

5 September 2008

European Commission
DG Markt Services
B-1049 Brussels
Belgium

Re: Proposal for a Regulatory Framework for CRAs and
Embedded Ratings Policy Options

The Commercial Mortgage Securities Association welcomes the opportunity to comment on the Commission's 31 July 2008 consultation paper proposing draft legislation to govern the authorisation, operation, and supervision of Credit Rating Agencies ('CRAs') and (2) policy options to address a perceived overreliance on ratings in EU legislation. We understand the Commission's desire to examine the role of CRAs in the market turmoil and to formulate appropriate responses where justified; however, we have serious reservations about the nature and scope of the proposed measures.

In addition, we have read the separate joint submission ('Joint Submission') of the Securities Industry and Financial Markets Association and European Securitisation Forum on the Commission's two consultation papers proposing (1) draft legislation to govern the authorisation, operation, and supervision of Credit Rating Agencies ('CRAs') and (2) policy options to address a perceived overreliance on ratings in EU legislation. We are in general agreement with their analysis and endorse their conclusions.

General Observations

While we agree that certain credit ratings issued by CRAs played a role in causing the market turmoil that has now lasted over a year, the vast majority of structures not exposed to subprime do continue to perform in line with their ratings. Blanket proposals to address what are seen as issues in certain areas of structured finance do not necessarily justify measures that may do more harm than good to liquidity and orderly markets in other sectors, particularly commercial mortgage backed securities ("CMBS"). We believe that many of the problems identified are best dealt with through increased transparency and improved disclosure.

We believe that regulation of the type and extent contemplated should only be done in consultation with all other constituents involved in the regulation of CRAs and cannot be done in haste without detailed consultation with all sectors of the industry and other interested parties. The consultation period for this proposal has been far too short given the extent of regulation being proposed.

Areas of Particular Concern

Absence of Global Regulatory Coordination: CRAs are global businesses operating in a dynamic global market and require a convergent global regulatory approach. Any proposed regulation would be best done in conjunction with other regulators and global bodies such as IOSCO to provide a harmonised approach. While the draft directive states that its proposal ‘aims to ensure, as far as possible, close alignment with international regulatory standards’, there is little evidence of coordination with other branches of EU government, national regulators, or foreign jurisdictions. None of them has recommended reforms of the nature and scope of what is being proposed.

Intervention in Rating Content: We are very concerned that the current draft legislation appears to give regulatory authorities the power to interfere in ratings decisions. For example, the draft directive would grant substantive powers to the home regulator, and a right of intervention to competent authorities in other states, should they feel their national interests so require. Analytical independence is the core of the rating business and should be explicitly protected. We would refer you to the equivalent US legislation which expressly prohibits the SEC, States and sub-divisions thereof from interference in ratings content and processes.

Interference with CRA Business Matters: The problem of disproportion crops up frequently in provisions that override managerial decisions with rigid formulae or impose amorphous standards. Some of the proposed rules are too specific and would not leave enough room for appropriate business and professional judgment. Other rules would impose vague standards that are not necessarily consistent with existing legal standards and practice, and so would tend to sow confusion about what is required. Many of these measures will, separately or together, increase CRA response time, increase cost, create undue risk aversion, and bring innovation to a standstill in an industry that requires a fresh start and a new outlook if market confidence is to be restored.

Limitation on Rating Activities: Article 13 limits the freedom of CRAs to rate structures that are of such complexity or novelty that ‘serious questions’ arise about the credibility of the rating. It is particularly with complex or novel structures where a rating opinion, an objective credit opinion from a third party, can be of significant value to investors. This provision could in fact operate to decrease – not enhance – investor protection and result in reduced innovation in Europe. It would be much better for the concerns around these situations to be addressed through greater disclosure and transparency.

Hiring, Compensation, and Management Policies: Articles 7, 10, and 11 regulate the entire spectrum of employment matters, including hiring, compensation structures, and analyst assignments. For the most part, we defer to the CRAs themselves to comment in detail on specific provisions. Nevertheless, several provisions strike us as likely to be detrimental to improving the rating process in that they impede the development of skill and experience. In particular, Article 7(2) and Article 10(4) which establish forced rotations will act to sacrifice valuable experience, increase costs, and lower the average level of expertise. There may be a rationale for this type of action in relation to corporate ratings but with securitisations, where each transaction generally involves a new pool of assets, knowledge of other transactions in the market and the overall asset type is key for consistent application of rating principles.

Withdrawal of Existing Ratings: In a number of situations, the draft legislation requires CRAs to withdraw existing ratings. Most of these situations are related to conflicts of interest and novel structures. Withdrawal of an existing rating or the suspension of ratings could trigger sales of securities by those asset managers who are required to hold securities with a particular rating. We believe this would result in a sell-off of structured securities into already illiquid markets that would prolong precisely the type of market instability, loss of confidence, and economic damage to individual investors that the European Commission is seeking to remedy.

Comments on Individual Provisions

Article 9 – Conflicts of Interest; Revenue Concentration – Article 9 directly addresses two sources of potential conflict that are of particular concern. The first deals with conflicts that arise from revenue concentration. In its current form, Article 9(3)(a) creates an irrebuttable presumption that an irresolvable conflict of interest arises on the mere fact that a rated entity (including its related parties) represents 5% or more of CRA revenue, and then requires the CRA to withdraw from the engagement. We do not agree that revenue concentration necessarily indicates a conflict of interest. We believe that any potential for conflicts of interest can be dealt with by internal management within the rating agencies, i.e. by removing any discussion of fees from the purview of those actually involved in setting the ratings, and through disclosure. We would therefore recommend deletion of this Article 9(3)(a), or, in the alternative, replacement with a provision modeled on the IOSCO Code: a disclosure obligation that is triggered at 10%.

Article 9 – Conflicts of Interest; Differentiation between ‘core’ and ‘consultancy’ services – The second source of conflicts that Article 9 addresses arises out of the provision of consultancy services. Article 9(4) prohibits a CRA from engaging in consultancy services and, more important, explicitly forbids analysts to make recommendations on the design of structured finance instruments that the agency intends to rate. Our concern with this provision is that it could inhibit the iterative process that occurs between an issuer, arranger, underwriter, and CRA during the process of rating structured finance securities. Rather than being problematic, this is an important and necessary part of the process. If the process of issuing a rating is to maintain the integrity required to preserve public confidence, open dialogue that benefits all parties should be preserved and managed carefully.

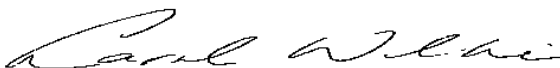
Article 14 – Disclosure and Presentation of Credit Ratings: The CMSA is opposed to any proposal to create an identifier to be applied to ratings of structured finance instruments to differentiate them from other financial instruments. We believe that this proposal will have more negative than positive consequences. First, most investors in structured finance issues are sophisticated institutional investors and are unlikely to gain any new information from an appended identifier. Our discussions with investors indicate that they do not support the introduction of such an identifier. Rather the investors are focused on improved information disclosure and greater transparency in rating agency methodology and process. Second, the addition of an identifier could trigger the type of market disruption described above in the discussion of withdrawn ratings. Third, the identifier proposal raises systems and cost issues.

Articles 15 and 16 – Special and Periodic Disclosure: The CMSA is committed to improved disclosure not only from the rating agencies but in all aspects of the CMBS process; however, we are concerned by the provision that calls for quarterly disclosure of the arrangers, originators, sponsors, or related third parties that have sought ratings on a particular structured finance instrument from more than one CRA. The inference is that there is something wrong with a structure where the opinion of a rating agency has been sought in the structuring phase and then not continued to a final rating. This is not a correct inference to draw and could be very confusing for investors.

Conclusion

We thank the Commission for the opportunity to comment and hope that our comments will prove helpful. We wish to note that this letter has not been reviewed by, and therefore does not necessarily represent the views of, the Credit Rating Agencies that are members of the CMSA.

Sincerely,



Carol Wilkie
Managing Director, CMSA-Europe



Jaymon Jones
Director, Strategic Initiatives