

# Circular 2012/1

## Credit rating agencies

### Recognition of external credit assessment institutions (credit rating agencies)

Reference: FINMA Circ. 12/1 "Credit rating agencies"  
 Date: 29 June 2011  
 Entry into force: 1 January 2012  
 Last amendment: 24 October 2014 [Modifications are listed at the end of the document.]  
 Concordance: Previously FINMA Circ. 08/26 "Rating agencies" dated 20 November 2008  
 Legal framework: FINMASA Art. 7 para. 1 let. b  
 CAO Art. 6  
 ISO Art. 41 ff. and Art. 79  
 LiqO Art. 15b  
 FINMA-GebV Art. 5 ff.

Addressees																											
BankA			ISA			SESTA	FMIA					CISA					AMLA		Other								
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Intermediaries	Securities dealers	Trading venue	Central counterparties	Central securities depositories	Trade repositories	Payment systems	Participants	Fund management companies	SICAVs	Limited partnerships for C/ISs	SICAFs	Custodian banks	Asset manager C/ISs	Distributors	Representatives of foreign C/ISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies	
X	X		X	X		X							X	X	X	X	X	X								X	X

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## **I. Purpose**

This Circular governs the recognition of institutions that assess creditworthiness (credit rating agencies) whose credit ratings are used within the context of financial market regulation by FINMA-supervised institutions . 1

The provisions for recognising credit rating agencies set down in this Circular are intended to ensure that the prerequisites for minimum qualitative credit rating standards for regulatory use (see Section IV) are fulfilled. 2

## **II. Scope of application**

This Circular is directed at all institutions supervised by FINMA that use credit ratings pursuant to Section IV. 3

The use of credit ratings for purposes other than regulatory purposes, e.g. for information purposes or to support the risk management of supervised institutions, is not restricted irrespective of whether or not the credit rating agency is recognised by FINMA, and is not covered in this Circular. 4

## **III. General principles**

Institutions supervised by FINMA may only use credit ratings for regulatory purposes that are provided by credit rating agencies recognised by FINMA. 5

With respect to the regulatory use of credit ratings, FINMA-supervised institutions are to maintain professional scepticism and limit their dependency on these credit ratings by appropriate means. 6

Regardless of the use of credit ratings, the supervised institutions are responsible for identifying their risks (credit risks, investment risks, market risks, etc.) properly and for assessing, limiting and monitoring them independently. 7

Credit rating agencies are not supervised by FINMA on an ongoing basis. FINMA provides no assurance for the correctness and reliability of the credit ratings issued by recognised credit rating agencies. 8

## **IV. Regulatory use of credit ratings**

Institutions supervised by FINMA may use credit ratings issued by recognised credit rating agencies for the following regulatory purposes: 9

Banks and securities dealers:	10
• Calculation of capital adequacy requirements for credit and market risks and risk diversification under the Capital Adequacy Ordinance (CAO; SR 952.03) and calculation of high quality liquid assets in accordance with the Liquidity Ordinance (LiqO; SR 952.06).	11*
Insurers:	12
• Determining capital in accordance with the Swiss Solvency Test;	13
• Determining tied assets	14
Abrogated	15*
• Abrogated	16*
The rules on the regulatory use of credit ratings as specified in margin nos. 9-14 are prescribed in the relevant FINMA ordinances and in those of the Federal Council as well as in the related FINMA circulars. The key point of this Circular is the superior recognition of credit rating agencies (Sections V and VI).	17*

## **V. Recognition of credit rating agencies**

### **A. Market segments**

FINMA may recognise a credit rating agency for credit ratings of all or some of the following market segments:	18
• Public finance and its credit instruments;	19
• Commercial entities, including banks and insurance providers and their credit instruments;	20
• Structured finance, including securitisations and derivatives.	21

FINMA may recognise a credit rating agency for its credit ratings of other market segments. 22

FINMA may recognise a credit rating agency if the requirements of this Circular (margin no. 24 ff.) and other regulations are fulfilled. 23

### **B. Requirements**

The recognition of credit rating agencies is based on the provisions of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (current version), which recognised credit rating agencies are required to observe at all times. 24

FINMA may make the recognition of a credit rating agency subject to conditions or additional requirements, or effective only for a given period of time. 25

**a) Objectivity**

The credit rating methods used to determine the credit ratings should be factually sound. 26

The methods of awarding credit ratings should be strict and systematic and subject to a validation process that is based on historical experience. Moreover, the credit ratings should be reviewed periodically and reflect changes in the business and financial situation as well as the relevant market environment. 27

Before qualifying for recognition by FINMA, the credit rating methods should have been in use for at least three years and, in accordance with FINMA's criteria, their quality should have proven effective (e.g. back testing). In justified exceptional cases, FINMA may reduce the period of proven application of the credit rating methods to not less than one year. 28

The credit rating methods are to comprise qualitative and quantitative elements. 29

The credit rating agency should have documented procedures for ensuring that its credit ratings are based on careful analysis of all information that is known to it and is relevant to the methods applied. 30

The credit rating agency should observe a code of conduct which essentially corresponds to the provisions of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (current version). The code of conduct of the credit rating agency should be publicly available. If the credit rating agency deviates from any of the provisions of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, it is required to disclose any such deviations and indicate the reasons for them. 31

**b) Independence**

The credit rating agency and its credit rating procedures should be independent and should not be subject to any political or economic pressure that might influence the credit rating. In particular, the credit rating agency should ensure that neither the agency itself, its employees and analysts nor any related parties have any economic relationships (e.g. financial participations and loans) that could cause a conflict of interests. 32

The credit rating agency may not be associated with public sector entities, companies or issuers of structured finance products for which it produces credit ratings (credit rating issuers and issues) or with FINMA-supervised institutions which use the credit ratings issued by the credit rating agency. An inadmissible association also applies to employees, analysts and related parties and is deemed to exist not only in the case of a participating interest, but also if the credit rating agencies or individual credit ratings could be influenced, or there is the appearance of such influence. 33

The credit rating agency should identify all potential conflicts of interest and eliminate them or, if this is not possible within a reasonable period of time, disclose them. 34

The credit rating agency should have independent and adequate internal control systems. In addition to reviewing the credit ratings themselves, the credit rating methods and the models used are to be reviewed periodically. 35

The credit rating agency should have a compliance function which monitors the compliance of internal guidelines and procedures with regulatory requirements. 36

At an organisational level, the credit rating agency should ensure that there is an adequate functional separation between operational rating activities and advisory activities which proves to be effective. 37

### **c) Access and transparency**

The credit rating agency should make publicly available the individual credit ratings, the key elements on which the credit ratings are based, whether or not the issuer participated in the credit rating process, and the guidelines adhered to for the credit rating process. Each credit rating not initiated at the request of the issuer (unsolicited credit rating) should be identified as such and the policies and procedures regarding unsolicited credit ratings should be disclosed. 38

Where a credit rating agency has an “investor-pay” business model, it can make its credit ratings and the details prescribed in margin no. 38 accessible only to its subscribers under similar conditions. 39

In addition, the credit rating agency should disclose the procedures, the methodology and the assumptions which resulted in the credit rating. The conditions of access to this information are to be similar for all interested parties. 40

Private credit ratings, which are communicated to the issuer only, are exempted from these rules (margin nos. 38 to 40). 41

### **d) Disclosure**

The credit rating agency is to disclose the following information: 42

- Code of conduct; 43
- Principles of the remuneration agreements with the debtors and issuers who are rated; 44
- Credit rating methods including the definition of default, the time horizon of the credit ratings and the significance of each credit rating category; 45
- The default rates observed in each credit rating category; 46
- The migration rates of each credit rating category (migration matrix). 47

## **e) Resources**

The credit rating agency should have sufficient resources (finances, personnel, infrastructure, etc.) to issue credit ratings of a high quality. In the case of participation of the issuer (solicited credit rating), the credit rating agency's resources should allow close contact with the executive bodies of the debtor being rated / the issuer of the credit instruments being rated. 48

## **f) Credibility**

The credit rating agency and its credit ratings should be credible. 49

Credibility is attained through permanent compliance with the criteria set down in this Circular. Furthermore, the use of a credit rating agency's credit ratings by independent third parties (investors, trading partners, etc.) is also taken as an indicator of the credit rating agency's credibility. To ensure credibility, the credit rating agency should have internal procedures in place that safeguard against the misuse of confidential information. 50

## **C. Recognition procedure**

### **a) Recognition of credit rating agencies domiciled in Switzerland**

FINMA decides whether to recognise a credit rating agency on the basis of an application for recognition by the credit rating agency. The credit rating agency is to document the following in its application to FINMA: 51

- The market segment(s) for which recognition is being sought; 52
- How it meets the requirements for recognition; 53
- To what extent it complies with the current version of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. 54

In evaluating the application, FINMA takes into account whether the credit rating agency is recognised by foreign supervisory authorities. 55

FINMA publishes a list of the recognised credit rating agencies, indicating the market segments for which it has granted recognition. 56

The credit rating agency bears the costs of the recognition process in accordance with the FINMA Fees and Charges Ordinance (FINMA-GebV; SR 956.122). 57

### **b) Recognition of credit rating agencies domiciled abroad**

In general, credit rating agencies domiciled abroad and credit rating agencies domiciled in Switzerland are subject to the same requirements. 58

If a credit rating agency domiciled abroad is subject to ongoing supervision in that jurisdiction, FINMA may apply a simplified recognition process or waive proof of 59

compliance with the recognition requirements (margin no. 24 ff.).

It is currently assumed that the regulation and supervision of credit rating agencies in the following jurisdictions are sufficient: 60

- Australia 61
- EU countries
- Japan
- USA

#### D. Classification of credit ratings for regulatory purposes

FINMA publishes tables which show the regulatory classification of credit rating categories provided by the recognised credit rating agencies. 62

FINMA publishes mapping tables linking the credit rating categories and risk weightings in accordance with the Basel minimum standards. 63

### VI. Compliance with recognition requirements

The credit rating agencies recognised by FINMA are not subject to ongoing supervision. FINMA provides no assurance for the correctness and reliability of the credit ratings or the activities of the credit rating agencies it has recognised. 64

At any time, FINMA may review the compliance of the recognised credit rating agencies with the recognition requirements. 65

For this purpose, FINMA may hold discussions with the recognised credit rating agencies or request information and documentation. 66

For credit rating agencies that are subject to foreign supervision, FINMA may take the findings of the foreign supervisory authorities or the measures they impose on the credit rating agencies into consideration when evaluating a credit rating agency's compliance with the recognition requirements. 67

If shortcomings are found in a credit rating agency's compliance with the recognition requirements, FINMA may impose measures appropriate to remedying the shortcoming or may temporarily or permanently revoke recognition. If FINMA revokes a credit rating agency's recognition, the credit ratings of that agency can no longer be used for regulatory purposes by FINMA-supervised institutions. The credit rating agency bears the costs of the procedures that resulted in the revocation of its recognition in accordance with the FINMA-GebV. 68



## VII. Entry into force and transitional provisions

### A. Entry into force

This Circular will enter into force on 1 January 2012. The recognition of credit rating agencies by FINMA and its predecessor authorities prior to this date still applies. Credit rating agencies that applied for recognition to FINMA or to its predecessor authorities before 1 January 2012 should consistently comply with the provisions prescribed in this Circular. 69

The FINMA Circular 2008/26 “Rating agencies” will be rescinded when this Circular enters into force. Excluded are the regulations on export credit agencies (margin no. 46 ff. FINMA Circ. 08/26) that are still applicable for the purposes specified in margin nos. 11 and 13 until the ordinances and circulars on the implementation of the Basel III frameworks (foreseen for 1 January 2013) come into effect. 70

### B. Transitional provisions

Regarding the use of credit ratings to determine tied assets (margin no. 14), the provisions of this Circular shall enter into force as of 31 March 2016, in divergence from margin no. 69. By this date, credit rating agencies which are not yet recognised by FINMA and whose credit ratings are used by insurance companies for regulatory purposes should have applied to FINMA for recognition. Up until this date, insurance companies may continue to use credit ratings issued by credit rating agencies which by then qualify as ‘recognised’ under FINMA Circular 08/18 “Investment Guideline - Insurers”. 71\*

# List of modifications



## **This Circular has been modified as follows:**

These modifications were adopted on 1 June 2012 and will enter into force on 1 January 2013:

*References to the Capital Adequacy Ordinance (CAO; SR 952.03) have been adapted according to the version which will enter into force on 1 January 2013.*

These modifications were adopted on 24 October 2014 and will enter into force on 1 January 2015:

modified margin no.            11, 17, 71

abrogated margin no.        15, 16