

**Filed Electronically**

January 6, 2010

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Senior Advisor  
Credit & Regulatory Unit

Mr. Robert Carcano  
Sr. SVO Counsel  
Securities Valuation Office

Mr. Dan Daveline  
Assistant Director  
Financial Regulatory Services Department

Rating Agency Working Group (“RAWG”)  
Financial Condition Committee  
National Association of Insurance Commissioners (“NAIC”)

**Re: RAWG’s evaluation of state insurance regulatory use of the credit ratings of nationally recognized statistical rating organizations and recommendations thereto**

Dear Messrs. Newman, Carcano and Daveline:

DBRS appreciates the opportunity to comment on the RAWG’s evaluation of state insurance regulatory use of the credit ratings of nationally recognized statistical rating organizations (“NRSROs”) and recommendations thereto (“NAIC recommendations”). DBRS is a registered NRSRO whose ratings are used by the NAIC<sup>1</sup>.

**Background**

Over the course of 2009, the RAWG conducted an evaluation of the reliance on NRSRO ratings by the NAIC, the insurance industry and the insurance marketplace. As an ARO, DBRS received a detailed questionnaire from and provided a comprehensive response to the RAWG in May 2009. DBRS also participated in a public hearing held on September 24, 2009 in Washington and participated in a second public hearing via conference call held on November 18, 2009 regarding ARO’s rating of municipal securities.

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<sup>1</sup> The NRSROs whose ratings are used by the NAIC are referred to as Acceptable Rating Organizations (“ARO”). Currently, they are Standard & Poor's, Moody's, Fitch, DBRS, A.M. Best, and Realpoint.



*Insight beyond the rating.*

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On December 1, 2009, the RAWG published a report that recommends that the NAIC:

- Examine ways to reduce its reliance on ARO ratings for structured securities;
- Expand alternatives for investment risk assessment for regulator use, perhaps including expansion of SVO scope of assessment;
- Explore how regulators can reduce their reliance on ARO ratings in new, structured, or alternative asset classes, particularly by introducing additional or alternative risk measurement benchmarks; and
- To the extent that traditional ratings continue to be a part of the regulatory system, require rating agencies to make major structural reforms in order to obtain or maintain the ARO status.

The NAIC recommendations are particularly focused on Structured Finance ratings. ARO ratings for the majority of RMBS will not be used for 2009 valuation. The NAIC has hired a third party to undertake such. The NAIC has indicated that it will re-evaluate its position regarding RMBS valuation in 2010.

### **DBRS comments on NAIC recommendations**

DBRS has focused its comments on those NAIC recommendations that it suggests require additional clarity/information and those recommendations with which it disagrees.

#### General NAIC recommendations

- NAIC should evaluate whether to expand the use of the SVO and increase regulator reliance on the SVO for evaluating credit and other risks of securities.

*DBRS understands that the use of ARO credit ratings by the market increased over time due to the ARO's historical expertise in the field of credit analysis. This expertise was gained through the skills and experience of its credit analysts that takes years to build.*

Recommendations for Structural Rating Agency Reform - The following are observations that the RAWG believes merit the serious attention of rating agency representatives. Rating organizations should:

- Create committees and processes to identify when new proposed transactions or securities do not warrant a rating. The committees would approve the logic for rating new types of securities. Determinations of such committees and the identified risks that support this determination should be made publicly available.
- Not only apply their newer rating models for new securities, but consistently for all applicable securities, including those in the secondary market.

*With respect to the above proposals, DBRS employs criteria committees for each of its Corporate and Structured Finance rating sectors whose primary purpose is to review new and updated methodologies, models and rating approaches. DBRS publishes approved methodologies and models on its public website at [www.dbrs.com](http://www.dbrs.com).*

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- Create a real-time automated process that would apply a rating agency's original assumptions to the monthly servicer remittance data.

*DBRS provides surveillance information for transactions issued in the U.S. in the form of Performance Analytic Reports, available free of charge on its public website at [www.dbrs.com](http://www.dbrs.com). DBRS continues to enhance its surveillance systems with an open architecture so investors can understand DBRS assumptions and can also input their own assumptions.*

- Disclose monthly service remittance data or any similar underlying asset performance information publicly.
- Create a data library for planned transactions where details about the proposed collateral could be posted so that investors could “inspect the collateral” before purchasing a transaction.
- Have a third party, independent from both the investment banker and the originator, review the loans proposed for the collateral pool.

*DBRS suggests that the above proposals should be imposed on the issuer or servicer, as applicable. That is, these proposals should be imposed on the party who provides the information to the NRSRO in the first place.*

- Monitor and use monthly servicer performance data to update/correct their initial models and assumptions.

*DBRS monitors and uses monthly servicer performance data to update its initial models and assumptions.*

- Create an Office of Chief Statistician and Models reporting to an independent committee of the board of directors.

*As noted above, DBRS has implemented criteria committees that are focused on comprehensive model review prior to use by rating analysts. DBRS suggests that its current approach achieves the intent of the above proposal without the burden of significant extra cost.*

- Require the development of standards, greater standardization of definitions and greater consistency in the agreements used for structured securities.

*DBRS believes that the standardization of the legal documents and terms used within the legal documents governing transactions would be helpful to investors. Standardization of the origination data has been a focus of the American Securitization Forum's Project Restart. This effort is expected to assist investors to more easily evaluate the quality of the assets in a Structured Finance transaction. With regards to rating standards including methodologies for example, DBRS would be concerned that such standardization could lead to standardized credit rating opinions. The market needs a diversity of credit rating opinions. The Credit Rating Agencies Act of 2006 does not permit intrusion into the substance of credit ratings but rather*

*focuses on the integrity and objectivity of ratings, and on the independence and transparency of NRSRO operations.*

ARO ratings should no longer be used to set RBC for structured securities.

- Probability of default methodology for structured securities does not reflect the loss severity characteristics of different senior tranches in different securitizations.
- Structured securities are particularly vulnerable to market risk and are also highly illiquid - two risks that not measured by ARO ratings.
- The NAIC should develop tools to address market and liquidity risk in structured securities.

*DBRS suggests that this is a very broad recommendation that treats all Structured Finance securities the same and does not recognize the variability of specific securities being rated. Moreover, NRSROs in some cases have discussed loss severity and can be encouraged to provide additional transparency regarding the implications of loss severity.*

References to AROs in Legislation

- State regulators should be encouraged to identify references to AROs in state insurance laws and to propose modifications that refer to alternative risk assessment methods or providers so as to lessen reliance on AROs.
- The NAIC should consider whether references to AROs in NAIC Model investment laws should be retained or changed.
- The Investment of Insurers Model Act Revision (E) Working Group should consider if NAIC Model investment laws should be amended to reflect the filing exempt process.

*DBRS suggests that the NAIC reconsider this proposal in light of SEC and Congressional initiatives. The SEC has also recently adopted new rules to fortify NRSRO regulation, particularly regarding transparency and disclosure, conflicts of interest and unfair practices, and has also proposed additional rules for comment.*

Assessing Impact of ARO Insight or Action on Insurer Ratings

- DBRS analytical process for speculative grade securities should be considered to assess whether a different analytical or regulatory approach to speculative grade securities owned by insurers is warranted.

*DBRS's analytical methodology for speculative grade corporate credits incorporates both the risk of default and also the likelihood of recovery in the event of default. DBRS understands the NAIC's official credit policy has traditionally called for doing this as well. The challenge is to make sure the rating from the ARO on the instrument that the insurer purchases, and which is used as a basis for assignment of the NAIC SVO rating, is in fact a rating that incorporates both the default and recovery elements. This is very important in the private placement market in which so many insurance companies invest, inasmuch as many private placement issuers are modestly sized companies that occupy the "cusp" between speculative and investment grade. Many of them, if issuing public bond-type debt without any lender protections like collateral or covenants, would fall into the BB range. But with appropriate collateral and/or covenant structures that allow professional lenders to closely monitor and manage the credit risk, and to*

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*mitigate loss in the event of default, they can issue debt that appropriately deserves ratings in the BBB range. DBRS believes that “getting the rating right” requires a thorough instrument-level analysis of these features. Indeed, not to incorporate these default-mitigating features, and to use ratings that only focus on default risk, can be a form of “size-bias” that not only leads to inaccurate ratings, but is poor public policy, especially in the current economic environment where it is precisely the more modestly-sized companies that have been the most challenged to find credit.*

### **Conclusion**

DBRS is particularly pleased with the citation regarding its analytical process for speculative grade securities, and would be pleased to have a follow-up discussion on this area. DBRS would also be happy to supply the RAWG with additional information regarding any of its responses provided herein. Please direct any questions about these comments to the undersigned.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Mary Keogh', with a stylized flourish at the end.

Mary Keogh  
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