Chapter 2

Commission Delegated Regulation (EU) No 447/2012

Article 7 Assessing that a credit rating methodology is subject to validation based on historical experience including back testing

(1) A credit rating agency shall use credit ratings methodologies that are supported by quantitative evidence of the discriminatory power of the credit rating methodology.

(2) A credit rating agency shall use credit rating methodologies that describe the following:

(a) the historical robustness and predictive power of credit ratings issued using the relevant methodology over appropriate time horizons and across different asset classes;

(b) the degree to which the assumptions used in the rating model deviate from the actual default and loss rates.

(3) The validation of a credit rating methodology shall be designed to:

(a) examine the sensitivity of a credit rating methodology to changes in any of its underlying assumptions, including qualitative or quantitative factors;

(b) perform an adequate and appropriate assessment of historic credit ratings produced by means of that credit rating methodology;

(c) use reliable inputs, including appropriate size of the data samples;

(d) take appropriate account of the main geographical areas of the rated entities or financial instruments for each of the credit rating categories rated such as structured finance, sovereign, corporates, financial institutions, insurances, public finance.

(4) A credit rating agency shall have processes in place to ensure that systemic credit rating anomalies highlighted by back-testing are identified and are appropriately addressed.

(5) In the process of reviewing credit rating methodologies, a credit rating agency shall include:

(a) regular credit rating and performance reviews on rated entities and financial instruments;

(b) in-sample and out-of-sample testing;

(c) historic information on validation or back-testing.