Single Rulebook Q&A

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Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876 (CRR2)
Topic	Credit risk
Article	183
Paragraph	-
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	EBA/GL/2017/16 - Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures
Article/Paragraph	62
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Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	Criteria for rating transfer
Question	Can “clear policies” referred to in paragraph 62 – such as recognising the relationship between a subsidiary and its consolidating parent or recognising any other form of control as defined in Article 4(1)(37) of Regulation (EU) No 575/2013 – which lack the features of a material contractual support – be considered as “appropriate guarantee", thereby supporting the rating transfer?
Background on the question	It is unclear whether the following conditions can be considered “appropriate” as evidence of no difference in risk between the obligor and the third party for the purposes of the requested guarantee, thereby supporting the “rating transfer” in line with the "EBA Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures": the third party having the majority of the shareholders’ or members’ voting rights in the relevant obligor or equivalent provisions in memoranda of associations; or the existence of articles of association of the third party granting its rights or the ability to exercise a dominant influence over the relevant obligor. The EBA states in Chapter 5.2.3 “Treatment of ratings of third parties”, paragraph 62 that: “Institutions

	should have clear policies specifying the conditions under which the rating of a third party who has a contractual or organisational relation with an obligor of the institution may be taken into account in the assessment of risk of the considered obligor" Afterwards, the EBA lists the possible manners in which the rating of such a third party may be taken into account in the assessment of risk of the considered obligor. In particular, under par.62(a) the EBA requires that: "the rating of such third party being transferred to a relevant obligor ('rating transfer'), where there is no difference in risk between the obligor and the related party because of the existence of an appropriate guarantee and the rating of a third party is assigned internally in accordance with the rating system for which the institution has received permission in accordance with Article 143(2) of Regulation (EU) No 575/2013" According to the above, a prerequisite for "rating transfer"' is "the existence of an appropriate guarantee". What par. 62 implies is that while it is on the intermediary to specify the conditions of a clear policy on the use of the rating of a third party in the assessment of risk of the considered obligor, the guarantee required for risk transfer has to be "appropriate". Therefore, it does not need to be "eligible" under Article 183 of Regulation (EU) No 575/2013 and, as a consequence, the definition of the "clear policy" set by the institution should also include and support a definition of "appropriate" guarantee.
EBA answer	Paragraph 62 of EBA/GL/2017/16 describes the possible approaches by means of which the rating of a third party that has a contractual or organisational relation with an obligor may be taken into account in the assessment of risk of the obligor. Depending on the nature and strength of such relation, its effects can be recognised in the rating of the obligor through one of the approaches described in points (a) to (c) of paragraph 62. Institutions should specify in their policies which types of contractual or organisational relations between third parties and the obligors are recognised in the rating of the obligor and the approach this is based on. In order to use the 'rating transfer' based on paragraph 62(a) of EBA/GL/2017/16 the following conditions have to be fulfilled: 1. there is no difference in risk between the obligor and the related party because of the existence of an appropriate guarantee provided by a third party to the obligor, which is legally binding and enforceable in all relevant jurisdictions and 2. internal rating of the third party is assigned based on an approved rating system. The guarantee referred to under point 1. is not a credit risk mitigation technique in the sense of points (57) and (59) of Article 4(1) CRR, because it

	is provided by the third party to the obligor and not to the institution. Such a guarantee is considered appropriate when a contractual agreement relation between the third parties and the obligors effectively prevents the potential default of the obligor, i.e. there are legally effective and enforceable unrestricted and unconditional provisions for preventing the potential default of the obligor. For the purpose of the use of "rating transfer", the existence of articles of association of the third party being a majority stakeholder granting its rights or the ability to exercise a dominant influence over the obligor would be considered insufficient. For that purpose, a guarantee or hard letter of comfort with similar effect, worded in a way considered legally binding and enforceable in the relevant jurisdiction(s) as well as fully recognised in the financial statement (including annex) of the provider of the letter, could be considered eligible, while any other form of a letter of comfort would be considered insufficient. As per paragraph 64 EBA/GL/2017/16, the use of rating transfer should only affect the assignment to grades or pools, and cannot result in a change of exposure class, rating system or model. See also Q&A 4598.
Link	https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2019_4745