CRE Finance Council
WHERE CAPITAL AND IDEAS MEET

November 15, 2010

VIA ELECTRONIC FILING – rule-comments@sec.gov
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Issuer Review of Assets in Offerings of Asset Backed Securities, Release Nos. 33-9150, 34-63091; File Number S7–26–10

Dear Ms. Murphy:

On behalf of the Commercial Real Estate (CRE) Finance Council, we appreciate the opportunity to comment on the SEC's proposed rules concerning issuer review of assets in offerings of asset-backed securities under Section 932 and Section 945 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1] The CRE Finance Council is the collective voice of the entire $3.5 trillion commercial real estate finance market, including issuers; investors such as insurance companies, pension funds, and money managers; portfolio and commercial mortgage-backed securities (CMBS) lenders; commercial and investment banks; rating agencies; accounting firms; servicers; and other service providers.

Our principal missions include setting market standards, facilitating market information, and education at all levels, particularly related to securitization, which has been a crucial and necessary tool for growth and success in commercial real estate finance. To this end, we have worked closely with policymakers in an effort to ensure that legislative and regulatory actions do not negate or counteract economic recovery efforts in the CRE market. We will continue to work with policymakers on this effort, as well as our ongoing work with market participants and policymakers to build on the unparalleled level of disclosure and other safeguards that exist in the CMBS market, prime examples of which are our "Annex A" initial disclosure package, and our Investor Reporting Package™ for ongoing disclosures.

[1] Issuer Review of Assets in Offerings of Asset Backed Securities, Proposed Rule, 75 Fed. Reg. 64182 (Oct. 19, 2010) (hereafter, "Proposing Release").

I. Overview

Overall, the CRE Finance Council does not object to the SEC's Proposing Release, and our comments are focused on providing perspective from CMBS market participants with respect to certain clarifications we believe are necessary, and on the issue of standards for the review of assets that must be conducted by issuers of registered ABS offerings under proposed new Securities Act Rule 193. We support the SEC's proposal not to adopt a particular standard for the level or type of review, recognizing that review practices necessarily differ depending on the asset class involved. As the SEC acknowledges for example, in CMBS transactions, the review of assets may involve an examination of each asset in the pool.[2] In contrast, review of each asset typically is not practical in a residential mortgage-backed security (RMBS) issuance because there are thousands of loans in the pool. And in still another example, a different type of review would be necessary for ABS with revolving assets in the underlying pool, such as credit card receivables.

Moreover, the nature and level of review within an asset class may differ, depending on other circumstances, such as the degree of continuing sponsor involvement. This fact was also recognized by the SEC.[3]

Because so much variance is possible across asset classes, and there can be further variance within an asset class depending on the particular circumstances for an issuance, we believe the SEC's decision not to prescribe review standards is a sound judgment. Indeed, a one-size-fits-all approach would be in direct opposition to the rationale for the tailored regulatory approach that Congress directed agencies to take in the risk retention context. We believe Congress recognized that ultimately, it is important to ensure that securitization reforms do not counteract the securitization market's gradual progress toward recovery. Accordingly, as the SEC proposes, the asset review rule should require that an issuer disclose information regarding the nature of the review that is conducted, rather than a mandate to conduct a particular type of review.

Our comments will begin with a brief background discussion of the current state of the CRE market, followed by our specific observations regarding the Proposing Release.

II. Background: Current State of CRE Market and CMBS

The CRE market has been greatly impacted by the recent downturn in the economy – especially high unemployment, low consumer confidence and falling property values. With more than $1 trillion in commercial mortgages maturing in the next several years (many of which face an "equity gap" between property value and loan amount), the CRE Finance Council has a particular interest in facilitating a revival of the CMBS market, which presently represents approximately 25% of all outstanding commercial mortgage debt and accounted for approximately 50% of all CRE lending in 2007.

Today, uncertainty related to regulatory and accounting changes remains a major impediment to private lending and investing that is critical to a CRE recovery. There are serious questions about

[2] *Id*. at 64184.

[3] *Id*. at 64183.

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the viability of the CMBS market, for example, when considering the combined impact of reforms on the market and concerns about whether implementing regulators will coordinate reforms and customize risk retention requirements for inherently different classes of ABS, as directed by Section 941(b) of Dodd-Frank. Likewise, market participants are concerned about the impact of other requirements imposed by Dodd-Frank such as the asset review requirements addressed in the Proposing Release, and whether these new requirements will appropriately take into account market realities and investor needs.

Unlike some asset classes, such as residential mortgage-backed securities (RMBS), which remain relatively dormant, we believe it is important to note that the CMBS market is showing signs of revitalized activity, which makes deliberate and coordinated policy even more crucial at this critical time. In fact, there have been seven CMBS deals completed this year with a total issuance of $4.5 billion through the third quarter. Further, industry analysts predict that CMBS issuance for the fourth quarter 2010 alone will range from an additional $4 billion to $8 billion, with expectations for as much as $35 billion of CMBS issuance in 2011, depending on a number of factors, including regulatory certainty. These figures are small compared to the $238 billion in issuance in 2007, but the progress is timely given the number of CRE loan maturities in the next few years, and encouraging given that private issuance ceased for six quarters until the first non-TALF deal was issued in December 2009.

It also is worth noting that the CMBS transactions that have recently taken place have been structured with low-leveraged and well-underwritten loans, and feature even greater transparency that further amplifies the differences between CMBS and other asset classes. We are also acutely aware, however, that even though the new requirements imposed under Dodd-Frank will have a significant impact on the commercial real estate securitization markets, they appear to be driven primarily by subpar performance in the subprime and prime residential markets.

III. The SEC Has Correctly Decided That The Asset Review Rule Should Not Prescribe a Particular Level or Type of Review

Dodd-Frank Section 945 directs the SEC to issue rules that require an issuer of registered ABS to perform a review of the assets underlying the ABS and disclose the nature of the review. To implement this directive, the SEC proposes to adopt a new Rule 193 under the Securities Act. Rule 193 would not mandate that any particular type or level or review be conducted, but would require disclosure pursuant to a new Regulation AB Item 1111(a)(7) of the scope of the review and the manner in which it was conducted, such as whether review was done of each asset or of a representative sample. Findings and conclusions of the review would also be disclosed, as well as information about "exception loans" – loans included in the pool that do not meet the disclosed underwriting criteria. The disclosure requirements would track those previously proposed for a revised Regulation AB, with the addition of a new requirement for disclosure of which entity made the decision to include an exception loan in the pool.

The SEC explained the decision not to mandate a particular standard for the level or type of review by describing current practice with respect to asset review, which can vary significantly depending on the asset class involved. The Proposing Release seeks comment, however, on whether a mandated level and type of review should be imposed by new Rule 193, and whether issuers would undertake a meaningful review in the absence of minimum review standards.[4]

[4] *Id.* at 64185-86.

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We believe that the appropriate decision is for the Commission not to prescribe a particular level and type of review, for the reasons the Commission articulated in the Proposing Release. Following on the Commission's reference to CMBS transactions as a specific example, as the SEC correctly observed, the review of assets underlying a CMBS issuance may involve an examination of each asset in the pool.[5]

We would add that the multiple levels of diligence and review, as well as the type of review conducted by CMBS market participants, also distinguishes CMBS from other types of assets. In particular, loan-by-loan and property-by-property-level analysis is undertaken, rather than reliance on historical statistical analysis that is typical of other asset classes. Such analysis is necessary because CMBS pools are not homogeneous enough to rely on statistical information, but are instead dependent upon property-level analysis to project security performance. Accordingly, for example, CMBS market participants gather detailed information about income-producing properties and the integrity of their cash flows, credit quality of tenants, and integrity of the borrower and its sponsors.[6]

In contrast, such extensive review typically is not practical in the RMBS context because there are thousands of loans in the pool, and this type of review would not be possible for other types of ABS, such as those backed by credit card receivables. In such cases, review of a representative sample of loans may be more practical, as the SEC notes with respect to RMBS.[7] Moreover, as the SEC observed, the type of review may differ depending on other circumstances, such as the degree of continuing sponsor involvement.[8]

In sum, there can be a significant degree of variance in what type of review will be possible and what will be practical, depending on the asset class. And there can be further variance depending on the particular circumstances for an issuance. We do not believe mandated review standards would be sound policy because, as the SEC discusses in the Proposing Release, the level and type of review depends on the asset class involved. Nor do we believe that it is necessary to attempt to mandate a particular type of review for each asset class, due to the fact that some variance may be necessary even within an asset class based on the circumstances for a particular issuance. Rather, we concur with the SEC's judgment that disclosure regarding the level and type of review will give investors the ability to evaluate the level and adequacy of the issuer's review.[9] The Commission should also take care to avoid imposing a review mandate that so far exceeds what the capital markets can bear that market activity slows once again.

[5] *Id*. at 64184.

[6] More fundamentally, it should be kept in mind that in the CMBS context at least, asset review is performed by loan sellers/issuers/sponsors as the basis for making enforceable representations and warranties concerning the securities, and therefore, these parties have a strong incentive to perform a meaningful asset review.

[7] Proposing Release, 75 Fed. Reg. at 64184.

[8] *Id*. at 64183.

[9] *Id*. at 64184.

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As a matter of principle, a one-size-fits-all approach would run counter to the rationale for the tailored regulatory approach that Congress directed agencies to take in the risk retention context, which was echoed by the Federal Reserve in its recent report on the effect of risk retention mandates on the securitization market. In that regard, it was recognized that the simple, uniform application of rules is "unlikely to achieve the stated objective of the Act—namely, to improve the asset-backed securitization process and protect investors from losses associated with poorly underwritten loans,"[10] and that regulations should "recognize differences in market practices and conventions, which in many instances exist for sound reasons related to the inherent nature of the type of asset being securitized."[11]

IV. Requests for Clarification

A. Responsibility for Conducting the Review

Dodd-Frank Section 945 directs the Commission to adopt rules requiring the "issuer" of a registered ABS offering to conduct a review of the assets underlying the ABS. Proposed Rule 193 adopts this nomenclature by imposing the review obligation on the "issuer," which term would be defined as the "depositor" or "sponsor" of the securitization.[12] "Sponsor," in turn, is described as the entity that organizes and initiates an ABS transaction by selling or pledging assets that it has originated itself or acquired on the secondary market, to the entity (usually a specially-created trust) that issues the ABS.[13] "Depositor" is described as an intermediate entity to whom the sponsor transfers the assets on occasions where the transfer of assets from the sponsor to the trust is a two-step, rather than a direct, process.[14]

We recommend clarification of the responsibility for conducting the proposed review in two respects. First, the rule should clarify that for purposes of Rule 193, the terms "sponsor," "depositor," and "issuer" have the same meaning as in Item 1101 of Regulation AB, for precision and consistency in defining terms. "Issuer," for Rule 193 purposes, should not be defined as a "sponsor" or "depositor," because an "issuer" is not synonymous with "sponsor" or "depositor." Rather, an "issuer" is the trust or other entity created at the direction of the sponsor or depositor that owns or holds the pool assets and in whose name the asset-backed securities supported or serviced by the pool assets are issued, as defined in Regulation AB.

Proposed Rule 193, therefore, should refer to review by the "sponsor." We recognize that the Commission may have attempted to define "issuer" as the "sponsor" or "depositor" to reconcile use of the term "issuer" in Dodd-Frank Section 945 with the reality that it is the "sponsor" that typically conducts diligence of assets. But such nomenclature is imprecise and may prompt confusion regarding responsibility for conducting review of underlying assets.

[10] Report to the Congress on Risk Retention, Board of Governors of the Federal Reserve System (October 2010), at 3 (available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf).

[11] *Id.* at 83.

[12] Proposing Release, 75 Fed. Reg. at 64184.

[13] *See id.*, n.23 (citing definition of "sponsor" in Item 1101 of Regulation AB).

[14] *Id.*

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Second, the unique process by which multiple lenders cooperate to form an aggregate pool of CRE loans for a CMBS securitization should be recognized. In CMBS, the firm that registers the offering in a transaction is referred to as the "depositor," and contractually the depositor purchases loans from multiple originators, each of whom would be a "sponsor" of the transaction. It follows that the disclosure requirement of asset review should run to each of the sponsors in its individual capacity, and that the depositor should not be required to conduct an independent review of each sponsor's loans. We note that this recommendation is most efficient from a practical perspective, because each CMBS sponsor makes, and is liable, for its own representations and warranties, and therefore incentivized to perform meaningful review of its loans. Furthermore, in those situations where a sponsor relies on a network of independent correspondent firms to originate loans, a CMBS sponsor is typically under an affirmative obligation to conduct a review of the loans originated by the correspondent, which is consistent with the Commission's proposal to require the sponsor to perform the review where the loan originator and sponsor are different and unaffiliated parties, such as in transactions involving an aggregator.[15]

B. For CMBS, "Third Party" Review is Not Due Diligence Per Se, and Should Not Trigger Expert Liability

Proposed Rule 193 would also allow the required asset review to be performed by a third party "engaged for purposes of performing the review" provided that the third party is named in the registration statement and consents to being named as an expert in accordance with Rule 436. The Proposing Release requests comment on which entities should be considered a "third party engaged for purposes of performing review."[16]

In the CMBS context, sponsors do not outsource the conduct of due diligence per se. As the Proposing Release recognizes, however, CMBS sponsors do receive reports on discrete issues from accountants and attorneys. For example, accountants may be hired to verify numbers and provide "comfort letters," and attorneys may be asked to provide 10b-5 letters. Based on our members' experience in the industry, we believe it is highly unlikely that the entities providing any of these types of reports would be willing to do so as "experts" subject to liability under Section 11 of the Securities Act. Indeed, we expect the consequence would be consistent with the events that transpired after Dodd-Frank Section 939G went into effect and potentially exposed NRSROs to liability as experts for their credit ratings – NRSROs refused to consent to be named as experts, precluding issuers from disclosing ratings in registration statements, which led to the complete shut-down of the ABS market until the SEC intervened to provide temporary relief from the obligation to include ratings in registration statements.

A rule that would require the assumption of expert liability would create the anomalous result of discouraging, rather than encouraging, disclosure. Moreover, the difficulty of obtaining these professionals' consent to assuming liability as experts would incentivize issuers to avoid the public market completely. Such an outcome would be inconsistent with the Commission's aim to encourage disclosure and increase the efficiency of the public markets. Accordingly, we recommend that the rule

[15] *Id*. at 64184.

[16] *Id.*

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be clarified to provide that consent to being named as an expert would only be required where a sponsor has completely outsourced the conduct of due diligence to one or more third parties. In this way, the appropriate disclosure incentives are created with respect to third parties merely providing reports and information to those sponsors who are taking responsibility for due diligence.

We also seek clarification that Proposed Rule 193 is intended to address reports obtained by *sponsors* from third parties in connection with the preparation of the securitization, and not reports obtained by originators in connection with the origination of the securitized assets. In many CMBS transactions, the sponsor of the securitization is also the originator (or an affiliate of the originator) of the assets being transferred into a securitization. In this context, it would be highly unusual for any extra level of diligence to be performed on the assets themselves in connection with the securitization since the sponsor is intimately familiar with the assets, having previously underwritten those assets via the origination process. In this instance, disclosure of the sponsors' due diligence would merely be a description of its underwriting procedures, which is already required pursuant to Item 1110 of Regulation AB. However, in the course of origination of a mortgage loan, it is common for an originator to involve third-parties in the course of its underwriting due diligence. Those third parties include credit reporting, insurance consultants, property inspectors and appraisers, etc. When these loans are securitized, the material components of this information are collected and made available to investors in Annex A. Therefore, it would be cumbersome and duplicative to require disclosure of originator-level third party reports.[17] Moreover, those who provide reports to mortgage originators are unlikely to consent to liability as experts in connection with these reports. It is our belief that these origination-level reports are not what proposed Rule 193 intends to address. However, some questions about this issue have been raised by our members and therefore, we seek confirmation that proposed Rule 193 is intended to address review of "assets" that are already existing, and not review performed in connection with origination of a securitized asset.

Similar clarification is necessary with regard to proposed Rule 15Ga-2, which would require issuers and underwriters to disclose the findings and conclusions of any report of "a third party engaged for purposes of performing a review of pool assets," to implement Dodd-Frank Act Section 932. As discussed above, CMBS sponsors do not hire third parties to conduct due diligence on underlying assets, so it is unclear whether this proposed rule would require no disclosure, or whether the aim of the rule is for disclosure of any report obtained by a CMBS sponsor in connection with origination of the underlying assets.

C. Clarification is Needed Regarding the "Findings and Conclusions" of an Asset Review

In a related vein, we also seek clarification regarding the "findings and conclusions" of an asset review conducted by a sponsor or third party. The terms "findings and conclusions" are used repeatedly with respect to proposed Rule 193 and Rule 15Ga-2 but are not defined.[18] While the construct described in the Proposing Release may more readily fit the RMBS context or other asset classes where there is an established practice of third parties performing due diligence review of assets, it does not fit as precisely for CMBS.

[17] We also note that disclosure on such a granular level would likely be unworkable in the RMBS context and others involving consumer debt, because the material generated in the originators' underwriting process would contain consumers' personal financial information, which is protected from disclosure by privacy laws.

[18] *E.g.*, *id*. at 64187, 64195.

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As previously discussed, in the CMBS context, the sponsor of the securitization is often also the originator (or an affiliate of the originator) of the assets being transferred into a securitization, and it would be highly unusual for any extra level of diligence to be performed on the assets themselves in connection with the securitization since the sponsor is already familiar with the assets, having previously underwritten them. In this instance, disclosure of the sponsors' due diligence would merely be a description of its underwriting procedures, which is already required pursuant to Item 1110 of Regulation AB, and the material components of third party reports obtained in the origination process which are collected and made available to investors in Annex A. Here again, it would be cumbersome and duplicative to require disclosure of originator-level third party reports. Consequently, in such case, the sponsors' "findings and conclusions" to be disclosed for purposes of proposed Rule 193 and Rule 15G a-2 should be defined as the description of its underwriting procedures (which is already disclosed pursuant to Item 1110 of Regulation AB) and the information disclosed in Annex A.

The Proposing Release seeks specific comment on whether the SEC should require an issuer to disclose all of the findings and conclusions provided to a B-piece buyer for purposes of the disclosure required by the rule.[19] The matter of enhanced disclosure is an issue the industry is actively working on, as evidenced by the CRE Finance Council's effort to update its Annex A. Currently, however, the SEC should be aware that there are some hurdles to public disclosure of reports provided to B-piece buyers. Significantly, the third party reports given to B-piece buyers are subject to confidentiality agreements that make the B-piece buyer liable for disclosure. Public disclosure of this information, would be difficult, as providers of the reports would not consent to their release without a confidentiality agreement in place. Moreover, B-piece buyers receive these reports not as agents of the issuers, but as part of the disclosure the B-piece buyer requires to have sufficient comfort to buy the privately placed securities. Additionally, it is not feasible from a practical perspective for all such information, which is voluminous and may be in several different formats including paper, to be made available in an offering document.

D. Identity of Entity That Decided to Include Exception Loans in the Pool

The Proposing Release seeks comment on the proposal to require disclosure of the identity of the entity that determined that an exception loan would be included in the pool despite not having met disclosed underwriting standards.[20] The Commission should be aware that because of the non-fungible nature of CMBS assets, and the unique structure of CMBS transactions, decisions to include assets in the pool are an iterative process that involve the sponsor, issuer, and at times investors, to largely the same degree. Therefore, decisions about CMBS pool assets are not susceptible to being attributed to a particular party, and such disclosure should not be required for CMBS. We note, however, that CMBS offering documents do presently describe the underwriting criteria employed, as well as an explanation of why the assets in the pool are believed to be consistent with those underwriting criteria, and we believe the disclosure of this information achieves the same ultimate aim as that sought by the Commission's proposal here.

[19] *Id*. at 64189.

[20] *Id*. at 64188.

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E. Signature and Filing of Report

The Proposing Release seeks comment on the signature requirement for Form ABS-15G.[21] The proposal would require forms filed under Rules 15Ga-1 and 15Ga-2 to be signed by "the" senior officer in charge of securitization. We urge the SEC to revise the rule to permit forms to be signed by "a" senior officer in charge of securitization. As acknowledged by the Commission in its Regulation AB Release, CMBS transactions already contain issuer liability as a result of the Chief Executive Officer's signature on the registration statement, for which liability is brought down in each takedown from a shelf, including disclosures included in the prospectus.[22] Therefore, a requirement that forms filed under Rules 15Ga-1 and 15Ga-2 be signed by "the" senior officer in charge of securitization does not add to requirements that already are in place.

V. Conclusion

The CRE Finance Council appreciates the SEC's consideration of our comments regarding issuer review of assets in ABS offerings. We urge the SEC to adopt its current proposal regarding the type and level of asset review, and to provide necessary clarification concerning the party responsible for review, the scope of third party "expert" review, the meaning of "findings and conclusions" to be disclosed, disclosures concerning exceptions to underwriting criteria, and signature requirements for Form ABS-15G. We stand ready to provide any additional assistance that may be helpful.

Respectfully submitted,

John D'Amico
Chief Executive Officer
CRE Finance Council

[21] *Id.* at 64190.

[22] *See* Asset-Backed Securities, Proposed Rule, Release Nos. 33–9117; 34–61858; File No. S7–08–10, 75 Fed. Reg. 23328, 23346 (May 3, 2010).