Annex 17

External Ratings Use Code

1. General Requirements

1.1 A commercial bank shall conduct due diligence processes and prudently choose the qualified external credit assessment institutions (hereinafter ECAI) and their assessment based on the eligibility criteria of the ECAI specified in this Annex.
1.2 A commercial bank shall assess the recognized ECAIs at least once every two years of their independence, professionalism, and internal control, and also through reviewing some disclosed documents to deepen understand the rational for their rating.
1.3 A Commercial bank shall report to the CBRC the name list of qualified ECAI(s) recognized and its change if any, as well as the result of its assessment.
1.4 A commercial bank shall use the chosen ECAIs and their ratings for each type of claim for both risk weighting and risk management purposes. A commercial bank shall not “cherry-pick” the assessment provided by different ECAIs and arbitrarily change the use of ECAIs if there are a number of ECAIs’ assessments on one credit issuer or one issue.

2. Eligibility Criteria of ECAIs

2.1 Objectivity

2.1.1 An ECAI shall establish assessment methodology for each market segment including rigorous back testing at least one year and preferably three years before being recognized.
2.1.2 ECAIs’ assessment methodology shallcombine both qualitative and quantitative analysis, assessment methodology should be rigorous,
systematic, and subject to some form of validation based on historical experience.

2.1.3 An ECAI must review its assessment on a regular basis, and update the assessment according to changes in financial position of the assessed institution.

2.1.4 The assessing staffs of the ECAI shall be impartial, without any prejudice during the assessing process.

2.2 Independence
An ECAI shall be independent and not be subject to political or economic pressures that may influence the rating. The staffs of internal credit review committee as well as the assessment team of the ECAI shall maintain independence in the assessment process and independently deliver assessment based on information collected and be free from external factors.

2.3 International access and Transparency
For individual assessments, An ECAI shall fully disclose the key elements during the assessment process and whether the assessed entities participate in the assessment process etc.

2.4 Disclosure
An ECAI shall disclose the following information:

2.4.1 Its code of conduct.

2.4.2 The general characteristics of the compensation arrangements between the ECAI and the assessed entities.

2.4.3 Its assessment methodology, including the definition of default, the time horizon, and the meaning of each rating.

2.4.4 The actual default rates experienced in each assessment category.

2.4.5 The transitions of the assessments.

2.5 Resources
An ECAI shall have sufficient resources to carry out high quality credit assessments. These resources shall allow for substantial ongoing contact with senior and operational levels within the entities assessed in order to add value to the credit assessments.

2.6 Credibility
2.6.1 The assessments of an ECAI shall be widely recognized and used by the market participants.
2.6.2 An ECAI does not have to assess firms in more than one country.
2.6.3 An ECAI shall build up the internal procedures to prevent the misuse of confidential information.

3. Use of Multiple Assessments

3.1 If there are two assessments by ECAIs chosen by a bank which map into different risk weights, the higher risk weight will be applied.
3.2 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 will be applied.

4. Determination of issue assessment

4.1 In circumstances where a particular issue has a specific assessment by qualified ECAIs, the risk weight of the claim shall be based on this assessment.
4.2 In circumstances where a claims does not have a specific assessment by qualified ECAIs (“unrated claim”), following principles should be used by commercial banks to determine risk weight of the claims:
4.2.1 In cases where the assessed entity has a high quality credit assessment for its other claim (which map into a risk weight lower than that which applies to an unrated claim), and the corresponding risk weight may only be applied to the “unrated
claim” if “unrated claim” ranks *pari passu* or senior to the “rated claim” with an assessment in all respects.

4.2.2 In cases where the assessed entity has an external assessment, but this assessment only applies to senior unsecured claims on that assessed entity, while other “unrated claim” of the assessed entity will be treated as unrated.

4.2.3 In cases where the assessed entity or its “rated claim” has a lower rating (mapping into a risk weight not lower than one applicable to unrated claim), and the sonority of the “unrated claim” is not super to senior unsecured claims or “rated claim”, then the “unrated claim” will be assigned the same risk weight as is applicable to the low quality assessment.

4.3 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 it.

4.4 In order to avoid any double counting of credit enhancement factors, no supervisory recognition of credit risk mitigation techniques will be taken into account if the credit enhancement is already reflected in the issue specific rating.

### 5. Other Assessment Implementation Consideration

#### 5.1 Domestic currency and foreign currency assessments

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 would be used for exposures in foreign currency. Domestic currency ratings, if separate, would only be used to risk weight claims denominated in the domestic currency.

#### 5.2 Level of application of the assessment
External assessments for one entity within a corporate group can not be used to risk weight other entities within the same group.

5.3 Unsolicited ratings
In principle, commercial banks should use solicited ratings from eligible ECAIs. Commercial banks may use unsolicited ratings in case unsolicited ratings are not inferior in quality to general quality of solicited ratings. However, there may be the potential for ECAIs to use unsolicited ratings to put pressure on entities to obtain solicited ratings. Such behaviour, when identified, should cause banks to deprive such ECAIs of being eligible ECAIs.

Unsolicited ratings refers to the credit assessment initiated by ECAIs according to public information. Solicited ratings refers to the credit assessment conducted by the ECAIs that is solicited by the assessed entity.