A.M. BEST
6th Floor, 12 Arthur Street
London EC4R 9AB, UK
Tel: +44 (0)20 7626 6264
Fax: +44 (0)20 7626 6265
www.ambest.com

Roger Sellek, CEO
A.M. Best Europe
Rating Services Ltd
6th Floor, 12 Arthur Street
London EC4R 9AB, UK

20th February 2013

Dear Sir / Madam,

A.M. Best – Response to Consultation Paper – Guidelines and Recommendations on the Scope of the CRA Regulation

I am writing to provide comments on behalf of A.M. Best Europe – Rating Services Limited (AMBERS) regarding the above consultation paper which was published by ESMA on 20 December 2012. With effect from February 2013, AMBERS is a member of the European Association of Credit Rating Agencies (EACRA) and the comments below should be considered alongside those provided by EACRA under separate cover.

Q1 - Do you agree with the approach set out above on the obligation to register?

AMBERS welcomes the additional attempt to provide clarity in this area and the attempt to provide a level playing field for all those operating in the Credit Rating sector. However, care needs to be taken to ensure that the proposals do not serve to act as a further barrier to competition in the sector. We entirely support the principle of registration for all those genuinely engaged in the provision of Credit Ratings within the European Union but would urge that further consideration is given to ways in which the burdens on smaller CRAs can be eased both to promote further competition in the sector and to reflect the generally lower risk profile of such firms.

Many of those firms who will be brought into the scope of regulation as a consequence of these proposals are unlikely to have any ratings coverage on sovereign or local government debt or on traditional asset-backed securities. However, these firms will be subject to the requirements of an extensive and complex regulatory framework and will be required to build appropriate systems and controls. Whilst there are a small number of areas where limited exemptions are available to smaller CRAs and ESMA have commendably striven to apply a risk-based approach to CRA supervision, the costs of compliance are, nevertheless, considerable. Indeed, AMBERS' belief is that the manner in which global CRA regulation has been implemented has served to entrench further the dominant global market position of the big 3 CRAs whose existing scale enables them to absorb more readily the increased cost of compliance.

Q3 – Do you agree with the explanation of credit ratings provided in this document?

AMBERS has no particular concerns with the theoretical definition of credit ratings as outlined in the consultation paper. However, AMBERS would agree with the observations made by EACRA regarding the practical examples listed on page 12 of the consultation paper.

Q4 – Do you believe the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scoring?

AMBERS agrees that the intervention of a ratings analyst is an important distinguishing factor between credit ratings and credit scoring. However, there are a number of other differences and so AMBERS would support the publication of a comparative table of the type proposed by EACRA. We believe such a table would serve to considerably aid consumer and market understanding.

Q5 – Do you agree with the explanations of private ratings provided?

AMBERS is broadly comfortable with the definition of private ratings outlined in the consultation paper.

Q6 – Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?

Q7 – Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?

Q8 – Do you agree that ESMA's capacity to deliver effective supervision would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?

AMBERS believes that the manner in which the global CRA regulatory framework has evolved has led to the proliferation of a number of local CRAs but has also served to consolidate the position of the big 3 pan-global CRAs and has therefore served to reduce global competition in the sector.

In theory the fact that each regulatory system uses the IOSCO building blocks as the basis for CRA regulation should serve to limit costs by enabling firms to implement global policies and controls. However, the wider non-CRA specific requirements which apply to CRAs as a consequence of being brought within a regulated environment vary considerably from jurisdiction to jurisdiction and are applying significant additional cost for no apparent benefit in terms of enhancing the quality and integrity of the ratings process.

A particular source of significant cost can be the licensing and reporting process required by an individual regulator. For example, as a general condition of being authorised in Japan there is a requirement for a CRA to have established a physical office in Japan. This restriction applies regardless of the volume of ratings undertaken and thus acts as a significant barrier to entry to any firm other than those with the scale to absorb the costs of establishing an office in Japan. Such requirements are not exclusive to Japan. For example, the restrictions in Russia are even more onerous with CRAs being impacted by multiple regulatory agencies. Under Russian Insurance regulations, credit ratings can only be used for counter-party credit purposes where those ratings have been issued by a CRA licensed in Russia. However, the Russian CRA licensing requirements require both a physical presence and for a CRA to issue a certain minimum number of ratings.

In addition, CRAs are increasingly being impacted by regulation that has apparently limited applicability to the sector but which has been introduced to apply to all regulated firms in a particular jurisdiction. For example, CRAs are increasingly being required to introduce policies, procedures, training and monitoring to comply with Money Laundering regulations despite the fact that the business model used by most CRAs is not at all conducive to Money Laundering activity.

The above examples are not exhaustive but serve to highlight A.M. Best's view that the manner in which the global regulation of CRAs is being implemented is serving to severely restrict global CRA competition. Potential competitors for the big three CRAs are being forced out of the market because they lack the cross-sector scale to absorb the costs of establishing a global network of offices. The big three CRAs by contrast are better able to absorb these costs by virtue of their existing coverage.

In broad terms, within the current regulatory framework, AMBERS does not object to the principle of ESMA taking responsibility for the oversight of branches established outside of the European Union and agrees that firms wishing to establish branches outside of the Union should be required to demonstrate an objective reason for doing so. However, if ESMA is to take responsibility for such activity, it is imperative that this does not lead to dual regulation from both ESMA and the local regulator in the jurisdiction in which the branch is located. This would be a recipe for confusion and would lead to significantly enhanced costs for no tangible benefit given the convergence of approach to the regulation of CRAs.

AMBERS does not agree with the implied assumption in question 8 that effective supervision can only be delivered through ESMA oversight. As outlined above, given the broad convergence of regulatory approaches, it should not necessarily matter who provides the oversight providing regulators are prepared to make effective use of supervisory colleges to gain appropriate assurance as to the quality of supervision. Whilst AMBERS accepts that political sensitivities make such a model unlikely, AMBERS' preferred regulatory model would be to move towards a more global approach to regulation whereby a "lead regulator" is appointed to oversee the global activities of a CRA with other interested parties gaining appropriate assurance via IOSCO Supervisory Colleges. Additional regulation would only then take place where a regulator could demonstrate that the provision of ratings in their jurisdiction was of systemic importance to that particular jurisdiction.

Consequently, A.M. Best was disappointed that the IOSCO Technical Committee ruled out proposals which would have seen IOSCO taking on specific supervisory responsibilities in this area.

Q9 – Q11

AMBERS has no comments in respect of these questions.

Q12 – Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?

Notwithstanding the earlier comments regarding the need for ESMA to continue to adopt a risk based and proportionate approach, it is self-apparent that any effective form of regulation requires the regulator to have the power and appetite to take action to prevent the abuse of its requirements. However, the formulaic nature of the fining structure devised by the European Parliament could lead to disproportionate impacts on smaller CRAs and so AMBERS believes greater flexibility should be afforded to ESMA in respect of the application of the enforcement regime.

I trust that the above comments will be of value. Please do not hesitate to contact me should you require clarification on any of the points we have made or should you have any other queries.

Yours sincerely

Roger Sellek
Chief Executive Officer
A.M. Best - EMEA & Asia Pacific