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By Electronic Mail

Re: European Commission's draft Directive / Regulation with respect to the authorization, operation and supervision of credit rating agencies (CRAs).

A.M. Best Company (A.M. Best) appreciates the opportunity to comment on the European Commission's (Commission) proposed Directive/Regulation regarding the authorization, operation and supervision of credit rating agencies (CRAs). In the United States, A.M. Best is a nationally recognized statistical rating organization (NRSRO) registered under section 15E of the Securities and Exchange Act of 1934. Founded in 1899, A.M. Best has reported on the financial health of insurers and the insurance industry for more than a century. The company, headquartered in Oldwick, New Jersey, USA, has subsidiaries located in London (A.M. Best Europe Ltd) and Hong Kong (A.M. Best Asia-Pacific Limited).

A.M. Best supports the overall objectives embodied in the Commission's proposed Directive/Regulation. We also agree with the Commission's observations in its introductory remarks that "...independent ratings are essential for the proper functioning of the financial markets" and that any substantive requirements placed on CRAs as a result of future regulation should "not interfere with the content of ratings...". Additionally, we are pleased that the Commission has also noted in its introductory remarks that rating activity used for regulatory purposes within the European Union is concentrated among a few players and that an authorization and supervision regime should be adapted to "specificities of the rating activity".

We ask the Commission to keep these observations in mind while determining what it believes to be appropriate authorization and supervision mechanisms and in its determination as to what extent substantive regulatory requirements should dictate the operations of CRAs. Set forth below are our general comments on the proposed Directive/Regulation and comments on specific Articles of the proposal:

1. Analytic Independence

As noted above, the Commission has acknowledged in the consultation paper the importance of CRA independence in the rating process and that substantive requirements of future regulation should not include regulating the content of ratings. We strongly agree with the Commission's observations and believe that the Commission should specifically provide for the protection of CRA analytic independence in its adopted Directive/Regulation. To that end, we respectfully suggest that the Commission consider adding a new Article 3 (Limitation) to Title 1 Subject Matter and Definitions.

New Article 3

The specific rules concerning the authorization, conduct of business, or the supervision of credit rating agencies under this Directive/Regulation may not regulate the substance of a CRA's ratings, or the procedures and methodologies by which a CRA determines ratings.

2. Directive/Regulation should be principles based

We believe that the most appropriate oversight/regulation regime for credit rating agencies is a principles-based approach, for example, the IOSCO Fundamentals of a Code of Conduct for Credit Rating Agencies. Such an approach allows for the differences in the size and scope of a particular CRA's operations, specifically through manage and disclose mechanisms, and avoids being overly prescriptive.

We believe the Commission can achieve its goals through instituting an oversight/regulatory regime based on the existing IOSCO Code of Conduct Fundamentals and modified to include authorization, reporting and supervision requirements, including the specific nature of its examination privileges.

3. Supervisory framework should be unified and consistent with global practices

In order to promote fairness and efficiency, we believe that the supervisory framework adopted by the Commission should require identical standards and rules to be implemented by community members. We also believe that, to the extent possible, those standards and rules should be consistent with other regulatory bodies that are currently charged with formally regulating credit rating agencies, such as the U.S. Securities and Exchange Commission. We would also note that many credit rating agencies have achieved international recognition for the quality of rating services they provide. Given the global recognition of some agencies, we believe that the proposed Directive/Regulation requiring that a CRA establish a subsidiary or branch office within the community is unnecessary, provided that such a CRA satisfies all other authorization, operational and reporting requirements, and submits to examination.

4. Comments on specific Articles

Article 7

Persons who effectively direct the business

2. The home Member State competent authority shall verify that the non-executive members of the administrative board or the members of the supervisory board shall in their majority have sufficient experience in understanding credit risk and relevant modelling sensitivity analysis techniques across the range of investments and credit structures that fall within the scope of activity of the credit rating agency. Their remuneration shall be linked to their experience and skill and to the contribution they make and are contractually expected to make to the supervision, quality, accuracy and integrity of the rating process and activity and not to the growth in earnings or share price of the credit rating agency. Their term of office, which shall be for a preagreed fixed period, shall not be renewable.

We believe that the Commission's proposed requirement mandating non-executive (independent) board members and their related experience/functions (e.g. as stated in this Article and Article 8 items 4 and 5, Article 15 item 3) is unnecessary, over-burdensome, greatly exceeds any governance standards of other regulatory bodies, and will give rise to the unintended consequence of inhibiting credit rating agency competition in the European Union. We agree with the Commission that a CRA should maintain credit rating staff with appropriate knowledge and skill sets to produce credible ratings for the various types of credit ratings assigned by a particular CRA, and that persons within the CRA that are not responsible for directly assigning those ratings should periodically review methodologies and significant changes to methodologies used by the CRA. However, for all but the very largest of CRAs, maintaining such redundant personnel at a board level position is impractical, if not infeasible, for smaller, credible credit rating agencies. The commission's "ability to authorize, supervise and, if appropriate, impose sanctions on credit rating agencies" provides the necessary governance incentives for CRAs to maintain policies and procedures designed to ensure that ratings are reliable and credible. We would also note that as a privately-held company, A.M. Best is under no obligation to have non-executive board members.

Article 8

Organisational requirements and internal policies

4. A credit rating agency shall establish a review function responsible for periodically reviewing the methodologies, models and significant changes to methodologies and models it uses, as well as the appropriateness of those methodologies and models for the assessment of new financial instruments. This review function must be independent of the business lines which are responsible for credit rating activities and report to the independent committee of the administrative or supervisory board referred to in paragraph 5 of this Article.

We agree with the Commission that such a function can play a key role in promoting ratings quality. We note, however, that credible CRAs, such as A.M. Best, may focus credit rating services on a particular asset class of issuers and obligors, and as such, it would be impractical or infeasible for us or other such CRAs to adopt such an independence standard. IOSCO considered such issues in its recently revised Code of Conduct Fundamentals for Credit Rating Agencies.

*Article 10
Employees*

4. A credit rating agency shall ensure that analysts and persons approving credit ratings shall not be involved in providing the credit rating services to the same rated entity or its related third parties for a period exceeding four years. The period after which the analysts and persons approving credit ratings may again be involved in providing the credit rating services to the same rated entity or its related third parties may not be shorter than two years.

A.M. Best does not object to analyst rotation in principle. However, we believe that CRA's should be responsible for establishing appropriate analyst rotation policies, taking into account the size and scope of the CRA's credit rating services, and publicly disclose its policies.

*Article 15
General and periodic disclosures*

2. Credit rating agencies shall make available in a repository open to the public all credit ratings and historical performance data.

We acknowledge that ratings information is of interest to users of ratings and we publish, free of charge, each current rating on our website. We do not believe, however, that CRAs should be required to make proprietary information regarding the history of each rating available to the public free of charge. We agree with the Commission's observation that the ratings history of each rating may be useful to users of ratings and would not object to making this information available to interested parties, provided that the commercial value of this proprietary information is protected. We suggest that this information could be licensed or otherwise be made available to interested parties on a subscription basis by CRAs.

*Article 16
Transparency report*

1. A credit rating agency shall publish annually a transparency report which should include, at least, the information set out in Annex II, Section C, Part III.

The credit rating agency shall make public its annual report at the latest three months after the end of each financial year and shall ensure that it remains publicly available on the company's website for at least five years.

A.M. Best Company has been privately owned since its founding in 1899 and as such has no obligation to publicly disclose financial information. We understand that regulatory authorities should have access to financial information to ensure for regulatory purposes that a CRA maintains a sound financial position and that its operations are not subject to undue influence by any particular rated entity. As such, we are not opposed to supplying regulatory authorities such financial information on a confidential basis.

Article 20

Powers to be made available to competent authorities

(to be adapted following the option chosen with respect to the supervisory architecture)

1. In order to fulfil their duties competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions. Within the limits provided for in their national legal frameworks competent authorities shall exercise their powers:

- (a) directly; or*
- (b) in collaboration with other authorities; or*
- (c) by application to the competent judicial authorities.*

2. The supervisory and investigatory powers referred to in paragraph 1 shall be exercised in conformity with national law but shall include at least the rights to:

- (a) have access to any document in any form whatsoever and to receive a copy of it;*
- (b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;*
- (c) carry out on-site inspections;*
- (d) require existing telephone and existing data traffic records.*

The supervisory and investigatory powers as proposed are overly broad. The Commission should restrict its supervisory and investigatory authority to areas related to the examination of CRA compliance with established policies and procedures related to the management of conflicts of interest, records required to be maintained related to rating methodologies, ratings history, the rating process, and any other records that are specified by the Commission to ensure the independence and credibility of the CRA and its ratings. As an example of the overly broad nature of Article 20, it is unlawful in certain jurisdictions for a CRA to disseminate certain personal information about its employees. We would also note the impracticality of retaining every document produced by the company. For the sake of efficiency and global consistency, we would appreciate the Commission considering the recordkeeping requirements established by the U.S. Securities and Exchange Commission for registered credit rating agencies operating in

the United States. The Commission could modify those requirements, if needed, for the specific needs of the Commission.

Article 21

Sanctions

(to be adapted following the option chosen with respect to the supervisory architecture)

3. Each Member State shall ensure that appropriate and dissuasive sanctions are put in place in national legislation in case of gross malpractice or lack of due diligence by the credit rating agencies.

Article 21 as proposed requires that each Member State legislate due diligence standards for authorized credit rating agencies. Credit rating agencies are not in a position to verify or “guarantee” the extensive amount of information used in the credit rating process, for example, regulatory filings. CRAs rely on those with first hand knowledge of the information. Placing such an obligation on CRAs would be not only infeasible, but also be inconsistent with the fundamental role that CRAs play in the financial markets.

Again, we appreciate the opportunity to provide comments on the Commission’s consultation draft on authorization, operation and supervision of credit rating agencies. We would be happy to discuss our comments with the Commission or its staff.

Sincerely,

/s/ Larry G. Mayewski

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