To
European Securities and Markets Authority
Submitted via email

Date: September 2nd, 2016

Reference: Consultation Paper 2016/1121 dated July 13th, 2016 on "guidelines on the validation and review of CRAs methodologies"

Dear Sir,

With reference to the above Consultation Paper, we are pleased to hereby submit the response of our association, currently representing 10 registered and 1 certified CRA. Attached to this letter, you will find the responses to the 8 questions asked.

Compared to the Discussion Paper 2012/1735 on the same topic dated November 2015, we positively note that ESMA has introduced some flexibility regarding the quantitative/statistical measures to be used. Next to the "typically expected measures" and "complementary measures", we propose that "alternative measures" should equally be considered.

Reference question 7 regarding data enhancement techniques, this requirement is likely to impact more on new and smaller CRAs given their limited own track record. In line with the general EU law principle of proportionality, the validation techniques should also take into account the nature, size and complexity of a CRAs business and structure". Additionally and similar to EBAs "RTS on the assessment methodology for IRB approach" dated July 21st, 2016, we propose that the first-time validation of a methodology should undergo a stringent process while the review of methodologies may be done in a lighter format if the envisaged changes are not material to the methodology.

While CRAs will strive to validate their methodologies according to Article 7 of the RTS, as mentioned already in EACRAs response to the Discussion Paper leading to this Consultation Paper, we think that the proposed techniques in §30 to §32 will reach the expected goal of "pure" quantitative validation only in few market segments (for CRAs entering new market segments, having therefore limited or no rating history available, the case is even more constraining). We therefore think that the notion of "sensible predictors of credit worthiness" according to Article 8 of the RTS should equally take into account the overall qualitative analysis, which builds on the rating analytical experience of CRAs as well as market feed-back while consulting on proposed methodologies.

Sincerely yours

Thomas Missong	Adolfo Estevez Beneyto
EACRA President	EACRA Secretary General

On behalf of the following ESMA registered or certified CRAs (in alphabetic order): AMBERS, ARC Ratings, Assekurata Assekuranz Rating-Agentur, Axesor, Capital Intelligence Ratings, Cerved Rating Agency, Creditreform Rating Agentur, CRIF Rating, Euler Hermes Rating, Kroll Bond Rating Agency and Scope Ratings

Q1: Has ESMA captured all related costs and benefits in its analysis under Annex II?

While we agree with ESMA that the requirement to validate rating methodologies is already embedded in Level 1 and Level 2 legislation, we think that the proposed guidelines will nonetheless increase compliance costs to CRAs. ESMA notes that additional resources in the CRAs Review Functions and training costs for staff will materialize. We further think, that IT, data infrastructure, reporting and analytical staff costs will equally increase. In addition, some CRAs will use third party services and data in order to cope with the proposed requirements.

Q2: Do you agree that it is appropriate to set out certain measures as ones that ESMA "typically expects"? If not, please explain why.

We are of the view that defining "typically expected measures" (and "complimentary measures") has benefits as well as certain risk.

The benefit of such an approach is that ESMA provides a more precise guidance to CRAs.

On the other hand, it entails the risk that these measures are seen as the unique standard of validation – given the diversity of asset classes rated, we think that more flexibility is required. In the feed-back statement to the Discussion Paper leading to this Consultation, ESMA notes that other measures could have been selected, but that these were not retained for a lack of industry wide usage. Since these measures would cope with the regulatory requirements, we propose that these measures be included as "alternative measures" – this will expand the list of "expected measure" available to CRAs.

Further, we further would appreciated if ESMA defined in the guidelines, criteria for "limited quantitative evidence" so that both ESMA and the CRAs have a clear understanding whether a methodology should be validated in accordance with Article 7 or Article 8 of the RTS on rating methodologies.

Q3: Where a CRA diverges from measures ESMA typically expects to be used, do you agree that it should document its rationale and explain how it meets the regulatory requirements? If not, please explain why.

The proposal to explain the rationale for deviating from ESMA expected measures create a documentation requirement towards ESMA.

Given that ESMA has identified other measures meeting the regulatory requirements, we propose that these should be listed as "alternative measures". This additional list of "accepted" measures will reduce the reporting requirement of CRAs.

Q4: Do you agree that where a CRA does not use the CAP curve, the ROC curve should be added as an alternative measure that ESMA should typically expect? If not, please explain why.

We understand that the CAP and ROC curves are highly comparable. We therefore propose that CRAs should be able to use either of the two.

Given that §12 of the consultation paper defines future status as defaulted or not defaulted, we recall here that these statistical measures may not be appropriate for low-default portfolios or may not be meaningful for CRAs with limited rating track record.

Q5: Do you agree that ESMA should include a reference to qualitative measures under potential complementary measures? If not, please explain why.

Yes. Given the inherent nature of credit ratings, which include the “rating analytical input of an analyst”, we request that ESMAs supervisory review of rating methodologies does not only focus on quantitative measures but that qualitative assessments are equally duly considered.

Q6: Do you agree that the Population / System Stability Index is more appropriate as a complementary measure? If not, please explain why.

We understand that the historical robustness of rating methodologies should be first demonstrate with Rating stability analysis and transition matrixes and that “the Population /system Stability index” is only a complementary measure. We agree with this approach.

Q7: Do you agree that where a CRA chooses to use data enhancement techniques it should be subject to verifying data quality and safeguarding the characteristics of the rated population, including its default rate? If not, please explain why.

The use of data enhancement techniques will usually include the purchase of relevant data from a third party. While a high-level review of the data quality could be done, CRAs can’t be held responsible for the quality third party data. Furthermore, since data enhancement techniques are used to circumvent the perceived lack in the rated population, it is likely that the characteristics of the rated population will be changed.

In practice it can be very difficult to get data proxies which are perfectly representative. In case of low-default portfolios, data enhancement techniques will not trigger higher defaults rates. Additionally, data enhancement techniques are feasible only in few sectors, where publicly available information is ample and of good quality – in various sectors (such as securitizations or structured finance) such information is not publicly available to the degree required to perform validation.

Q8: Do you agree that a CRA needs to adopt a consistent approach in setting thresholds for both qualitative and quantitative validation techniques? If not, please explain why.

We think that setting unique thresholds across asset classes will be very difficult to set and therefore propose that expert judgment should be possible.