September 13, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Solicitation of Comment to Assist in Study on Assigned Credit Ratings, File Number 4–629.

Dear Ms. Murphy,

The Mortgage Bankers Association[1] (MBA) welcomes the opportunity to comment on the Securities and Exchange Commission's ("Commission") study on the feasibility of establishing a system in which a public or private utility or a self-regulatory organization (''SRO'') assigns nationally recognized statistical rating organizations (''NRSROs'') to determine credit ratings for structured finance products ("the Study").[2] The Study is required by Section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[3] (the ''Dodd-Frank Act'').

MBA is concerned that the assignment of credit ratings by an independent body ("assigned ratings") to NRSROs would stifle ratings innovation while not materially improving the credit ratings process.[4] Moreover, recent legislation and regulations have significantly increased NRSRO rating disclosure and reporting requirements which call into question whether a

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[1] The Mortgage Bankers Association is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. For additional information, visit MBA's Web site: www.mortgagebankers.org.
[2] 76 Fed. Reg. 28265-28297 (May 16, 2011).
[3] Public Law 111–203, 124 Stat. 1376, H.R. 4173 (2010)
[4] The current practice is for the securitization issuer to select the NRSRO that performs the securitization's rating and also pays the rating fee directly to the selected NRSRO. The Study will examine having an independent organization make the NRSRO ratings assignment.

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prescriptive regulatory construct for assigning credit ratings would significantly advance credit rating reliability.

Our comments first address the scope and purpose of the Commission's Study. The various domestic and international efforts to increase the transparency of the credit ratings process are then examined. Finally, we offer our observations about the challenges that assigned credit ratings create for NRSROs and the securitization industry.

I. SEC Study on Assigned Credit Ratings under the Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. Under Section 939F of the Dodd-Frank Act, the Commission must submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, not later than 24 months after the date of enactment of the Dodd-Frank Act, a report containing:[5]

(1) The findings of the Study on matters related to assigning credit ratings for structured finance products.
(2) Any recommendations for regulatory or statutory changes that the Commission determines should be made to implement the findings of the Study.

Section 939F provides that the Commission, in carrying out the Study, shall address the following four areas:[6]

(1) The credit rating process for structured finance products and the conflicts of interest associated with the issuer-pay and the subscriber-pay models.
(2) The feasibility of establishing a system in which a public or private utility or an SRO assigns NRSROs to determine the credit ratings for structured finance products, including: (1) An assessment of potential mechanisms for determining fees for NRSROs for structured finance products; (2)appropriate methods for paying fees to NRSROs to rate structured finance products; (3) the extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government; and (4) any constitutional or other issues concerning the establishment of such a system.
(3) The range of metrics one could use to determine the accuracy of credit ratings for structured finance products.
(4) Alternative means for compensating NRSROs that would create incentives for accurate credit ratings for structured finance products.

[5] 76 Fed. Reg. 28266.
[6] 76 Fed. Reg. 28266.

After completion of the Study, the Commission has the authority to issue a rule to establish a system for the assignment of NRSROs to determine the initial credit ratings of structured finance products, in a manner that prevents the issuer, sponsor, or underwriter of the structured finance product from selecting the NRSRO that will determine the initial credit ratings and monitor such credit ratings.[7]

II. Policy Efforts to Enhance Transparency of the Ratings Process

Credit Rating Agency Transparency Enhancement Efforts

Prior to the passage of the Dodd-Frank Act in 2010, the regulation of NRSROs received considerable attention by both regulatory and legislative policy makers. In fact, the rating agencies fell under the regulatory authority of the Commission in 2006 with the passage of the Credit Rating Agency Reform Act of 2006 ("Reform Act").[8] The Reform Act, among other things, set the regulatory parameters for a rating agency to qualify for NRSRO status. Since that time, legislators, the Commission, and international rating agency regulatory coordination bodies have undertaken concerted efforts to increase the transparency of the ratings process. These efforts are summarized in the paragraphs that follow.

Rule 17g Regulatory Requirements

On December 4, 2009, the Commission adopted new disclosure rules for NRSROs that were implemented on June 2, 2010.[9] The Commission indicated that "the rule amendments being adopted today are designed to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[10] The regulatory program established by the Credit Rating Agency Reform Act of 2007 allows the Commission to promulgate rules regarding public disclosure; recordkeeping and financial reporting; and substantive requirements. Rule 17g supplement previous rules implemented by the Commission under the Credit Rating Agency Reform Act in June 2007. Rule 17g has dramatically increased NRSRO ratings transparency in the following ways: [11]

- Because underlying data used to issue a rating must be disclosed to other NRSROs, multiple unsolicited rating opinions can be developed for each asset-backed security ("ABS") ;

[7] 76 Fed. Reg. 28266.
[8] Public Law 109-291, 120 Stat. 1327 (2006)
[9] 74 Fed Reg, No. 232, pp.63832-63865 (December 4, 2009)
[10] Fed Reg, No. 232, pp.63832
[11] For a detailed explanation of the issues listed below, see Appendix A.

- 100 percent of ratings history will have to be disclosed within 12 months after its release for issuer-paid ratings for securities issued after June 25, 2007, and a random sample of 10 percent of all issuer-paid ratings;
- Enhanced rating transitions reporting;
- Enhanced record keeping of ratings performance;
- Reduced rating agency staff conflicts; and,
- Annual NRSRO reporting on rating activity.

For a more comprehensive summary of required NRSRO disclosures under Rule 17g, please see page 1 of the *Appendix*.

Removal of Credit Ratings from Federal Regulations

Section 939A of the Dodd-Frank Act requires the removal of statutory references to credit ratings. In compliance with Section 939A, on August 3, 2011, the Commission adopted amendments to remove references to credit ratings in rule and form requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 for securities offering or issuer disclosure rules that rely on, or make special accommodations for, security ratings (for example, Forms S–3 and F–3 eligibility criteria) with alternative requirements.[12] The Commission provided the following statement in the rule:[13]

> While we recognize that credit ratings play a significant role in the investment decisions of many investors, we want to avoid using credit ratings in a manner that suggests in any way a ''seal of approval'' on the quality of any particular credit rating or rating agency, including any nationally recognized statistical rating organization (''NRSRO''). Similarly, the legislative history indicates that Congress, in adopting Section 939A, intended to ''reduce reliance on credit ratings.''[18] [14] The rules we are adopting today seek to reduce our reliance on credit ratings for regulatory purposes while also preserving the use of Form S–3 (and similar forms) for issuers that we believe are widely followed in the market.

Clearly, the legislative and regulatory intent of removing references to credit ratings in regulations was to avoid the overreliance on ratings by investors. In addition, regulator concern about creating a moral hazard by relying on credit ratings to determine purchase eligibility for securities (i.e. the top four rating classes) will go away as reliance on credit ratings is removed from federal regulations. Consequently, the removal of the government's "seal of

[12] 76Fed.Reg. 44603-444621 (August 3, 2011)

[13] 76Fed.Reg. 44604

[14] Footnote 18 from 76Fed.Reg 44604 is as follows: *See* Report of the House of Representatives Financial Services Committee to Accompany H.R. 4173, H. Rep. No. 111–517 at 871 (2010). The legislative history does not, however, indicate that Congress intended to change the types of issuers and offerings that could rely on the Commission's forms.

approval" for ratings is intended to foster heightened structured security purchaser due diligence and eliminate the practice of using ratings as a proxy for purchaser-performed due diligence. Instead, ratings will assume their intended role of being one of many data points taken into consideration by investors when making structured security purchase decisions.

Consequently, a highly regulated prescriptive assignment process for credit ratings appears to be at odds with concerted government efforts to eliminate reliance on credit ratings in federal regulations.

Dodd-Frank Act NRSRO Requirements

In addition to removing references to credit ratings from federal regulations, some additional requirements for NRSROs specified in the Dodd-Frank Act include:

- Annual reports on internal controls
- Conflicts of interest with respect to sales and marketing practices
- "Look-backs" when credit analysts leave the NRSRO
- Fines and penalties
- Disclosure of performance statistics
- Application and disclosure of credit rating methodologies
- Form disclosure of data and assumptions underlying credit ratings, among other things
- Disclosure about third party due diligence
- Analyst training and testing
- Consistent application of rating symbols and definitions
- Specific and additional disclosure for ratings related to ABS products

These requirements in tandem with Rule 17g requirements have decreased potential conflicts of interest for NRSRO employees while increasing the transparency of the ratings process. MBA believes that the strengthened laws and regulations governing NRSROs have provided the transparency required for both regulators and investors to identify NRSROs whose ratings clearly deviate from their peer organizations.

International Credit Rating Agency Reform Efforts

In February 2011, the Technical Committee of the International Organization of Security Commissioners[15] ("IOSCO") published a report ("IOSCO Report") that examined the compliance of national securities regulatory bodies with a set of principles that were established for rating agencies.[16] The IOSCO CRA Principles articulate four objectives that rating agencies,

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[15] IOSSCO is an association of organizations that is recognized as an international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions.

[16] Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies – Final Report, Technical Committee of IOSCO (February 2011).

regulators, issuers and other market participants should strive to achieve in order to improve investor protection and the fairness, efficiency and transparency of the securities markets as well as to reduce systemic risk.

Based upon the IOSCO evaluation, NRSROs operating in the United States have demonstrated that the laws and regulations governing are consistent with the four IOSCO Principles: (1) quality and integrity of the ratings process; (2) address credit rating agency independence and conflicts of interest; (3) promotes transparency and timeliness of ratings disclosures; and, (4) protects confidential information. This provides further indication that recent laws and regulations have increased NRSRO rating transparency and the integrity of the ratings process. See page 3 of the *Appendix* for a more detailed discussion of NRSRO conformity with the IOSCO Principles.

III. MBA Views

MBA supports efforts to increase transparency and reliability in credit ratings of securities backed by real estate mortgage. MBA is mindful that the financial services system has witnessed a tremendous increase in the level of complexity and sophistication in financing options, investment products and liquidity channels. Consequently, MBA has consistently and strongly supported the Commission's efforts to increase the transparency of the ratings process and ratings data. Increased ratings transparency allows investors to more closely compare their analysis with the work performed by the NRSRO to make informed securities purchase decisions.

Such transparency was not available in the past, which effectively allowed the practice of "ratings shopping." Given the advent of greater ratings transparency paired with the requirement for the securitization issuers to provide information that allows unsolicited ratings to be developed (Rule 17g), MBA believes that both regulators and investors will be able to quickly detect when ratings shopping materially impacts the credit rating of a securitization.

In the context of the heightened regulatory environment for NRSROs, MBA believes that assigned credit ratings would not significantly improve the accuracy of the ratings process. Before moving forward with assigned ratings, the Commission should carefully evaluate if Rule 17g and the Dodd-Frank Act have not already addressed, for the most part, the improvement to the ratings process anticipated by assigned ratings.

Given that assigned ratings would radically alter the current business model for many NRSROs, MBA urges the Commission to carefully consider the potential benefits of this approach to the potential unintended consequences it may have on the credit rating industry and its broader impact on the securities industry. These concerns include:

- Assigned credit ratings could stifle NRSRO innovation by eliminating the financial incentive to refine and improve rating models, which could result in NRSRO rating methodologies not keeping pace with innovations in structured securities

- Primary and secondary market purchasers may discount the price paid for securities rated by an assigned NRSRO that does not have an established track record for the category of securitization.

- In the case of commercial and residential mortgage-backed securities (CMBS and RMBS), the uncertainty of transitioning to a new rating regiment could potentially slow new issuance.

- Recent changes in RMBS criteria by rating agencies indicate that their assumptions remain extremely conservative. Thus, there does not seem to be any cause at this time for actions that would impose further impediments to the return of a private RMBS market.

MBA appreciates the opportunity to comment and request that you consider our concerns. Any questions about MBA's comments should be directed to George Green, Associate Vice President, Commercial Real Estate, at (202) 557-2840 or ggreen@mortgagebankers.org.

Sincerely,

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association

Appendix

Rule 17g Regulatory Requirements

On December 4, 2009 the Commission adopted new disclosure rules for NRSROs that were implemented on June 2, 2010.[1] The Commission indicated that "the rule amendments being adopted today are designed to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry"[2]. The regulatory program established by the Credit Rating Agency Reform Act of 2007 allows the Commission to promulgate rules regarding public disclosure; recordkeeping and financial reporting; and substantive requirements. The rules supplement previous rules implemented by the Commission under the Credit Rating Agency Reform Act in June 2007. Rule 17g was added to the Securities Exchange Act of 1934 and includes:

- **Making Available to NRSRO Underlying Data for Ratings** – Amended Rule17g-5 prohibits an NRSRO from issuing a rating for a structured finance product paid for by the product's issuer, sponsor, or underwriter unless the information about the product provided to the NRSRO to determine the rating and, thereafter, monitor the rating is made available to other NRSROs. NRSROs are required to report deals that they are in the process of rating to other NRSROSs. Issuers must provide a representation to the NRSRO hired to perform the rating that it will make available the same information to other NRSROs. In addition, NRSROs seeking to access information maintained by the NRSROs and the arrangers would need to furnish the Commission an annual certification that they are accessing the information solely to determine credit ratings and will determine a minimum number of credit ratings using the information. Specifically, the Commission amended Rule 100 of Regulation FD to permit the disclosure of material non-public information to NRSROs regardless of whether they make their ratings publicly available.

- **Disclosure of 100 Percent of Recent Ratings** - The amendments to Rule 17g-2 require NRSROs to disclose ratings history information for 100 percent of their current issuer-paid credit ratings in an XBRL format. Further, they only would apply to issuer-paid credit ratings determined after June 25, 2007 (the effective date of the Rating Agency Act). A credit rating action would not need to be disclosed until 12 months after the

[1] 74 Fed Reg, No. 232, pp.63832-63865 (December 4, 2009)
[2] Fed Reg, No. 232, pp.63832

action is taken.

- **Records of Rating Actions -** This rule requires an NRSRO to make publicly available a random sample of 10 percent of their issuer-paid credit ratings and their histories documented for each class of issuer-paid credit rating for which the NRSRO is registered and has issued 500 or more ratings. This information would be required to be made public on the NRSRO's corporate Internet Web site in XBRL format no later than six months after the rating is made. The proposal amends the instructions to Exhibit 1 of Form NRSRO to require an NRSRO to disclose where in its Web site these ratings histories would be made available.

- **Enhanced NRSRO Reporting Requirements** - The rule amends the instructions to Form NRSRO to require enhanced disclosures by NRSROs and applicants for registration as NRSROs. The amendments to the instructions to Exhibit 1 require an NRSRO or NRSRO applicant to provide transition statistics for each asset class of credit ratings for which it is registered or is seeking registration, broken out over one-, three-, and ten-year periods. The amended instructions clarify that all ratings transitions (i.e., upgrades as well as downgrades) must be included in these statistics. In addition, the default statistics must show defaults relative to the initial rating and incorporate defaults that occur after a credit rating is withdrawn. The amendments to the instructions to Exhibit 2 require NRSROs to provide enhanced disclosure in three areas: (1) whether and, if so, how much verification performed on assets underlying or referenced by the structured finance transaction is relied on in determining credit ratings; (2) whether and, if so, how assessments of the quality of originators of structured finance transactions play a part in the determination of the credit ratings; and (3) more detailed information on the surveillance process, including whether different models or criteria are used for ratings surveillance than for determining initial ratings.

- **New Enhanced Record Keeping Rules** - This rule adds three new record keeping requirements to Rule 17g-2 and makes one non-substantive change to an existing requirement. The first new recordkeeping requirement requires an NRSRO to make and retain records of all rating actions related to a current rating from the initial rating to the current rating. The second new recordkeeping requirement requires that if a quantitative model is a substantial component of the credit rating process for a structured finance product, an NRSRO must keep a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued. The third new recordkeeping requirement would require that an NRSRO retain records of any complaints regarding the performance of a credit analyst in determining, maintaining, monitoring, changing, or withdrawing a credit rating.

- **NRSRO Annual Credit Ratings Report** - This amendment to Rule 17g-3 requires an

NRSRO to provide the Commission with an annual report of the number of credit rating actions that occurred during the fiscal year for each class of security for which the NRSRO is registered.

- **Prohibited NRSRO Conflicts** - These amendments would add three new prohibited conflicts to Rule 17g-5(c). The first amendment prohibits an NRSRO from issuing a credit rating with respect to an obligor or security where the NRSRO or an affiliate of the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. The second amendment prohibits a person within an NRSRO who participates in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings from participating in any fee discussions, negotiations, or arrangements. The third amendment prohibits an NRSRO from allowing a credit analyst who participated in determining or monitoring the credit rating to receive gifts, including entertainment, from the obligor being rated or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities, such as meetings, that have an aggregate value of no more than $25.

International Credit Rating Agency Reform Efforts

In February 2011, the Technical Committee of the International Organization of Security Commissioners[3] ("IOSCO") published a report ("IOSCO Report") that examined the compliance of national securities regulatory bodies with a set of principles that were established for rating agencies.[4] This Final IOSCO Report addresses several of the recent regulatory initiatives that impact or will shortly impact credit rating agencies (CRAs) that are active in multiple jurisdictions. In particular, the paper reviewed CRA supervisory initiatives in Australia, the European Union (EU), Japan, Mexico, and the United States in order to evaluate whether, and if so how, these regulatory programs implemented the four principles set forth in the 2003 IOSCO paper *Statement of Principles Regarding the Activities of Credit Rating Agencies* (IOSCO CRA Principles).

The IOSCO CRA Principles articulate four objectives that rating agencies, regulators, issuers and other market participants should strive to achieve in order to improve investor protection

[3] IOSCO is an association of organizations that is recognized as an international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions.

[4] Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies – Final Report, Technical Committee of IOSCO (February 2011).

and the fairness, efficiency and transparency of the securities markets as well as to reduce systemic risk. These four principles and the US compliance with these principles, as extracted from the IOSCO Report, are provided below:

1. **Quality and integrity in the rating process** – Credit rating agencies ("CRAs") should endeavor to issue opinions that help reduce the asymmetry of information among borrowers, lenders and other market participants.[5]

    The US CRA regulatory program also has a number of provisions designed to promote the objective of the first IOSCO CRA Principle. The stated purpose of the legislation granting the SEC the authority to implement registration, recordkeeping, financial reporting and oversight rules with respect to CRAs that register as NRSROs is —To improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry.[63] To that end, the US CRA regulatory program mandates that the SEC deny a CRA's application for registration as an NRSRO if it finds that the applicant does not have adequate financial and managerial resources to consistently produce credit ratings with integrity and materially comply with its disclosed procedures and methodologies.[64]

2. **Independence and conflicts of interest** – CRA rating decisions should be independent and free from political or economic pressures and from conflicts of interest arising due to the CRA's ownership structure, business or financial activities, or the financial interests of the CRA employees. CRAs should, as far as possible, avoid activities, procedures or relationships that may compromise or appear to compromise the independence and objectivity of credit rating operations.[6]

    The US CRA regulatory program promotes the second IOSCO CRA Principle by requiring an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest. [105] The program also has a provision that sets forth nine categories of conflicts of interest an NRSRO is prohibited from having unless it discloses them and has implemented procedures to address and manage them.[106]

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[5] IOSCO Report, page 19.
[6] IOSCO Report, page 28.

3. **Transparency and timeliness of ratings disclosure** – CRAs should make disclosure and transparency an objective of their ratings activities.[7]

    The US CRA regulatory program promotes the third IOSCO CRA Principle by requiring NRSROs to update and disclose information on Form NRSRO, including information about how ratings are determined. Specifically, an NRSRO must disclose its methodologies for determining as well as for monitoring credit ratings. [133] NRSROs must also define on Form NRSRO the credit rating categories, notches, grades, and rankings it assigns.[134]

4. **Confidential information** – CRAs should maintain in confidence all non-public information communicated to them by any issuer, or its agents, under terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially.[8]

    The US CRA regulatory program has provisions that are designed to promote the objectives of the fourth IOSCO CRA principle. For example, it has provisions that require an NRSRO to have procedures to address the handling of material non-public information received during the rating process and the trading of securities while in possession of material nonpublic information, as well as to avoid the selective disclosure of a pending ratings decision. Specifically, an NRSRO's written policies and procedures must include policies and procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of material nonpublic information obtained in connection with the performance of credit rating services.

Based upon the IOSCO evaluation, NRSROs operating in the United States have demonstrated that the laws and regulations governing are consistent with the four IOSCO principles: (1) quality and integrity of the ratings process; (2) address credit rating agency independence and conflicts of interest; (3) promotes transparency and timeliness of ratings disclosures; and, (4) protects confidential information. This provides further indication that recent laws and regulations have increased NRSRO rating transparency and the integrity of the ratings process.

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[7] IOSCO Report, page 32
[8] IOSCO Report, page 35