



August 22, 2012

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

Re: Commission Guidance Regarding Definitions of Mortgage Related Security and Small Business Related Security [Release No. 34-67448; File No. S7-06-12]

Dear Ms. Murphy:

The Mortgage Bankers Association¹ (MBA) welcomes the opportunity to comment on the Securities and Exchange Commission's transitional interpretation regarding mortgage related securities ("Guidance") and small business related securities.² MBA, with its focus on policies that impact residential and commercial real estate finance, directs our comments toward the Guidance on mortgage related securities.

The Guidance was prompted by section 939(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act³ ("Dodd-Frank Act") that required references to the top two rating categories (AAA and AA) to be removed in defining a mortgage related security and be replaced by "standards of credit-worthiness established by the Commission"⁴. The SEC was required to promulgate a Final Rule for this section by July 20, 2012.⁵ However, because the Commission requires additional time to develop its standards of credit-worthiness, the Commission has issued the Guidance that will be in effect until such time that it is replaced by the Final Rule. The Guidance keeps intact the

¹The 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 77 Fed. Reg. 42980-42988 (July 23, 2012).

³ Public Law 111-203, 124 Stat. 1376-2223 (July 21, 2010).

⁴ Public Law 111-203, 124 Stat. 1886 (July 21, 2010).

⁵ Public Law 111-203, 124 Stat. 1887 (July 21, 2010).

existing definition of a mortgage related security being “rated in one of the two highest rating category by at least one nationally recognized statistical rating.”⁶

MBA commends the Commission for taking the necessary additional time to “analyze and understand the potential impact that could result from the establishment of the definitions of the terms ‘mortgage related security’ and ‘small business related security.’”⁷ This thoughtful and deliberative process could potentially avoid unintended consequences that could result from a Final Rule promulgated to meet a statutory deadline. Consequently, MBA supports the Guidance.

The challenge that the Commission has had in developing a replacement for nationally recognized statistical rating organization (“NRSRO”) ratings has been shared with the other federal regulatory agencies⁸ (collectively, the “Agencies”). MBA strongly supports the intent of the Dodd-Frank Act of “reducing the reliance on ratings”⁹. MBA encourages the Commission’s continued deliberative steps toward ensuring a framework that appropriately accounts for the credit worthiness of mortgage related securities. We believe that the Final Rule should allow credit ratings to be taken into consideration as part of multifaceted analytical process for defining a mortgage related security, but not be required. On this matter, we encourage the Commission to look to steps taken by other federal agencies, including the Office of the Comptroller of the Currency, as discussed below.

The discussion below addresses the statutory underpinnings for the Guidance and its relationship to NRSRO ratings for defining a mortgage related security. We then discuss the ongoing efforts of the Commission to remove reliance on NRSRO ratings from its rules and forms. A recent Final Rule issued by the Office of the Comptroller of the Currency (“OCC”) that allows banks to utilize NRSRO ratings in their structured security analytical process is then examined. Finally, we offer our recommendation for the role that NRSRO ratings should play in defining a mortgage related security that is consistent with the intent of the Dodd-Frank Act.

⁶ 77 Fed. Reg. 42981 (July 23, 2012).

⁷ 77 Fed. Reg. 42981 (July 23, 2012).

⁸ The federal regulatory agencies that are participating in the Dodd-Frank Act rule-making process include: the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Secretary of Housing and Urban Development, and the Federal Housing Finance Authority, the Office of the Comptroller of the Currency, the Department of Treasury (serving in a coordination capacity).

⁹ H.R. Rep. No. 11-517, Dodd-Frank Wall Street Reform and Consumer Protection Act Conference Report, H.R. 4171 at 871 (June 29, 2010).

Statutory Background

Section 939A of the Dodd-Frank Act requires references to and reliance on NRSRO ratings to be removed from federal regulations:

SEC. 939A. REVIEW OF RELIANCE ON RATINGS.

- (a) AGENCY REVIEW.—Not later than 1 year after the date of the enactment of this subtitle, each Federal agency shall, to the extent applicable, review—
 - (1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and
 - (2) any references to or requirements in such regulations regarding credit ratings.
- (b) MODIFICATIONS REQUIRED.—Each such agency shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. In making such determination, such agencies shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness.¹⁰

While Section 939A provides the overall mandate to remove reliance on NRSRO credit ratings from federal regulations, Section 939(e) applies this requirement to mortgage related securities. Section 939(e) amends the Securities Exchange Act of 1934¹¹ and section 939(g) provides the implementation requirement for Section 939(e):

- (e) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a) Securities Exchange Act of 1934 (15 U.S.C. 78a(3)(a)) is amended—
 - (1) in paragraph (41), by striking “is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization” and inserting “meets standards of credit-worthiness as established by the Commission”¹²
- (g) EFFECTIVE DATE.—The amendments made by this section shall take effect 2 years after the date of enactment of this Act.

¹⁰ Public Law 111-203, 124 Stat. 1887 (July 21, 2010).

¹¹ 15 U.S.C. 78a(3)(a).

¹² Public Law 111-203, 124 Stat. 11886-1887 (July 21, 2010).

Importantly, in issuing the Guidance, the Commission provided the following explanation:

the Commission does not believe that, in the absence of established standards of creditworthiness by the Commission, Congress intended for the statutory definitions to become unworkable or to create market uncertainty regarding the status or meaning of these definitions. Consequently, the Commission is issuing this transitional interpretation to ensure that the markets can continue to function while the Commission continues its work on rule proposals to establish standards of creditworthiness to implement section 939(e) of the Dodd-Frank Act.¹³

The Commission also indicated that Congress did not intend for the lack of a definition for mortgage related security to cause it to become “unworkable or create market uncertainty.” This standard should be applied not only in the absence of a replacement to credit ratings but to the alternative to credit ratings should it prove to be “unworkable or create market uncertainty”.

SEC Efforts to Remove NRSRO Ratings in Its Regulations

Since 1994, the Commission, through a total of six proposals and concept releases has addressed reliance on ratings in its regulations. Examples of this effort include:¹⁴

- In 1994, the Commission published a concept release soliciting comment on whether references to NRSRO credit ratings should be eliminated from its rules.
- In February 2011, the Commission proposed to remove references to credit ratings in rules and forms promulgated under the Securities Act and the Exchange Act related to offerings of securities or issuer disclosure. A Final Rule was promulgated on August 3, 2011.

Clearly, the Commission has undertaken concerted efforts to remove ratings from its rules and regulations. In the Guidance, the Commission provided the following explanation for not moving forward with the replacement of NRSRO ratings:

In the case of some proposed amendments under section 939A, commenters—as explained below—have raised concerns that replacing the benchmark of credit ratings with another standard could, among other things, be harmful to

¹³ 77 Fed. Reg. 42981 (July 23, 2012) (emphasis added).

¹⁴ 77 Fed. Reg. 42984-42986 (July 23, 2012).

investors, increase risk to financial institutions, distort financial markets, and increase burdens and costs.

While the Commission has been able to remove references to ratings in some of its rules and forms, removing them from the mortgage related security definition has proven to be challenging because of strong concerns that have been raised about potential unintended market impacts. MBA echoes these concerns and urges the Commission to consider a flexible approach regarding NRSRO ratings, as demonstrated by a recently released OCC Final Rule.

OCC Use of External Credit Ratings in Its Regulations

On June 13, 2013, the OCC issued a Final Rule entitled, “Alternatives to the Use of External Credit Ratings in the Regulations of the OCC” (“the OCC Final Rule”).¹⁵ The OCC Final Rule addresses the definition of “investment grade” security, which in the past were securities with a NRSRO credit rating in the top four ratings categories (AAA, AA, A, BBB). In issuing the Final Rule, the OCC indicated that it did not want the Final Rule to impact the standards in which banks currently define investment grade:

The OCC does not intend for the elimination of references to credit ratings, in accordance with the Dodd-Frank Act, to change substantively the standards national banks must follow when deciding whether a security is “investment grade....”¹⁶

Clearly, the OCC did not intend for the removal of NRSRO ratings as investment grade qualification test to increase the due diligence requirements for bank purchases of structured securities. Instead, the OCC provided the following standard for how credit ratings can be appropriately used:

When determining whether a particular security is “investment grade,” the OCC expects national banks to consider a number of factors, to the extent appropriate. While external credit ratings and assessments remain valuable sources of information and provide national banks with a standardized credit risk indicator, **if a national bank chooses to use credit ratings as part of its “investment grade” determination and due diligence, the bank should, consistent with existing rules and guidance, supplement the external ratings with a degree of due diligence processes and additional analyses that are appropriate for the bank’s risk profile and for the size and complexity of the instrument.**¹⁷

¹⁵ 77 Fed. Reg. 35253-35259 (June 23, 2012).

¹⁶ 77 Fed. Reg. 35254 (June 23, 2012).

¹⁷ 77 Fed. Reg. 35254 (June 23, 2012) (emphasis added).

The OCC Final Rule allows banks to use credit ratings in their determination of an investment grade structured security provided that the bank performs its own due diligence that is consistent with existing rules and guidance. MBA believes that NRSRO credit ratings are an important assessment tool but should be supplemented by an institution's own due diligence. Notably, OCC Final Rule does not require banks to rely on NRSRO ratings for determining an investment grade security.¹⁸ The practice of not requiring banks to utilize NRSRO ratings while at the same time permitting banks to include them in their internal analysis process, if they so choose, we believe, reflects the Congressional intent of the Dodd-Frank Act against over-reliance on NRSRO ratings in securities purchases. At the same time this approach allows banks to take into consideration the due diligence performed by NRSROs underlying their ratings.

In addition, the OCC Final Rule provides guidance for how banks can consider NRSRO ratings for assessing adverse economic conditions.

To the extent a national bank would be expected to consider adverse economic conditions under the current "investment grade" and safety and soundness standards, the OCC would expect the national bank to continue to consider adverse economic conditions, as appropriate, when conducting investment securities activities. **Importantly, a national bank may not need to develop its own internal systems to measure potential adverse economic conditions to meet the revised standard. Instead, a national bank could consider projections provided by third parties, including those provided by NRSROs.**¹⁹

The OCC contemplates a meaningful role for bank utilization of NRSRO ratings if they choose to include them in their structured securities due diligence process. Once again, we believe that this reflects an appropriate role for NRSRO ratings.

Recommendation

In contemplating the role of NRSRO ratings its rules and forms, we would strongly urge the Commission to be guided by an approach similar to that in the OCC Final Rule, which allows NRSRO ratings to be used in the structured security purchase due diligence process while at the same time providing safeguards that prevent NRSRO ratings from being the sole consideration. The alternative of creating an entirely new classification method that entirely removes NRSRO ratings from the analytical framework has the potential for significant harmful and unintended consequences.

¹⁸ 77 Fed. Reg. 35254 (June 23, 2012).

¹⁹ 77 Fed. Reg. 35255 (June 23, 2012) (emphasis added).

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MBA appreciates the opportunity to comment and request consideration of our concerns. Any questions about MBA's comments should be directed to Thomas Kim, Senior Vice President of Commercial & Multifamily Policy (at 202-557-2745 or tkim@mortgagebankers.org) or George Green, Associate Vice President, Commercial/Multifamily Policy (at 202-557-2840 or ggreen@mortgagebankers.org).

Sincerely,

A handwritten signature in black ink, appearing to read "D.H. Stevens". The signature is written in a cursive, flowing style with a large initial "D" and "S".

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