by BCBS to determine the CDR benchmarks which may influence the comparability of its CDRs to the CDR benchmarks, the Bank shall consider qualitative factors in the mapping process.
48. Where an ECAI uses methodologies similar to those used by the international entities upon which BCBS constructed its benchmarks, the Bank shall use qualitative factors to adjust its quantitative assessment when conducting the mapping process.
49. The Bank shall consider the following qualitative factors:
 - (a) **the range and meaning of an ECAI's credit assessments** - No two ECAs use the same methodologies and even when credit assessments are considered by market participants to be highly comparable, they have, in

fact, different meanings;

- (b) **the definition of default** - The definition of default varies among ECAIs. An ECAI using a more stringent definition of default than the international benchmark would report more default events. The opposite may also occur;
 - (c) **the statistical significance of ECAI default rates** - The number of rated issues has to be sufficiently large. Particular attention will be paid to situations where an ECAI is sectorally focused or geographically specialised, or where an ECAI rates portfolios for which default data are very scarce;
 - (d) **the variable used to weigh default events** - The choice of variables such as the number of issues, the currency value of exposures rated, or other characteristics and their relative significance in the credit assessments may impact on credit assessments;
 - (e) **the nature and range of pool of issue** - The nature of the issuer pool including its size and scope affects the PD range and the grouping of ratings;
 - (f) **the geographic coverage** - An eligible ECAI shall provide information in respect of its coverage ratio;
 - (g) **dynamic properties and characteristics of the rating system or methodology** (e.g. a point in time rating system or a through the cycle system).
50. The Bank may consider the mapping on the basis of additional information and analysis provided by an ECAI.
51. Where an ECAI uses methodologies other than those used by international entities upon which the BCBS constructed its benchmark, it shall be required to explain how its methodologies differ from those used in the calculation of the CDR benchmarks.

Quantitative factors

52. An ECAI shall submit at least ten-year average of three-year CDR and the two most recent three-year CDR for each rating category. The data generating process (e.g. the definition default and time horizon) should be consistent over the period.
53. For a recently established ECAI which is unable to provide sufficient data to support its credit assessments, the Bank may, in lieu, require it to give an estimate of the ten-year average of three-year CDR for each risk rating and hold it accountable for this evaluation as and when its data series expand sufficiently to cover 10 years of default data.
54. The Bank shall compare CDR measures supplied by the ECAI over a three-year period, against the long run reference CDR Benchmark, and the "Monitoring"⁵

⁵ Exceeding the "monitoring" level CDR benchmark implies that an ECAI's current default experience for a particular credit risk-assessment grade is markedly higher than international default experience. This may

and “Trigger”⁶ Level Benchmarks, to determine the supervisory risk weight associated with a rating category.

Mapping assessment

55. The mapping assessment shall be carried out as follows:

Step 1:

The ECAI’s ten-year average of three-year CDR⁷ is compared with a long-run “reference” CDR in each step of its rating scale but it would not be expected to match exactly the long-run reference CDR.

Table 1 shows the long-run “reference” three-year CDRs for each credit risk category.

Table 1 – Long-run “reference” three-year CDRs as recommended by BCBS

| | | | | | |
|-----------------------------------|---------------|----------|------------|-----------|----------|
| S&P Assessment | AAA-AA | A | BBB | BB | B |
| Moody’s | Aaa-Aa | A | Baa | Ba | B |
| 20-year average of three-year CDR | 0.10% | 0.25% | 1.00% | 7.5% | 20.0% |

Step 2:

The ECAI’s two most recent three-year CDR⁷ is compared with CDR benchmarks for each step in its rating scale.

Table 2 shows the three-year CDR benchmarks for each category of credit risk.

Table 2 – Three-year CDR benchmarks as recommended by BCBS

| | | | | | |
|---------------------------|---------------|----------|------------|-----------|----------|
| S&P Assessment | AAA-AA | A | BBB | BB | B |
| Moody’s | Aaa-Aa | A | Baa | Ba | B |
| Monitoring level | 0.8% | 1.0% | 2.4% | 11.0% | 28.6% |
| Trigger level | 1.2% | 1.3% | 3.0% | 12.4% | 35.0% |

not necessarily imply a weakening of the ECAI’s credit assessment standards.

⁶ Exceeding the “trigger” level benchmark implies that an ECAI’s default experience is considerably above the international historical default experience for a particular assessment grade. If the “trigger” level benchmark is exceeded for two consecutive years, the presumption is that the ECAI’s credit standards are either too weak or not applied appropriately. Unless the ECAI can demonstrate otherwise, the assessment grades shall be moved to a higher risk weight category.

⁷ The CDR is provided by the ECAI.

The benchmarks shall be applied as follows:

(a) CDR⁷ < "Monitoring" Level

The Bank shall map the ratings to the relevant risk weights if the CDR is less than the "monitoring" level.

(b) Monitoring Level < CDR⁷ < Trigger Level

The Bank shall assign a higher risk category to the ECAI's credit risk assessment if the higher level default experience is attributable to weaker standards in assessing credit risk.

(c) CDR⁷ > "Trigger" level

The Bank shall map the risk category into a higher risk weight if the observed three-year CDR exceeds the "trigger" level for two consecutive years, unless the ECAI proves that the higher observed CDR is not attributable to weaker assessment standards.

56. Where the Bank has increased the associated risk category, the assessment may be mapped again to the original risk category if the ECAI is able to demonstrate that its three-year CDR falls and remains below the "trigger" level for two consecutive years.
57. The list of recognised ECAIs and the mapping of their assessments may be subject to future changes if considered appropriate by the Bank.

Disclosure

58. The Bank shall publish an explanation of the mapping process and a list of recognised ECAIs under both the direct and indirect method with a view to ensuring transparency. The disclosure shall include the name of each eligible ECAI together with the market segment(s) in which recognition has been granted.
59. A list of recognised ECAIs and the assigned supervisory risk weights is given in Annex 2 of this guideline.

PART II: USE OF EXTERNAL CREDIT ASSESSMENT INSTITUTIONS

Principles for consistent use of credit assessments

60. A bank shall nominate one or more ECAIs to determine risk weights under each risk category/market segment. The nominated ECAIs must have been declared eligible by the Bank or have been recognised under the indirect recognition scheme.
61. A bank shall notify the Bank of its nominated ECAI(s) and the application of the ratings of the ECAI(s) on each market segment. It shall seek the approval of the Bank on any subsequent changes to its list of nominated ECAI(s) and the application of its/their ratings.
62. The credit assessments of nominated ECAI(s) shall be used consistently within each segment. A bank shall avoid cherry-picking of ratings provided by different ECAIs to create a more favourable capital position. A bank shall not be permitted to use one ECAI's rating for a corporate bond, while using another ECAI's rating for another exposure on the same corporate.
63. A bank shall not be permitted to apply an eligible ECAI's ratings in segment(s) that does/do not fall within the Bank's recognition for risk weighting its exposures.
64. The credit assessments of nominated ECAI(s) shall be used consistently by a bank for both risk weighting and risk management purposes.
65. A bank shall demonstrate a good understanding of the methodologies employed by its nominated ECAI(s), and shall ensure that its/their ratings are used appropriately.
66. A bank shall demonstrate that it has procedures to monitor and respond to changes in the credit ratings of its nominated ECAI(s) on its credit portfolios, as and when the information is made public.
67. A bank shall not be permitted to use the credit assessment for one entity within a corporate group to risk weight other entities within the same group. Further, in cases where a corporate is rated by one nominated ECAI and is unrated by another nominated ECAI, the bank shall use the rated credit assessment.
68. A bank shall use solicited ratings from nominated ECAI(s). However, in circumstances where solicited ratings are not available, a bank may be allowed to use unsolicited ratings in the same way as solicited ratings, subject to the approval of the Bank.
69. A bank shall be required to inform the Bank of any deterioration in the quality of its credit portfolio by reporting to the Bank the ratings assigned to its impaired advances by its nominated ECAI(s) in Return 39 - 'Statement of Sectorwise Impaired Credit facilities' and Return 39.1 - 'Detailed List of Impaired Credit Facilities in excess of Rs 100,000'.
70. A bank shall treat all relevant exposures as "unrated" for risk weighting purposes if those exposures do not have ratings assigned to them by any of its

chosen ECAI(s).

Types of credit assessments

Multiple assessments

71. If there is only one assessment by an ECAI chosen by a bank for a particular claim, that assessment should be used to determine the risk weight of the claim.
72. If there are two assessments by ECAs chosen by a bank which map into different risk weights, the higher risk weight should be applied.
73. If there are three or more assessments with different risk weights, the assessments corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights should be applied.

Issuer versus issues assessment

74. Where a bank invests in a particular issue that has an issue-specific assessment, the risk weight of the claim shall be based on that assessment. Where a bank's claim is not an investment in a specific assessed issue, the following general principles shall apply:
 - (a) In circumstances where the borrower has a specific assessment for an issued debt – but the bank's claim is not an investment in this particular debt – a high quality credit assessment (one which maps into a risk weight lower than that which applies to an unrated claim) on that specific debt may only be applied to the bank's unassessed claim if this claim ranks *pari passu* or senior to the claim with an assessment in all respects. If not, the credit assessment cannot be used and the unassessed claim shall attract the risk weight for unrated claims;
 - (b) In circumstances where the borrower has an issuer assessment, this assessment typically applies to senior unsecured claims on that issuer. Consequently, only senior claims on that issuer shall benefit from a high quality issuer assessment. Other unassessed claims of a highly assessed issuer shall be treated as unrated. If either the issuer or a single issue has a low quality assessment (mapping into a risk weight equal to or higher than that which applies to unrated claims), an unassessed claim on the same counterparty shall be assigned the same risk weight as is applicable to the low quality assessment.
75. Whether the bank intends to rely on an issuer- or an issue-specific assessment, the assessment must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it⁸.
76. In order to avoid any double counting of credit enhancement factors, no supervisory recognition of credit risk mitigation techniques shall be taken into

⁸ For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with repayment of both principal and interest.

account if the credit enhancement is already reflected in the issue-specific rating.

Domestic currency and foreign currency assessments

77. Where unrated exposures are risk weighted based on the rating of an equivalent exposure to that borrower, the general rule is that foreign currency ratings shall be used for exposures in foreign currency. Domestic currency ratings, if separate, shall only be used to risk weight claims denominated in the domestic currency.

Short-term/long-term assessments

78. For risk-weighting purposes, short-term assessments are deemed to be issue-specific. They can only be used to derive risk weights for claims arising from the rated facility. They cannot be generalised to other short-term claims, except under the conditions of paragraph 80. In no event shall a short-term rating be used to support a risk weight for an unrated long-term claim. Short-term assessments may only be used for short-term claims against banks and corporates. Table 3 below provides a framework for banks' exposure to specific short-term facilities such as a particular issuance of commercial paper.

Table 3 – Risk weights for specific short-term facilities

| Credit assessment | A-1/P-1⁹ | A-2/P-2 | A-3/P-3 | Others¹⁰ |
|--------------------------|----------------------------|----------------|----------------|----------------------------|
| Risk weight | 20% | 50% | 100% | 150% |

79. If a short-term rated facility attracts a 50% risk weight, unrated short-term claims cannot attract a risk-weight lower than 100%. If an issuer has a short-term facility with an assessment that warrants a risk weight of 150%, all unrated claims, whether long-term or short-term shall also attract a 150% risk weight, unless the bank uses recognised credit risk mitigation techniques for such claims.
80. Under the *Guideline on Standardised Approach to Credit Risk*, Option 2¹¹ is applied to claims on banks. Consequently, the interaction with specific short-term assessments is expected to be as follows:
- (a) the general preferential treatment for short-term claims shall be applied to all claims on banks of up to three months original maturity when there is no specific short-term claim assessment;
 - (b) when there is a short-term assessment and such an assessment maps into

⁹ The notations follow the methodology used by Standard & Poor's Ratings Services and Moody's Investors Service. The A-1 rating of S&P includes both A-1+ and A-1-.

¹⁰ This category includes all non-prime and B or C ratings.

¹¹ Under this option, a preferential risk-weight that is one category more favourable shall be applied to claims with an original maturity of three months or less, subject to a floor of 20%. This treatment shall be available to both rated and unrated banks, but not to banks risk-weighted at 150%.

a risk weight that is more favourable (i.e. lower) or identical to that derived from general preferential treatment, the short-term assessment shall be used for the specific claim only. The general preferential treatment shall apply to other short term claims; and

- (c) When a specific short-term assessment for a short-term claim on a bank maps into a less favourable (higher) risk weight, the general short-term preferential treatment for interbank claims cannot be used. All unrated short-term claims shall attract the same risk weight as that implied by the specific short-term assessment.

PART III - USE OF EXPORT CREDIT AGENCIES

- 81. The *Guideline on Standardised Approach to Credit Risk* permits banks to use consensus country risk scores of Export Credit Agencies (ECAs) to determine risk weights for claims on sovereigns in cases where countries are not rated by eligible ECAs.
- 82. The Bank has not set up a recognition process for ECAs equivalent to the one required for ECAs. However, the ECAs must publish their consensus country risk scores and subscribe to the Organisation for Economic Cooperation and Development (OECD) agreed methodology in order for these to qualify for calculating capital requirements under the Standardised Approach to Credit Risk.
- 83. The OECD agreed methodology establishes eight risk score categories associated with minimum insurance premium. The ECA risk scores shall correspond to risk weight categories as detailed in Table 4 below:

Table 4 – ECA risk scores and corresponding risk weights

| | | | | | |
|------------------------|--------------|----------|----------|--------------|----------|
| ECA risk scores | 0 - 1 | 2 | 3 | 4 - 6 | 7 |
| Risk weight | 0% | 20% | 50% | 100% | 150% |

- 84. The rules as set out in paragraphs 60 to 67 and 69 to 70 of this guideline shall also apply to the credit assessments of ECAs to ensure that consensus country risk scores are used consistently and continuously by banks. The rules as set out in paragraphs 71 to 73 shall also apply to ECAs in cases of multiple assessments by different agencies.

Annex 1: List of minimum information required for recognition of an ECAI

General information

1. General information on the ECAI.
2. The type of recognition that is being sought.
3. A list of market segment(s) for which recognition is being sought.
4. A list of jurisdictions where the ECAI has been granted recognition.

Minimum information to be provided to the Bank for verifying the objectivity criterion:

5. Evidence that the credit assessment methodology is capable of analysing all types and features of an issuer debt; and the credit assessment methodology is conservative and has been established for at least one year and preferably 3 years before recognition is sought.
6. A detailed description of the credit assessment methodology and processes and how the methodology is determined, implemented and changed. Where different methodologies are applied to different market segments and/or products, separate explanations shall be provided for each market segment where recognition is sought.
7. A description of processes in place to ensure the consistent application of the assessment methodologies across all credit assessments, in particular the role of rating committees and guidelines governing them, the extent of input from rated entities, access to non-public information, etc.
8. A description of inputs used to determine an entity's creditworthiness for each market segment for which the ECAI seeks recognition. These shall include both quantitative inputs (e.g. key variables, data sources, assumptions and quantitative techniques used, extent of input from rated entities, etc.) and qualitative inputs (e.g. the strategy, business plans of the rated entities, etc.).
9. A description of the processes in place to ensure that credit assessments are reviewed at least annually and every time a new event impacts on the credit quality of a given obligor. The description shall include the persons/teams involved and the mechanism that allows systematic errors in credit assessments to result in changes in rating methods. A list of credit assessments reviewed and the results and outcomes thereof should also be provided.
10. A description of the backtesting methodology used to verify the accuracy, consistency, and discriminatory power of the rating systems, with details on the results and conclusions generated by such analysis. Evidence that the backtesting has been up and running for at least one year should also be submitted.
11. Evidence such as default studies, recovery studies, and transition matrices to support credit assessments.

Minimum information to be provided to the Bank for verifying the independence criterion:

12. An overview of the group structure of the ECAI showing the holding company and subsidiaries, if any. A list of shareholders who hold more than 5% of the ECAI's equity and the composition of the board of directors.
13. A detailed description of the safeguards in place when shareholders, subsidiaries, or other entities belonging to the group are rated.
14. A description of the processes in place to manage/limit potential conflicts of interest in situations where its board of directors or any staff involved in the assessment process are related to the entities. A list of such entities and the persons involved should be submitted.
15. Self-certification that the Code of Conduct adheres to principles set out by IOSCO and explanations for non-adherence, if any.
16. A description of the processes to ensure that the ECAI's ratings are independent from its major clients and issuers, and the safeguards in place to ensure that staff and their relationships with rated entities are regularly monitored.
17. The organisation structure and a detailed description of the responsibilities of staff involved in each credit assessment process.
18. A description of the remuneration policy of staff involved in credit assessments and self-certification that staff remunerations in general or any part thereof are not linked to credit assessment, fees from issuers, or revenues from investors or subscribers.
19. A description of rating committees and a list of directors and staff involved therein.
20. A description of the internal audit function. Self-certification of internal audit function to ensure that internal policies are followed – including details of remit, independence, resources and power.
21. The ECAI's financial statements for the past three years and forecasts for the next three years where applicable; alternatively, letter of support from parent entity.
22. The ECAI's fee policy.
23. A list of major customers accounting for 5 per cent or more of total revenue.

Minimum information to be provided to the Bank for verifying the international access/transparency criterion:

24. Evidence that the ECAI's general methodology and credit assessments are made available to all legitimate domestic and foreign users on equal terms.
25. A description of the methods used to make the information available to all domestic and foreign users with legitimate interest.

Minimum information to be provided to the Bank for verifying the disclosure criterion:

26. Evidence that the ECAI has made available to all legitimate users a general description of the principles of its credit assessment methodology, definition of default, time horizon, rating definitions, actual default rates and transition.

Minimum information to be provided to the Bank for verifying the resources criterion:

27. Evidence that the ECAI has sufficient staff with skills and experience to perform the tasks required of them.
28. A description of the recruitment and training policy.
29. Evidence that the ECAI has necessary quantitative techniques and models to analyse large quantity of data.
30. Evidence that the ECAI has the financial resources to invest in technological infrastructure.

Minimum information to be provided to the Bank for verifying the credibility criterion:

31. Evidence demonstrating market reliance on the credit assessments, such as market share, number of issuers, how long the ECAI has been active in the market, the revenues generated by the rating activity or any other evidence.
32. A description of the internal procedures to deal with the misuse of confidential information.

Mapping

Minimum information to be provided to the Bank to enable it to perform the mapping of the ECAI rating scales to supervisory risk weights:

33. The two most recent 3-year CDRs and 10-year average of 3-year CDRs. If these are not available, estimates should be provided.
34. A description of the qualitative factors used to calculate the CDR:
 - (a) the range and meaning of the assessment;
 - (b) the definition of default;
 - (c) the variables used to weigh default events;
 - (d) the nature and range of pool of issuers;
 - (e) the geographic coverage; and

- (f) the dynamic properties of the rating methodology.
35. An explanation of the dissimilarity in methodologies used in the calculation of the CDR benchmarks when they differ from those used by international entities upon which BCBS constructed its benchmark.
 36. The statistical significance of default rates.

Annex 2

List of international credit rating agencies

The ratings of the following international credit rating agencies may be used for capital adequacy purposes by banks for risk weighting their claims in **all market segments**:

1. Standard and Poor's Ratings Services
2. Moody's Investors Service
3. Fitch Ratings

List of recognised ECAs under the indirect recognition method

- The ratings of the following rating agency may be used for capital adequacy purposes by banks for risk weighting their claims in **all market segments**.

Rating and Investment Information, Inc.

- The ratings of the following rating agencies may be used for capital adequacy purposes by banks for risk weighting their **claims on corporates only**.

1. Credit Analysis and Research Limited (CARE)
2. Credit Rating Information Services of India Limited (CRISIL)
3. FITCH India
4. Investment Information and Credit Rating Agency of India (ICRA)

Table 5 - Long-term ratings¹²

| External Rating Grade | 1 | 2 | 3 | 4 | 5 | 6 |
|---|------------|----------|--------------|------------|--------------|-----------|
| Standard & Poor's Ratings Services / Fitch Ratings | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to BB- | B+ to B- | CCC+ to D |
| Moody's Investors Service | Aaa to Aa3 | A1 to A3 | Baa1 to Baa3 | Ba1 to Ba3 | B1 to B3 | Caa1 to D |
| Rating and Investment Information, Inc. | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to BB- | B+ to B- | CCC+ to D |
| CARE, CRISIL, FITCH INDIA, ICRA¹³ | AAA | AA to A | BBB | | BB and below | |

Table 6 - Short-term ratings¹⁴

| External Rating Grade | 1 | 2 | 3 | 4 |
|--|------|------------|-----|--------|
| Standard & Poor's Ratings Services | A-1 | A-2 | A-3 | others |
| Moody's Investors Service | P-1 | P-2 | P-3 | others |
| Fitch Ratings | F1 | F2 | F3 | others |
| Rating and Investment Information, Inc. | a-1 | a-2 | a-3 | others |
| CARE | PR1+ | PR1 PR2 | PR3 | others |
| CRISIL | P1+ | P1 P2 | P3 | others |
| FITCH INDIA | F1+ | F1 F2 | F3 | others |
| ICRA | A1+ | A1 A2 | A3 | others |

^{12, 14} The long term ratings will apply for all market segments except for the ratings of CARE, CRISIL, FITCH INDIA and ICRA which shall apply exclusively to claims on corporates.

¹³ Where "+" or "-" notation is attached to the rating, the corresponding main rating category risk weight should be used, e.g. A+ or A- would be considered in the A rating category.

Table 7 - Risk weights for claims on sovereigns in currency other than their local currency

| | | | | | | |
|---|------------|----------|--------------|-----------|----------|---------|
| Credit Assessment of Standard & Poor's Ratings Services / Fitch Ratings | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to B- | Below B- | Unrated |
| Credit Assessment of Moody's Investors Service | Aaa to Aa3 | A1 to A3 | Baa1 to Baa3 | Ba1 to B3 | Below B3 | Unrated |
| Credit Assessment of Rating and Investment Information, Inc. | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to B- | Below B- | Unrated |
| <i>Consensus risk scores of ECAs participating in the Arrangement on Officially Supported Export Credits</i> | 0 - 1 | 2 | 3 | 4 - 6 | 7 | |
| External rating grade | 1 | 2 | 3 | 4,5 | 6 | Unrated |
| Risk weight | 0% | 20% | 50% | 100% | 150% | 100% |

Table 8 - Risk weights for claims on banks

| | | | | | | |
|--|------------|----------|--------------|-----------|----------|---------|
| Credit Assessment of Standard & Poor's Ratings Services / Fitch Ratings | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to B- | Below B- | Unrated |
| Credit Assessment of Moody's Investors Service | Aaa to Aa3 | A1 to A3 | Baa1 to Baa3 | Ba1 to B3 | Below B3 | Unrated |
| Credit Assessment of Rating and Investment Information, Inc. | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to B- | Below B- | Unrated |
| External Rating Grade | 1 | 2 | 3 | 4,5 | 6 | Unrated |
| Risk weight | 20% | 50% | 50% | 100% | 150% | 50% |
| Risk weight for short term claims | 20% | 20% | 20% | 50% | 150% | 20% |

Table 9 - Risk weights for claims on corporates

| | | | | | |
|--|------------|----------|-------------|-----------|---------|
| Credit Assessment of Standard & Poor's Ratings Services / Fitch Ratings | AAA to AA- | A+ to A- | BBB+ to BB- | Below BB- | Unrated |
| Credit Assessment of Moody's Investors Service | Aaa to Aa3 | A1 to A3 | Baa1 to Ba3 | Below Ba3 | Unrated |
| Credit Assessment of Rating and Investment Information, Inc. | AAA to AA- | A+ to A- | BBB+ to BB- | Below BB- | Unrated |
| External Rating Grade | 1 | 2 | 3,4 | 5,6 | Unrated |
| Risk weight | 20% | 50% | 100% | 150% | 100% |

Table 10 - Risk weights for long term and short term claims on corporates

| | | | | | |
|---|------|------------|------|----------------|---------|
| Long term credit assessment of CARE, CRISIL, FITCH INDIA, ICRA | AAA | AA to A | BBB | BB and below | Unrated |
| Short term credit assessment of CARE | PR1+ | PR1 PR2 | PR3 | PR4 and PR5 | Unrated |
| Short term credit assessment of CRISIL | P1+ | P1 P2 | P3 | P4 and P5 | Unrated |
| Short term credit assessment of FITCH INDIA | F1+ | F1 F2 | F3 | B, C and D | Unrated |
| Short term credit assessment of ICRA | A1+ | A1 A2 | A3 | A4 / A5 | Unrated |
| Risk weight | 20% | 50% | 100% | 150% | 100% |