

Banking Regulation and Policy Department  
Bangladesh Bank  
Head Office  
Dhaka

September 23, 2008

BRPD Circular No. 07

Date:-----  
Ashwin 08, 1415

Chief Executives  
All Scheduled Banks in Bangladesh

Dear Sir,

**Guidelines for recognition of eligible  
External Credit Assessment Institutions (ECAIs)**

You are aware that Risk Based Capital Adequacy (Basel I) has been introduced in Bangladesh since 1996 vide BRPD Circular number 01 dated January 08, 1996. To make the capital maintenance more risk sensitive as well as to make the banking industry more shock absorbent and stable, Risk Based Capital Adequacy framework (Basel II) will be implemented in Bangladesh from January 2009. For this a National Steering Committee headed by Deputy Governor of Bangladesh Bank (BB) and the members comprising of CEO/MD of some commercial banks and representative from Institute of Chartered Accountants of Bangladesh (ICAB) has been working in this regard since July, 2005. In addition, a Coordination Committee on Basel II implementation headed by Executive Director and member comprising some officials of BB, commercial banks and representative from Bangladesh Institute of Bank Management (BIBM) is providing supportive efforts to the National Steering Committee.

Furthermore, to assess the supervisory and regulatory strength and operational independence of BB, a self audit on compliance with Basel Core Principles (BCP) for effective banking supervision was made in October 2006. Afterwards, to know the banks' awareness and preparedness and their view on the alternative approaches for calculating Minimum Capital Requirement (MCR), a Quantitative Impact Study (QIS) was conducted in April-May 2007. Both the study showed that banks have favorable environment for Basel II implementation in Bangladesh. The QIS findings suggested for initial Basel II implementation with the following specific approaches:

- A) Standardized Approach for calculating Risk Weighted Assets (RWA) against Credit Risk
- B) Standardized (Rule Based) Approach for calculating RWA against Market Risk
- C) Basic Indicator Approach for calculating RWA against Operational Risk

To this end, an Action Plan/ Roadmap has been issued vide BRPD Circular No. 14 dated December 30, 2007.

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Under the Standardized Approach of the Risk Based Capital Adequacy framework (Basel II), credit rating is to be determined on the basis of risk profile assessed by the External Credit Assessment Institutions (ECAIs) duly recognized by BB. All scheduled banks will be required to nominate recognized ECAI for their own as well as their counterparty credit rating. In this perspective, a set of guidelines on recognition of the eligible ECAI is issued and forwarded herewith for information. BB will complete the recognition process soon as and when application will be obtained from the interested credit rating agencies.

The guideline is also accessible at the BB website.

Please acknowledge receipt.

Yours sincerely,  
Sd/-

(Md. Jahangir Alam)  
General Manager  
Phone: 7117825

Enclosure: [A set of guidelines \(11 pages\)](#).

**Banking Regulation & Policy Department**  
**Bangladesh Bank**  
**Head Office**  
**Dhaka**

**Guidelines for Recognition of**  
**eligible External Credit Assessment Institutions (ECAIs)**

External Credit Assessment Institutions (ECAIs) duly recognized by Bangladesh Bank (BB) will be engaged in credit risk assessment under the Standardized Approach of the Risk Based Capital Adequacy framework (Basel II). On the basis of that assessment, risk weight will be mapped with the credit rating category and risk weighted assets (RWA) to be determined for calculating the capital requirement of banks against credit risk. The criteria of ECAI recognition and mapping process of risk weight (RW) has been developed in line with the “International Convergence of Capital Measurement and Capital Standards” (Basel II) issued by the Basel Committee on Banking Supervision (BCBS) in June 2006.

**1. Recognition criteria**

ECAIs that produce credit assessments of sufficiently high quality, uniformity and potency to be used by banks shall be eligible for recognition by BB for regulatory capital purpose. The following six criteria will be considered in determining the eligibility of an ECAI:

**A) Objectivity:**

The methodology for assigning credit assessments must be rigorous, systematic, and subject to validation based on historical experience. Moreover, assessments must be subject to ongoing review and responsive to changes in financial condition of the concerned entity. An assessment methodology for each market segment, including rigorous back-testing, must have been established for at least one year and preferably three years.

**B) Independence:**

An ECAI should be independent and free from political, social or economic pressure that may influence the rating. The assessment process should also be free from any such constraints that could arise in situations where the composition of the board of directors or the shareholder structure and the officials of the assessment team of the ECAIs may be seen as creating a conflict of interest.

**C) International access / Transparency:**

The individual assessment should be available to both domestic and foreign institutions with legitimate interests, and at equivalent terms. In addition, the rating methodology used by the ECAI should be publicly available.

**D) Disclosure:**

An ECAI should disclose its assessment methodologies, notch/notation to be used, definition of default rating category, the meaning of each rating, and its time horizon, actual default rates experienced in each assessment category; and the transitions of the assessment, e.g. the likelihood of AA ratings becoming A over time.

## **E) Resources:**

An ECAI should have sufficient resources to carry out high quality credit assessments. These resources should allow for substantial on going contact with senior and operational level executives within the entities assessed in order to add value to the credit assessments. Such assessment methodologies should be based on both qualitative and quantitative approaches.

## **F) Credibility:**

In addition to the above criteria, the reliance on an ECAI's credit assessments by independent parties (investors, insurers, trading partners) shall be evidences of the credibility of the assessments of an ECAI. The credibility of an ECAI is also underpinned by the existence of effective internal control to prevent the misuse of confidential information.

## **2. Mapping process**

2.1 BB will assign risk weight to an eligible ECAI's rating categories i.e. deciding which rating categories correspond to which risk-weights. BB will evaluate each credit rating category of an eligible ECAI which will be mapped with the numerals 1 to 6, with 1 being the best and 6 being the worst and includes 'Default Rating Category'\*. Each "short term credit rating category"\*\*\* will be evaluated and mapped with category S1 to S4, with S1 being the best. BB will assign risk weight on the basis of evaluation of variety of qualitative and quantitative factors relate to ECAI's rating category.

2.2 BB will consider a variety of qualitative and quantitative factors to differentiate between the relative degrees of risk expressed by each rating category. Both quantitative and qualitative parameters may help to promote a more consistent mapping of rating categories into the assigned risk-weights.

### **a) Quantitative factors:**

i) BB will evaluate the consistency of an ECAI's rating category (Notch/Notation) through analysis of Cumulative Default Rate (CDR). CDR is the measure of movement of a rating category into 'Default Rating Category '\* during a time period.

The following two measures of CDR may be considered in this regard:

- Ten-year average of the three-year CDR for evaluating the long-run default experience; and
- Most recent three-year CDR for evaluating the short-run default experience.

ii) The transition of individual notch/notation towards default rating category observed in a particular ECAI rating category will be compared to the standards available domestically/ regionally/ internationally.

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\* This rating is applicable for those counterparties who are in default position. A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place.

- The bank considers that the obligor is unlikely to pay its credit obligations to the banking company or syndicate banking group, without recourse by the bank to actions such as realizing security (if held).
- The obligor is past due for more than 90 days or more as defined by BB.

\*\* Short-term ratings may only be used for short-term claims against banks and corporate counterparties.

iii) The long-run transition towards default category of the ECAI ratings will be compared with the reference values of CDRs available domestically/regionally/internationally. In this connection, internationally accepted long-run reference values are stated below for information:

**Long-run “reference” three-year CDRs\***

<b>S&amp;P assessment</b>	<b>AAA-AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>	<b>B</b>
<b>Moody’s</b>	<i>Aaa-Aa</i>	<i>A</i>	<i>Baa</i>	<i>Ba</i>	<i>B</i>
<b>20-year average of three year CDR</b>	<b>0.10%</b>	<b>0.25%</b>	<b>1.00%</b>	<b>7.50%</b>	<b>20.00%</b>

\*Ref. Table-2 Annexure-2 of International Convergence of Capital measurement and Capital standards, published by BCBS (June 2006)

iv) BB will use two benchmark CDRs namely “monitoring” level CDR and a “trigger” level CDR in interpreting whether a CDR falls within an acceptable range for a rating category to qualify for a particular risk-weight. BB will adopt the two benchmarks of CDR standard in line with domestic/regional/international standard. In this connection, Basel Committee standards are specified in the following table for information:

**Three-year CDRs benchmark\***

<b>S&amp;P assessment</b>	<b>AAA-AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>	<b>B</b>
<b>Moody’s</b>	<i>Aaa-Aa</i>	<i>A</i>	<i>Baa</i>	<i>Ba</i>	<i>B</i>
<b>Monitoring level</b>	0.8%	1.0%	2.4%	11.0%	28.6%
<b>Trigger level</b>	1.2%	1.3%	3.0%	12.4%	35.0%

\*Ref. Table-3 Annexure-2 of International Convergence of Capital measurement and Capital standards, published by BCBS (June 2006)

v) Exceeding the “monitoring” level CDR benchmark implies that a rating agency’s transition to default rating for a particular notch/ notation is markedly higher than domestic/regional/international transition experience to default rating. A consultation process with a relevant ECAI will commence to understand why the default experience appears to be significantly worse. If the BB determines that the higher default experience is attributable to weaker standards in assessing credit risk, they would be expected to assign a higher risk category to ECAIs credit risk assessments.

vi) Exceeding the “trigger” level benchmark implies that transition of an ECAI's notch/notation towards default rating is considerably above the domestic/regional/international standards. If the observed three-year CDR exceeds the trigger level in two consecutive years, the ECAIs rating category shall be degraded.

vii) ECAIs who have only a short record of transition and default data will be required to provide a projection of the ten-year average of the three-year CDR on the basis of two most recent CDRs.

viii) Definition of 'Default Rating' has an impact on the assessment of CDR. ECAI will declare definition of 'default rating' at their website and submit a copy to BB. Subsequently, if any amendment on the same is made must be reported to BB with due justification thereof.

## **b) Qualitative factors**

Criteria under qualitative factors will be set by BB's working group to assess different rating methodology and their scoring standard will form the necessary basis of the mapping process. Quantitative data may be inconclusive for mapping risk weights, in that situation qualitative criteria may be the only basis of mapping risk weight.

### **3. Application process**

3.1 Credit Rating Companies (Domestic & International) that are registered under Credit Rating Companies Rules, 1996 of Securities and Exchange Commission (SEC), Bangladesh and meet the eligibility criteria may apply to General Manager, Banking Regulation and Policy Department, Bangladesh Bank, Head Office, Dhaka for the recognition as an ECAI (Application **Form-A** along with information stated in **Annexure-1** ).

3.2 ECAIs will categorize their ratings into the following broad asset classes or market segments:

- a) Sovereign (Government, Public Sector Corporations & Autonomous Bodies )
- b) Financial Institutions (Banks, Insurances Co., Security firms and other Financial Institutions)
- c) Corporate (other than Government & Financial Institutions)
- d) Others (If any to be mentioned specifically)

3.3 A working group of BB will complete recognition process and follow a uniform minimum standard of the components are stated in annexure-1. They will define any required term(s), prepare check list and score list where necessary.

### **4. On-going recognition**

Recognition of an ECAI will be reviewed annually until they reach the point where the robustness of system is assured to BB's satisfaction. It is expected that an ECAI will continue to meet the eligible criteria for recognition and its methodologies and credit assessments remain appropriate over different periods of time and through changes in market conditions:

(a) ECAIs ratings will be reviewed at least annually and may be revised in response to changes in financial conditions; and their ratings are subject to back-testing on an annual basis.

(b) If any material changes occur that alter a significant number of ratings, ECAIs will inform BB about the changes promptly (e.g. change of ownership or internal structure and major deterioration in financial positions etc.). ECAIs will maintain minimum standard of the rating methodology set by BB from time to time.

(c) BB will review the eligibility of an ECAI on continuous basis. If it comes to BB's attention that there is a noticeable deterioration in the performance and/or market acceptance of the ECAI, BB will review the eligibility of the ECAI immediately.

d) BB may withdraw the recognition of an eligible ECAI if it ceases to comply with any of the recognition criteria. Before taking such decision of derecognizing, BB will first notify the concerned ECAI mentioning the eligibility criteria which is found as non-compliant. The ECAI will also be allowed to clarify their position within a reasonable time. After which appropriate decision in this regard shall be taken.

e) If an ECAI is suspended or their registration is cancelled by SEC under Credit Rating Companies rules 1996, BB will treat the particular ECAI as derecognized.

## **5. Guidelines applicable to Banks regarding nomination of ECAIs**

5.1. For the purpose of applying ECAI ratings to derive risk-weights for exposures under the portfolio of claims on sovereigns, claims on banks, claims on securities firms and claims on corporate, a bank should satisfy the following steps:

(i) Banks will nominate recognized ECAI for determining credit rating of banking book exposures and notify BB about the nominated ECAI.

(ii) Banks will use the ratings of the nominated ECAI for each of banking book portfolio constantly for a reasonable period. If they want to change the ECAI(s) must seek the consent from BB stating valid ground; and

(iii) A client may be counter party of many banks or may change his bank in a particular year. In such cases, credit rating assigned by any recognized ECAI will be considered as valid for that year by the bank.

5.2 Banks will require maintaining track record of their counterparty ratings over the years.

5.3 If any bank or a client has reasonable ground sufficient to raise question about ECAIs assessment of the credit rating, they may inform BB in writing with valid explanation. BB shall look into the matter and take necessary step(s) as it deem fit.

5.4 Bangladeshi banks, having exposures abroad, may use the ratings assigned by ECAIs recognized through indirect recognition. Indirect recognition process is that where BB is satisfied that host country supervisor has recognized an ECAI on the basis of recognition criteria which are well matched with this guidelines.

5.5 Banks will follow Credit Risk Grading Manual (CRGM) for assessing a borrower and making decisions of disbursing loans and advances/ investments. CRG may be customized for internal rating in such a way that can help to derive parameters like probability of default (PD), exposure at default (EAD) and loss given to default (LGD) which will be required for determining risk weight under Internal Rating Based (IRB) approach of Basel II.

## **6. General Instructions:**

6.1 The ECAI(s) will disclose credit ratings of related parties quarterly to BB after the assessment is finalized. All the rating will be supported by declaration (duly signed by CEO) that the rating is independent and free from conflict of interest. Such statement will be based upon the declaration made by each member/official related to rating activities.

6.2 The ECAIs should have a unique pricing system for credit rating. They should disclose their schedule of credit rating fees annually.

6.3 The ECAIs will follow the IOSCO/SEC Code of Conduct Fundamentals published for Credit Rating Agencies.

**FORM OF APPLICATION FOR RECOGNITION**  
*AS AN EXTERNAL CREDIT ASSESSMENT INSTITUTION*

To  
General Manager  
Banking Regulation and Policy Department  
Bangladesh Bank  
Head Office  
12th Floor (2nd annex building)  
Motijheel,  
Dhaka-1000.

Dear Sir,

We hereby apply for recognition as an External Credit Assessment Institution (ECAI). It is to mention that:

1. We are eligible for assessing credit standing of the Sovereign, Financial Institutions, Corporate and other clients.
2. We confirm that the credit assessments will be used for risk-weighting purposes under the Risk Based Capital Adequacy framework (Basel II).
3. Necessary information required for recognition listed as per annexure-1 (enclosed) is furnished herewith
4. We confirm that all the information outlined in this letter and the enclosed annexure are true and correct.

Yours Faithfully,

Signature of the Chairman/Managing Director/  
Chief Executive Officer/ Executive Director/Director



**List of information to be supported by document(s)**

<b><u>A) Regarding Objectivity</u></b>		Supported Documents/ Statements required
<b>1. Manuscript of Methodology</b>		Manuscript of Methodology will cover at least those information as mentioned in the annexure - 1(a) along with weightage score.
	- Risk area coverage	
	- Importance/ Weightage on each risk area	
<b>2. Internal Process</b>		
	- Analysis Team	List of Executives with qualification and experience
	- Rating Committee	List of Members with qualification and experience
	- Internal Verification system	Internally practiced Manual
<b>3. Rating Scale and their sensitivity</b>		
	- Number of Notches/ Notations to be used for ratings	Statement of Notches/ Notations to be used for each rating and Scoring system. Demonstration of methodology: how it is aligned with international ratings of S&P.
	- Scoring System for achieving the Notches/ Notation	
	Demonstration of Alignment with international ratings of Standard & Poor (S&P)	
<b>4. Validation system</b>		Brief description on supported rules, regulation, techniques of the validation system used by an ECAI. (Minimum 150 words).
	- Off-site analysis	
	- On-site examination	
<b>5. Ongoing Review</b>		Brief description on Database Management system which includes all these components. (Minimum 100 words).
	- Client wise yearly track record of rating	
	- Solicited Review	
	- Unsolicited Review	
<b>6. Database Management</b>		Brief description on this issue included in Database Management system. (Minimum 100 words).
	- Assessment/disclosure of the depth of default data available/held by the ECAI	
	- Transition matrices (Notch/Notation wise)	
<b>7. System Back Testing</b>		Brief description on this issue included in Database Management system. (Minimum 75 words).
	- Comparative Analysis (three year's comparison)	
<b><u>B) Regarding Independence</u></b>		Copy of Certificate of Registration
<b>1. Registration status with SEC</b>		
	- Registration No.	
	- Date of Registration	
<b>2. Ownership Quality</b>		Memorandum of Association, Articles of Association and
	- Nature of ownership	

	- List of major share holders (holding shares over 5%)	Certificate of Commencement along with up to date information.
	- Voting power of each share holder	
	<b>3. Procedure to ensure Independence</b>	Letter of undertaking for providing declaration of team members regarding activity which will be independent and free from conflict of interest.
	- Executives of analyst team is independent i.e. free from any political, social or economic pressure that may influence assessment/rating.	
	- Rating Committee is independent and free from any political, social or economic pressure that may influence assessment/rating.	
	- The names, profiles and backgrounds of each executive within the analyst teams.	Details C.V of each executive and members of the rating committee.
	<b>4. Board Members are free from influencing rating activities.</b>	Letter of undertakings of Board Members
	- Board Members careful about influencing rating function.	
	<b>5. Solvency of the Company</b>	Audited Balance Sheet and Income Statement, Cash flow statement for 3 years and Bank turnover statements for last 1 year.
	- Audited Balance Sheet and Income Statement	
	- Cash flow statement	
	- Net- worth	
	- Bank Solvency Certificate	
	<b>6. Schedule of credit assessment fees</b>	Published/Disclosed List of fees to be charged for making assessment.
	- Published/Disclosed list of fees	
<b><u>C) International Access/Transparency</u></b>		Accreditation or membership Certificate. Evidence of overseas experience.
	<b>1. International Exposure</b>	
	- Accreditation or membership of international/ regional credit rating association	
	- Evidence of overseas experience	
	<b>2. Accessibility of the ECAI's rating</b>	
	- Easy availability of credit rating to the public	Published Document
	- Website containing track record & transition matrices of credit rating	Statement of Web-site Address
	<b>3. Availability of Assessment Methodology</b>	
	- Disclosure of assessment methodology to public	Published Document
	- Website containing updated assessment methodology	Description on how to find out and consult with methodology placed in Web-site.
	<b>4. Nature of rating</b>	Database Management system should have these sorts of declaration.
	- Disclose whether the rating was Solicited or Unsolicited	

<b><u>D) Disclosure</u></b>		
<b>1. Definition of Default Rating Category</b>		Published Methodology should include this definition.
	- The rating agency's definition regarding default rating category and specific definition of 'Default'	
	The meanings of each rating and how they may be compared to standards of Moody's and S&P rating category.	Comparison statement with the standards of Moody's and S&P rating category.
<b>2. Actual transition rate towards default rating (business category wise and notch wise)</b>		Brief description on this issue (Minimum 75 words).
	- Publish the transition of notches towards default rating periodically in the websites	
<b>3. Disclosure of transition matrices</b>		
	- Publish the transition matrices regarding notches in the website	
<b>4. Code of Conduct</b>		
	- Declaration of compliance with IOSCO/SEC Code of Conducts	Declaration of Compliance
<b><u>E) Resources</u></b>		Audited financial statements of last 3 years.
<b>1. Capital Structure and Net Worth</b>		
	- Audited financial statements	
	- Significant change in net-worth (if any)	
<b>2. Hard and Soft Infrastructure</b>		
	- Office set up, support system and software system for rating	Brief description on these issues (Minimum 150 words).
<b>3. Number of professional staffs</b>		List of professional Staffs along with details of qualification and experience
	- List of professional staffs along with details of qualification and experience	
<b>4. Personnel Policy</b>		
	- Recruitment and training policy, Service Rules, Pay structure , staff regulations	Brief description and Supported by documents (Minimum 150 words).
	- Employee Turnover Rate	Statement on this issue
<b>5. Internal Work Relationship</b>		Work flow chart and organogram
	- Work flow chart and organogram	
<b>6. Data ware housing</b>		Brief description (Minimum 100 words).
	- Data storing of rated entities	
	- "Data Warehousing" could disclosures regarding the security system installed by the ECAI to protect confidential customer information.	

<b><u>F) Credibility</u></b>		
	<b>1. Degree of acceptance by the client</b>	Study Report (If any)
	- Evidence of dependability of rating by the client	
	- Study report on “ Degree of acceptance by the client” (if any)	Copy of the report
	- Policy of maintaining secrecy of information	Policy paper
	<b>2. Market Share of the ECAI</b>	Brief description and Study Report (If any)
	- Record of the borrower's credit rating	
	<b>3. Handling Conflict of Interest</b>	Brief description on this Policy issue (Minimum 150 words).
	- Existence of Policy and procedures for handling conflict of interest	
	<b>4. Market Penetration Approach</b>	Strategic Plan along with vision and mission of the ECAI.
	- Business expansion strategy	

**Methodology requires minimum  
information on following parameters**

**A. Corporate (other than Bank and Non-bank Financial Institution)**

<b>i) Financial Risk</b>	
	Leverage
	Liquidity
	Profitability
	Coverage ratio
<b>ii) Business/Industry Risk</b>	
	Size of Business
	Age of Business
	Business Outlook
	Industry Growth
	Competition
	Entry/Exit Barriers to Business
<b>iii) Management Risk</b>	
	Experience
	Succession
	Team Work
<b>iv) Security Risk</b>	
	Security Coverage
	Collateral coverage
	Support/Guarantee
	legal intervention (If any)
<b>v) Relationship Risk</b>	
	Account Conduct
	Utilization of Limit –If any loan from bank
	Compliance of covenants/conditions with banks & other counterparty
	Deposit with bank or others

**B. Bank and Non-bank Financial Institution**

<b>i) Quantitative Factors</b>	
	Capital Adequacy
	Asset Quality
	Earning quality
	Liquidity and Capacity of External Fund Mobilization
	Size of the Bank and Market Presence
<b>ii) Qualitative Factors</b>	
	Management
	Regulatory Environment & Compliance
	Risk Management
	Sensitivity to Market Risk
	Ownership (Share holding pattern) and Corporate Governance
	Accounting Quality
	Franchise Value

C. Quantitative and Qualitative risk factors for other business segments i.e. Securitization exposure, Insurance Company, Autonomous Bodies etc. have to be enclosed.