



July 21, 2008

Via Electronic Mail

Jill M. Peterson
Assistant Secretary
Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Rule-comments@sec.gov

**Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations
SEC File No. S7-13-08**

Dear Assistant Secretary Peterson:

The Commercial Mortgage Securities Association (“CMSA”) submits this letter in response to the Security & Exchange Commission’s (“SEC”) request for comment on its “Proposed Rules for Nationally Recognized Statistical Rating Organizations” (“Proposed Rules”) published in the Federal Register on June 25, 2008.¹

CMSA is the global trade organization for commercial real estate capital market finance. The organization’s primary mission is to promote the ongoing strength, liquidity and viability of commercial real estate capital market finance worldwide. Based in New York, with a government relations office in Washington DC as well as a strong presence in Canada, Europe and Japan, CMSA is the collective voice for the entire market, with a diverse global membership of over 400 member firms represented by more than 5,000 individuals who actively engage in commercial real estate capital market finance activities. These members embody the full spectrum of the commercial mortgage-backed securities (“CMBS”) market, including senior executives at the largest banks and investment banks, insurance companies, investors such as money managers and specialty finance companies, servicers, other service providers to the industry, and the rating agencies, including DBRS, Fitch Ratings, Moody’s, Realpoint and Standard

¹ 73 Fed. Reg. 36212-36252 (June 25, 2008).

& Poor's.² CMSA and its members are the leaders in setting standards and maintaining a favorable investing environment for the more than \$900 Billion in outstanding CMBS issuance in the United States, and we submit these comments in an effort to further advance these dual objectives.

In the Proposed Rules, the SEC has proposed 12 specific rule changes that would apply to the practices of Nationally Recognized Statistical Rating Organizations (“NRSROs”) that fall into three broad categories – new rules designed to eliminate NRSRO conflicts of interest; new NRSRO SEC reporting requirements; and a new market disclosure requirement that would apply solely to structured finance products. As a general matter and as explained in more detail in the ensuing comments, CMSA generally is supportive of the proposed new conflict-of-interest and reporting requirements and the comments on those rules generally are limited to requests for clarification.

Three issues, however, are of greater concern. First and foremost, CMSA is greatly troubled by the proposed new structured finance disclosure obligation that would require an NRSRO either to develop a unique structured finance symbology or issue a special report discussing its structured finance underwriting methodology. For the reasons explained below, CMSA and its members – especially its investor members – believe that the imposition of a separate structured finance symbology would be unnecessarily detrimental and is at odds with the markets’ understanding of the underlying purpose of the ratings themselves. CMSA would, however, welcome expanded transparency in the ratings process, and a set of specific recommendations designed to further that objective is included with our comments.

Second, CMSA is concerned that the proposed rule that would require that all information on which an NRSRO relied in making its rating determinations and/or in engaging in surveillance activities must be made publicly available would result in the public disclosure of confidential and proprietary borrower information. This creates a choice of two evils for borrowers – either accept the gross privacy intrusion or forego obtaining securitizable loans – and the many benefits that the availability of such financing has offered historically – in order to avert such public disclosure. Third, CMSA wants to ensure that the new prohibitions on NRSROs that issue credit ratings from making recommendations to the issuer does not bar NRSROs from responding to “what if” questions posed by the issuer during the rating process.

As the SEC makes clear in discussing the basis for the Proposed Rules, the proposals are anchored in concerns that have arisen in the securitized residential loan markets. Because the Proposed Rules would apply with full force to the rating process for commercial mortgage-backed securities (“CMBS”) as well, however, and because CMSA’s comments on the Proposed Rules focus solely on the potential impact on the commercial markets, a basic description and understanding of the commercial space is presented first below. More detailed comments on the Proposed Rules that raise concerns or for which CMSA seeks additional clarification then follows.

² This letter does not necessarily reflect the views of CMSA’s credit rating agency members.

Background

Commercial Mortgage-Backed Securities (CMBS). Like residential mortgaged-backed securities (“RMBS”), commercial mortgage-backed securities are bonds that are collateralized by pools of mortgage loans from which all of the principal and interest paid on those mortgages flows to investors. To create these investment vehicles, mortgage loans of varying dollar amounts, property type, and location are pooled and transferred to a trust. Bonds then are issued backed by the pool of assets held in the trust. Those bonds vary in yield (the amount of return on the bonds), duration (the length of time before the bond is expected to be paid off), and payment priority (the order in which investors are paid a return on their investment).

As described in more detail below, there are several important differences between RMBS and CMBS worth noting at the outset. First – and most obviously – RMBS are secured by residential mortgages and CMBS by commercial mortgages. Second, in contrast to the residential mortgages included in RMBS, the average size of the commercial mortgages included in the CMBS pools was approximately \$13.5 million in 2007, and the average number of commercial mortgages included in those pools was approximately 200 loans. Third, commercial mortgage underwriting – and the ratings based on that underwriting – is solely a function of revenue flows from the leases with third party tenants occupying the commercial properties being mortgaged rather than on the wealth or income attributes of the property owner.

Finally, every CMBS bond structure has a “B-piece;” the B-piece is non-investment grade. Its buyers are independent of any of the originators or sellers in the transaction and they occupy the first loss position – if there is a default of any of the loans in the underlying loan pool, the B-piece buyer absorbs that loss first and the par value of their investment is reduced by the loss. Because of that, B-piece buyers generally do their own independent review and assessment of each and every loan included in the proposed CMBS pool and loans that do not satisfy the B-piece buyers often are removed from the pools prior to the issuance of the bonds.

CMBS has grown from \$232.5 billion outstanding at year-end 2000 to \$410.0 billion at 2004 and, as of March 2008, total CMBS outstanding amounted to \$777.2 billion according the Federal Reserve Flow of Funds report.³ (Figures exclude government sponsored enterprises holdings. As of March 2008, GSE holdings amounted to \$143 billion.) Primary investors in CMBS are investment advisors/money managers, pension funds, banks and insurance companies.⁴

³ Flow of Funds Accounts of the United States, Flows and Outstandings First Quarter 2008. Federal Reserve, Release Z.1, June 5, 2008, Table L.219 (page 94) L. 220 (page 95). Also, Flow of Funds Accounts of the United States, Flows and Outstandings Third Quarter 2005. Federal Reserve, Release Z.1 December 8, 2005.

⁴ Morgan Stanley. Morgan Stanley Research, June 6, 2008, page 8.

Underlying Loans. There are many types of commercial real estate that serve as the collateral for the loan. As of May 2008, office buildings accounted for 27.0 percent of outstanding CMBS, retail properties 25.9 percent, multifamily 17.5 percent and lodging 8.9 percent. Other property types (mixed-use, health care, mobile home parks, self storage and others) make up the remaining 20.7 percent. Mortgaged properties are located in all 50 states with the largest concentrations in California (16.2 percent), New York (15.3 percent), Texas (7.7 percent), Florida (6.6 percent) and Illinois (4.0 percent).⁵ Borrowers of commercial mortgage loans typically are sophisticated and experienced with the lending marketplace and usually are represented by counsel who advise them throughout the lending process.

The Issuer and the Trust – Structuring and Pooling the Loans. The individually negotiated commercial mortgages are the building blocks of the commercial mortgage-backed security, and the “issuer” is the architect. The issuer gathers together the loans that are to be securitized and then defines the classes of bonds that are offered to investors. The issuer typically is an investment or commercial bank that evaluates and aggregates the loans for the CMBS trust and submits summaries of the loans in electronic spreadsheet form and hard copy text to the rating agencies so that their credit characteristics can be evaluated.

For CMBS, a key responsibility of the issuer in structuring the investment vehicle involves aggregating the loans – a process referred to in the industry as “pooling” the loans. In selecting the loans for the pool, the issuer typically strives to diversify the collateral and location to mitigate credit risk for investors. In other cases, the pool contains a more homogenous collection of loans. The purpose of such varied pools is to offer investors a variety of choices along a risk-return spectrum.

The issuer creates a trust to hold the pool of secured commercial mortgage loans and appoints a trustee to hold the loan documents and to oversee the distribution of payments to investors. That trust generally is structured as a statutorily-created holding entity known as a Real Estate Mortgage Investment Conduit (“REMIC”). REMICs were authorized by Congress in the Tax Reform Act of 1986 to allow trusts that satisfy the REMIC requirements to issue multiple classes of securities backed by the trust assets (here, commercial mortgage loans) without any adverse tax consequences to the trust. The REMIC framework enables the trust to hold the loans that are secured by real property without the same level of regulatory, accounting, and economic obstacles that exist in other forms of mortgage-backed securities. REMICs are analogous to limited partnerships or limited liability corporations in that they are created to allow an entity to pass through its income and its liabilities directly to its investor beneficiaries. The REMIC trust itself generally pays no tax on the income generated by the trust assets; instead, taxes are paid only by the individual investor(s) holding the beneficial ownership interest(s) in the REMIC. As a result, the applicable rules require the REMIC to operate as a holding entity for an unchanging (or “static”) pool of loans, except in the case where a loan is in default. If modifications are made to a securitized loan that is not in default, the REMIC runs the risk of being viewed as a business entity rather than a holding entity, and thus may be required, for example, to pay entity-level taxes.

From the pooled loans in the trust, the issuer defines different classes of bonds to be secured by the pool of mortgage loans. The specifications for such classes of bonds and a detailed set of data then are submitted to a rating agency, which in turn assigns risk ratings to each class of bonds.

⁵ CMSA Compendium of Statistics, July 11, 2008, Exhibit 11, page 13 (citing Trepp, LLC database statistics, May 2008).

Rating the Bonds. A rating is an assessment of the likelihood that the cash flows and recoveries from the collateral will be sufficient to pay the requirement of the security. In structured finance, ratings are assigned to an individual security or tranche and not to an issuer. Generally speaking, rating levels depend on expected frequency, severity, and timing of future losses.

There are currently four rating agencies involved in the ratings of CMBS: DBRS, Fitch Ratings, Moody's Investors Service and Standard & Poor's. Typically, CMBS deals are rated by at least two rating agencies. CMBS issuance in 2007 amounted to \$230 billion with Standard & Poor's rating 87.9 percent of the deals (on a dollar basis), Moody's 74.6 percent, Fitch 69.4 percent and DBRS 5.8 percent.⁶

The issuer of a deal determines which of the four rating agencies⁷ will be engaged to rate the issue. The issuer will then sign an engagement letter which outlines the engagement being undertaken by the rating agency and specifies the fees. Loan files containing all relevant data on the CMBS being analyzed are then delivered to the rating agencies that are engaged.

Nearly 90 percent of CMBS are "conduit deals"⁸ and, in 2007, conduits included an average of 200 individual mortgage loans.⁹ The average CMBS deal size in 2007 was \$2.7 billion.¹⁰ Since the mortgages underlying CMBS are not homogeneous assets, rating agencies employ a bottom up approach focusing on analyzing the underlying real estate collateral, including the individual property markets, cash flows and values.

While each rating agency has its own approach to the rating process, there are common elements that all utilize. In analyzing CMBS collateral, rating agencies sample between 40 to 75 percent of the dollar balance of each deal. The extent of the representative sample is based on the number of originators that have contributed loans to the deal, the size of each loan and the overall transaction, and the geographic and property type concentrations included in the transaction.

Analysis for the sampled properties includes:

- Site visits to select properties / Evaluation of the property manager and borrower
 - Approximately 40 to 75 percent of the aggregate pool balance is reviewed based on loan size, geographic location, property type, originator and other factors. Typically, the selected sample includes, among others, the 10 largest loans in the pool.

⁶ Commercial Mortgage Alert, January 18, 2008, p. 12.

⁷ In July 2008, Realpoint was granted NRSRO designation and they intend to rate CMBS.

⁸ A "conduit" transaction is a multi-class securitization. The collateral consists of a pool of senior commercial real estate loans to multiple borrowers, and secured by multiple properties. The loans are fixed rate, generally balloon loans, with original terms ranging from 5 to 30 years. The majority of the loans will be 10 year, fixed rate balloons. Generally, the loans will have also been originated for purposes of securitization, as opposed to a sale of seasoned loans by a portfolio lender.

⁹ Trepp, LLC. (website data runs).

¹⁰ Commercial Mortgage Alert CMBS Database and Commercial Mortgage Securities Association internal data.

- Meetings with on-site leasing / management representative
 - Understanding the manager's plan for the property
 - Management expertise
- Competitive properties analysis conducted
- Evaluation of cash flows/derivation of asset value including:
 - Historical, current and budgeted cash flows to determine sustainable net cash flow for the term of the loan given property cycles
 - Occupancy levels
 - Rental rates
 - Operating expenses
 - Capital expenditures
 - Leasing costs
- Review of third party reports
 - Appraisals
 - Phase I environmental report which identifies any environmental risks on actual property or adjacent sites
 - Structural engineering reports stating the current condition of the property and the resources needed to maintain the condition of the property over the loan term
 - Seismic and weather related studies by engineering companies
 - Determine probable maximum loss for property in event of an earthquake
 - Reviews exposure to weather-related events such as hurricanes and flooding
- Review of mortgage loan documents including:
 - Amortization terms
 - Cash management provisions
 - Transfers of property and borrower ownership interests
 - Restrictions on alterations
 - Insurance requirements
- Review of securitization documents and legal opinions
 - Review of offering materials including prospectus and term sheets
 - Review securitization documents and legal opinions

On a macro level, rating agencies also review current market characteristics, the overall diversity of the CMBS transaction in terms of property type concentration, sponsor concentration, distribution by geographic location and other factors. Although the rating process involves review of a comprehensive list of elements regarding bonds and their collateralizing assets, they are not an opinion on the yield, prepayment risk, market value risk, price volatility or liquidity of an issue.

Subordination Levels. Subordination is a form of credit enhancement that determines the structure of a CMBS transaction in terms of the distribution of the risk of credit loss via the face amount allocated to each rating class. Using a simple two class senior / subordinate structure as an example –

- 1) Class A, the senior class, will receive all cash flow up to the stated scheduled interest and principal payments;
- 2) the subordinate class, Class B, provides credit enhancement to Class A, and

- 3) Class B will absorb 100 percent of losses experienced on the collateral until cumulative losses exceed Class B's principal balance; thereafter Class A will absorb all losses.

The credit enhancement necessary for each tranche is based on a statistical analysis of the characteristics of the loans which are drivers of defaults and losses. Default and loss assumptions are derived from a combination of actual market experience of commercial mortgages that have been securitized for roughly the past 15 years, in addition to studies on insurance company portfolio loans over a longer time frame.

A Fitch Ratings review of actual CMBS loss experience from 1991 to 2006 for issuances that had been rated by Fitch found that the average annual loan default percentage was 0.8 percent with 45 percent of the loans defaulting experiencing a loss, and the loss severity on those loans which experienced a loss amounting to 35 percent. Thus the expected loss amounted to 1.26 percent on the average pool. The greatest losses experienced in commercial mortgage loans came from those originated in 1986 when, over a ten year term of the mortgages, 32 percent of all loans originated that year defaulted with 55 percent liquidated with an average loss severity of 33 percent. Estimated losses overall for that 1986 cohort of loans was approximately 8 percent.¹¹

Each of the major rating agencies employs different methodologies in determining its subordination levels, but generally the recommended credit support for each tranche is a function of the aggregate characteristics of the loans, individually and collectively as a pool, and will depend on the projected losses for each loan. Rating agencies use historical loan performance through cycles to analyze the major drivers of default and loss and use these findings to estimate the weightings of the different variables in their models. In addition to some of the factors described above, the rating process also includes geographic and property type concentrations, available property level reserves, economic conditions, natural disaster risk, the overall diversity of the transaction, and the size of the properties in relation to one another, to determine various loss scenarios by rating class.

For example, for a CMBS deal containing 100 commercial mortgage loans totaling \$1 billion, 40 to 75 percent of the loans by dollar balance are reviewed to determine sustainable cash flows, loan to value ratios and debt service coverage ratios among other data points. Information for those loans not directly analyzed is extrapolated from the results for those loans that were reviewed in the deal.¹² All loans in the deal are then run through simulations to estimate the possible loss scenarios.

Using this information, the AAA portion of a mortgage pool could be modeled to withstand 99.99 percent of all loss scenarios. In this hypothetical example, the average loss severity may be 12.5 percent across all loans. Therefore, for this set of mortgage loans in this particular deal, the subordination level for the AAA-rated class would be set at 12.5 percent to be able to withstand losses in almost all of the

¹¹ Fitch Ratings, "At a Crossroads: A Review of U.S. Bank and Broker Exposure to the Commercial Real Estate Market," May 13, 2008.

¹² The issuer calculation of loan-to-value ratio is the ratio of the principal amount on a mortgage at origination to the current appraised value of the property. Similarly, the debt service coverage ratio (DSCR) is the ratio of a property's net operating income or net operating cash flow to the debt service payments on the loan backed by the property. DSCR is a measure of a mortgaged property's ability to meet monthly debt service payments. The rating agencies each have different methods of determining cash flow but employ their own refinance constants to a cash flow which has been stressed, to arrive at their loan to value and debt service coverage ratios.

modeled scenarios. Or, in this simple \$1 billion deal, \$875 million of AAA bonds and \$125 million in non-AAA classes could be offered thus giving 12.5 percent support to the AAA-rated bonds.

Subordination levels for the other rating categories are established in a similar manner. For example, the A-rated class could be modeled to withstand 97 percent of all loss scenarios, the BBB-rated class at 95 percent, and so on for all the rating categories. If the BBB class in this hypothetical example can withstand losses of 5.0 percent to the pool, bonds rated less than non-investment grade (BB or lower) would account for 5.0 percent of the pool supporting the BBB tranche.

Alternatively, a rating agency may run scenarios to determine subordination levels for a base rating level. Once the subordination level for the base level is determined, the credit enhancement for the remaining classes is scaled up or down based on each rating agency's assumptions.

Reviewing actual data for 2007, junior AAA-rated CMBS carried, on average, 12 percent subordination levels and thus, given the loss studies discussed above, have significant cushion even in a historically severe commercial real estate downturn¹³.

For 2007, average subordination levels were:¹⁴

AAA	AA	A	BBB	BBB-	BB	B
12.0%	10.0%	7.6%	4.3%	3.1%	2.4%	1.6%

B-Piece Investments. Also lending support to the overall credit quality of commercial mortgage-backed securities are CMBS B-piece buyers. "B-piece" investing refers to the purchase of CMBS bonds rated BB+ and lower. In the typical CMBS transaction, these bonds are last to receive interest and principal cash flow and are therefore at the greatest risk in the capital structure. B-piece buyers are essential as they provide another independent fundamental analysis of the credit characteristics of the pool.

Firms involved in the B-piece market typically have significant commercial real estate experience. Because B-piece buyers are at the greatest risk in the capital structure, the firms independently perform in-depth analysis of the real estate underlying mortgages included in a securitization as well as the terms of the mortgages. Their analysis includes similar factors as the rating agencies. The B-piece investors consider rent rolls, occupancy rates, operating expenses, and property management to identify factors which might cause cash flow to change. Market supply and demand are reviewed together with economic factors, which might cause them to vary over time. The investor reviews the estimation of the property's stabilized net cash flow and often generates an independent assessment of a property's terminal value. Various other factors are reviewed including appraisals, property condition reports and environmental surveys.

¹³ DBRS, Fitch Ratings, Standard & Poor's use capital letters for their rating symbols (AAA, BBB) while Moody's Investors Service uses an initial capital letter followed by a lower case letter (Aaa, Baa).

¹⁴ JPMorgan, Commercial Mortgage Alert, Rating Agency Presale Reports. JPMorgan: An Introduction to CMBS.

After this analysis, mortgages deemed more risky may be removed from the pool on request from the B-piece buyer. These “kick-outs” further strengthen the overall quality of the mortgage pool. Based on their projections of the timing and size of defaults and losses on the loans included in the final pools, the B-piece buyers determine the price they are willing to pay for the bonds.

Through the data required to be reported by the CMSA Investor Reporting Package® (“CMSA IRP”) described in more detail below, B-piece buyers monitor the performance of the underlying mortgages in a CMBS transaction after issuance. This detailed loan and pool level information is displayed to investors on the servicer web sites, allowing them to spot trends and identify potential weaknesses in a mortgage prior to loan or bond defaults.¹⁵ CMSA has updated the CMSA IRP reporting criteria on numerous occasions to better address investors’ information needs. Investors also have access to many other sources of information from servicers, research firms like Trepp and Realpoint that accumulate and analyze data, and investment bank research departments, which essentially all CMBS investors utilize at some level to independently evaluate their investments and potential investments in this sector.

Defeasance. In CMBS, most loans have 10-year terms. Defeasance, which is used to mitigate prepayment risk, is a process whereby the mortgage collateral is replaced with qualifying government securities. Under these provisions, those government securities are required to have payment terms sufficient to make scheduled payments on the loan to qualify for the replacement. Defeasance is used as an alternative to prepayment of the loan, the key difference being that in defeasance the loan remains outstanding. For comparison purposes, the cost of the defeasance securities as replacement collateral over the outstanding balance of the loan could be compared to the yield maintenance or prepayment premium where the prepayment option is permitted.

A defeasance thus guarantees that future cash flows will be undisturbed by the substitution, and effectively raises the credit rating on the collateral to the US Government’s credit rating. If a sizable portion of a CMBS transaction becomes defeased, rating upgrades often occur due to the increased certainty of receipt of cash flows and the reduced risk of default and loss. Monthly defeasance volume for conduit CMBS averaged \$1.9 billion for the past 12 months ending May 2008.¹⁶

Thanks in large part to the use of defeasance, US CMBS upgrade/downgrade ratios have been very positive in recent years ranging from 3 to 1 (CMBS tranche upgrades to downgrades) in 2002 to a high of 34 to 1 in 2006.¹⁷ In addition, from the period 1991 to 2007, only 0.26 percent of tranches originally rated as AAA by Fitch were downgraded, but none lower than A. For single-A bonds, 79.8 percent retained their original rating, 19.6 percent were updated to either AAA or AA and only 0.58 percent were downgraded to either BBB or BB.¹⁸

¹⁵ Investing in B-Piece CMBS, The CMBS E-Primer, Commercial Mortgage Securities Association.

¹⁶ Credit Suisse CMBS Market Watch Weekly, June 20, 2008.

¹⁷ Fitch Ratings, “US Life Insurers: Large Commercial Mortgage Exposure Under Control,” April 15, 2008.

¹⁸ Fitch Ratings, “Fitch Ratings 1991-2007 Global Structured Finance Transition Study,” April 18, 2008.

Surveillance. Rating agencies monitor the CMBS transaction throughout the life of the deal. Surveillance ensures that the ratings accurately reflect current credit risk. Much of the information used by rating agencies to monitor deals is specified in the CMSA IRP. The CMSA IRP® is a transparent, standardized set of bond, loan and property level information provided for all commercial mortgage backed securities. It was initially rolled out in 1997 and the current version, 5.0, was implemented on February 1, 2008. The CMSA IRP provides over 350 data fields such as bond level information on interest and principal as well as property level information on current net rentable square feet, tenant data and net cash flows which are updated monthly. Rating agencies are thus able to monitor detailed information for every mortgage loan included in a securitization to identify credit changes that may result in possible upgrades or downgrades of deals. The CMSA IRP has become the model that other securitized asset classes are trying to emulate.

Comments on the Proposed Rules

1. Structured Finance Symbology/Methodology Report

CMSA and its members respectfully disagree with the SEC's proposal requiring NRSROs to differentiate their ratings of structured finance products from other debt vehicles. Specifically, the SEC's proposal would require an NRSRO, for all structured finance products, to undertake one of the following: (1) publish a report each time it issues a credit rating for a structured finance product describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments; or (2) use ratings symbols for structured finance products that differentiate these ratings from the credit ratings for other types of debt securities. We believe that differentiated rating structures will do little to inform investors or to strengthen public confidence in the capital markets.

The credit rating agency methodologies are created based on the principle that like ratings are comparable across asset classes as the underlying assessment is the same regardless of asset class – the likelihood that the bond obligations will be repaid in accordance with their terms. The introduction of a separate rating structure for structured finance products would be inconsistent with this longstanding principle and would create significant confusion for the investors in CMBS and other structured finance markets. Imposing a single differentiated rating scheme or reporting requirement across the entire range of structured finance asset classes – including RMBS, CMBS, securitized student loans, credit card and automobile loans, etc. – would only add to this confusion given the very different risk profiles and underwriting mechanics for each individual asset class.

The imposition of a new, differentiated rating structure also could call into question the ability of many public agencies and state and federally regulated financial institutions to invest in structured finance products at all. Forty-five states and the District of Columbia, along with at least six federal agencies, rely on the current investment rating structure in their regulations and many of those statutes and regulations require that investments be made only in securities that are in the highest or one of the highest investment ratings categories by NRSROs.¹⁹ Under the SEC's proposed differentiation rule, it

¹⁹ See, e.g., COLO. REV. STAT. § 24-75-601.1(b)(II) (prohibiting the investment of any public funds in any security unless the security is rated in its highest rating category by two or more nationally recognized organizations); FLA. STAT. § 215.47(j) (state monies may be invested only in commercial paper of the highest rating as provided for by at least one nationally recognized rating service); GA. CODE. ANN. § 33-11-83 (an insurer may acquire investments in investments pools that invest only in obligations that have an equivalent of a 1 or 2 rating by a nationally recognized statistical rating organization); GA. CODE. ANN. § 47-20-83 (Georgia Municipal Employees Benefit System may

would not be clear whether the differentiated ratings satisfy these investment requirements, potentially creating more confusion, imposing widespread costs to modify and update the statutory and regulatory requirements, and completely eliminating any liquidity in the CMBS markets for the foreseeable future as the structured finance markets likely would be brought to a standstill for what could be a very prolonged transitional period.

Moreover, even investors not subject to such statutory and regulatory investment constraints still would be forced to revise their investment policies to incorporate this new rating structure, to develop new analytical and monitoring infrastructure to interpret the new ratings, and to determine whether they need to have a specific investment allocation for each asset class. This also would add significant cost and further erode liquidity.

If the new reporting requirement to “describe how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of instruments such as corporate and municipal debt” is maintained, the SEC should clarify that such reports must be tailored for each structured finance asset class to make such reports meaningful. Investors, issuers and other CMBS market participants also would welcome the SEC’s expanding this reporting requirement to require NRSRO issuance of additional analysis about the specific risk characteristics of the bond loan pool being rated, as well as additional and targeted transparency related to the underlying rating methodology that is being employed in determining that specific rating assessment. Although the rating agencies that serve the CMBS markets do provide a wealth of valuable information, CMSA believes that the following expanded NRSRO transparency recommendations – which are intended to build on rather than replace information that currently is being provided – would benefit the investor community the ratings are intended to serve:

invest in securities provided they are listed as investment grade by a nationally recognized rating agency); HAW. REV. STAT. § 412:5-305(e) (banks may invest only in investment grade securities, which include those rated within the four highest grades by any nationally-recognized rating service); IDAHO CODE. ANN. § 67-6409(m)(4) (granting State Building Authority the right to invest in commercial paper rated in the highest category by a nationally recognized rating service); 205 ILL. COMP. STAT. 305/59 (2007) (a credit union’s investments in municipal securities must be limited to securities rated in one of the 4 highest rating categories by a nationally recognized statistical rating organization); KY. REV. STAT. ANN. § 304.7-407 (an insurer may acquire investments only in investment pools that invest only in obligations that have an equivalent of a 1 or 2 rating); TEX. GOV’T CODE ANN. § 404.024(b)(8) (state funds shall be invested only in obligations that have received the highest rating categories by a nationally recognized rating organization); UTAH CODE ANN. § 7-7-28(14) (associations may invest in securities rated in the top four ratings of a nationally recognized rating service); 12 C.F.R. §§ 1.2 & 1.3 (for national banks, imposing investment rules that vary depending on whether a security is “investment grade” (meaning that “a security that is rated in one of the four highest rating categories”)); no limitations are put on the purchase of investment grade securities ranked in the top two rating categories); 12 C.F.R. § 704.6 (2008) (prohibiting credit unions from investing in securities that, at the time of purchase, must be rated no lower than AA- for investments with long-term ratings and must be rated no lower than A-1 for investments with short-term ratings); 12 C.F.R. § 560.40 (2008) (for thrifts, investments in corporate debt securities must be rated in one of the four highest categories by a nationally recognized investment ratings service); 29 C.F.R. § 2520.103-11 (2007) (pension fund assets held for investment purposes shall include commercial paper with a maturity of not more than nine months if it is ranked in the highest rating category by at least two nationally recognized statistical rating services).

- *Methodology.* Publish and update on an as-needed basis –
 - The NRSRO Policies and Procedures related to CMBS valuations that are more specific than currently published;
 - A clear guide to the NRSRO’s model methodology, including specific guidance regarding the weighting of various inputs;
 - When the NRSRO’s model CMBS methodology is modified or updated, an explanation of the impact of that modification or update on existing deal ratings, if any; and
 - An explanation of the NRSRO’s internal committee processes, including any modifications to your governance procedures that have recently been, or will be, instituted.

- *Pre-Sale Reports.* The NRSROs should be required to end any editorial comments and adopt a standard pre-sale report template. This template could change over time but should include items such as –
 - Reference to published documents with the NRSRO’s latest methodology which should be accessible on its website;
 - A discussion of at least the largest 10 loans in the deal with an explanation of the underwriting assumptions for those loans and an outline of any assumptions in performance, both positive and negative;
 - A more specific and extended discussion of the strengths and concerns relating to the issuance and any specific loan in the pool in the Strengths and Concerns section of the Pre-Sale (for example, is it a strength if 1% of a deal is shadow rated or is it a concern if 22% of the pool is office properties?);
 - A conduit analysis that compares the proposed transaction to the average rated deal over a rolling timeframe; and
 - A detailed discussion of the NRSRO’s underwriting and valuation assumptions (e.g., cap rate, vacancy, base rent).

- *Surveillance Press Releases.* CMSA acknowledges that the NRSROs that rate CMBS typically provide a standard press release but CMSA believes that frequent communication is more important now than ever before. We suggest that all NRSROs be required to adopt a standard surveillance press release that would include, among other items, a discussion of why a deal was upgraded or downgraded; the current percentage of loans (by balance) that have defeased; any loss estimates; any weakness in the largest 10 loans; information on the “shadow rated” loans included in the deal, including the current rating for each in order to compare ratings with those in the pre-sale report; and an explanation of the impact, if any, of changes in the “shadow rated” loans ratings on the deal ratings, particularly when the shadow rated loan ratings fall from investment grade to below investment grade.

Ultimately, CMSA believes that new and targeted disclosure will benefit all of the CMBS market participants and that such enhanced transparency would be far preferable to the imposition of an arbitrary and potentially misleading differentiated rating scheme for structured finance products.

2. Information Provided To and Relied Upon By An NRSRO Must Be Made Publicly Available

The initial proposed rule in the SEC proposal is designed to enable credit rating agencies other than the one(s) retained by the issuer to rate a bond issuance to provide their own fully-informed rating. The proposal would require NRSROs – either directly or through the information provider – to disclose any information provided by issuers, underwriters, sponsors, depositors or trustees upon which the NRSRO relied in issuing a rating and/or in engaging in surveillance activities. CMSA has three comments on this proposal.

First, CMSA has no objection to the introduction of a procedure that would permit this type of secondary rating. It is important to note, however, that – at least with respect to CMBS – any potential benefits of this type of secondary rating process would probably be marginal at best given the additional layer of accountability that CMBS B-piece buyers already bring to the ratings process in this sector.

Second, if this requirement is maintained, the list of potential information providers encompassed by the rule should be expanded to include master and/or special servicers. In the CMBS markets, servicers are the primary providers of information during the surveillance process and their omission would undermine the ability of non-retained rating agencies to engage in surveillance activities as envisioned by the Proposed Rules.

Third, while CMSA has no objection to empowering non-retained rating agencies to engage in these ratings and surveillance activities, we are concerned that mandating that all of the relied upon information be made public will result in the disclosure of confidential and proprietary borrower information. Rating agencies are, for example, provided with access to a wide array of confidential and proprietary borrower information such as rent rolls for mortgaged properties, borrower net worth, detailed financial breakdown of sales and expenses for the property, and sales by tenant information. If such disclosure is mandated, borrowers will be left with an unappealing choice – either permit their business’ (and their tenants’) confidential and proprietary information to be disclosed (putting them at a potential competitive disadvantage in the marketplace) or decline to take advantage of the many economic advantages of borrowing through a securitized loan vehicle. CMSA can identify no public policy benefit to mandating such public disclosure and we urge the SEC to ensure that no such disclosure of confidential and proprietary information is mandated by or consequently results from its final rules.

3. NRSRO Recommendations Related To Rated Issuances

The second proposed rule would provide that NRSROs are prohibited from making “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” if the NRSRO also is rating that security. In its commentary on the proposed rule, the SEC attempts to clarify that NRSROs would continue to be permitted to explain why they issued a specific rating determination and the issuer can make adjustments based on that information but NRSROs would be precluded from making any affirmative suggestions regarding how the proposed rating could be modified. The SEC specifically asked whether the conflict it perceives between providing structuring advice and rating an issuance that was structured based on such advice could be addressed through a disclosure regime instead, and whether the SEC should provide more specificity on the line between feedback and recommendations.

CMSA generally is supportive of this separation requirement and notes that the practice of all of the NRSROs currently operating in the CMBS space is to not provide recommendations in the rating context. The NRSROs either have formalized this practice in their codes of conduct or are in the course of doing so.²⁰ CMSA requests, however, that the SEC specifically clarify in its final rules that NRSROs would remain permitted to respond to issuer inquiries during the rating process regarding the potential impact that different changes could have on the final ratings profile. For example, and as noted above, CMBS issuances are collateralized by loan pools that contain an average of approximately 200 loans. Issuers have an enormous degree of latitude in deciding which loans to include in a specific asset pool. The inclusion or exclusion of specific loans can have a significant impact on the rating process and issuers want and need to be able to discuss those potential impacts with the rating agencies during the course of that rating process. We suggest that the SEC clarify that responding to such inquiries during the rating process would not run afoul of the recommendation prohibition provided that the NRSRO is merely responding to a specific inquiry and not offering its own advice on how to structure a product to achieve a targeted rating.

4. Other Issues

As noted at the outset, CMSA generally either is supportive of or neutral on the balance of the Proposed Rules under consideration. CMSA would, however, offer the following more minor comments on three of the specific proposals.

a. Fee Discussions

The Proposed Rules include a new prohibition that would prevent NRSRO employees who participate in determining credit ratings or who participate in the development or approval of credit rating methodologies used to determine credit ratings from negotiating rating or surveillance fees. In proposing this rule, the SEC has asked whether this prohibition should be extended to include NRSRO

²⁰ See, e.g., DBRS Code of Conduct, *available at*

<http://www.dbrs.com/intnlweb/openpdf?fileName=21496902719350.pdf&docid=214969>;

Fitch Ratings Code of Conduct, *available at*

http://www.fitchratings.com/web_content/credit_policy/code_of_conduct.pdf

Moody's Code of Conduct, *available at* –

www.moody.com/cust/research/MDCdocs/01/2003400000425277.pdf

Standard and Poor's Code of Conduct, *available at* –

www.standardandpoors.com/spf/pdf/fixedincome/SP_RatingsServicesCodeOfConduct_June2007.pdf

See also United Nations Conference on Trade and Development, Credit Rating Agencies and Their Potential Impact on Developing Countries, No. 186, January 2008 (noting that in response to the International Organization of Securities Commission's ("IOSCO") Code of Professional Conduct, DBRS, Fitch Ratings, Moody's and Standard and Poor's published their own Code of Professional Conduct in the second half of 2005, thereby aligning their policies and procedures with IOSCO's Code.).

personnel with supervisory authority over the personnel that currently are the focus of the proposed fee negotiation prohibition.

In general, CMSA supports this proposed rule. CMSA recommends however, that the SEC not extend the fee negotiation separation requirement to cover supervisory personnel. CMSA believes that the participation of supervisory personnel in the fee discussions does not create a conflict because such individuals do not participate in the actual rating of any particular issuance, nor do they sit on the rating committees that are responsible for finalizing the ratings and the underlying rating methodologies. Moreover, as a practical matter, barring such supervisory personnel from negotiating the fee arrangements might mean that no one in the CMBS division of the rating agency would be involved with the business arrangements which could undermine the integrity of those arrangements over time.

b. Record of Rating Agency Actions

The Proposed Rules also include a requirement that all NRSRO actions related to a security be indexed into a log-like document that must be updated on the NRSRO's website within 6 months of the last rating action for that security. The proposal also would require that this log be made available in XBRL format.

Although CMSA has no objection to this new requirement, we want to ensure that it is in addition to and not in lieu of the current posting of rating actions done by the NRSROs that serve the CMBS markets. Rating actions currently are available and easily accessible on the NRSRO websites for CMBS investors and it is critical that the implementation of any new rating log requirement not disrupt access to those materials.

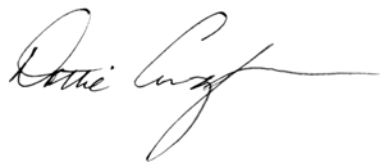
c. Record of Material Deviation From Model Output

The Proposed Rules also would require that any ratings that materially deviate from the rating implied by the NRSRO's model would need to be documented and explained. Although this type of rule may fit the RMBS rating process, it belies the realities of CMBS and its rating process. CMBS and commercial capital finance does not lend itself as easily to simple model underwriting formulas. For that reason, CMSA believes that the most useful additional transparency would be in accordance with the expanded NRSRO disclosures recommended above.

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CMSA appreciates the opportunity to comment on the SEC's Proposed Rules.

Sincerely,



Dottie Cunningham
Chief Executive Officer
Commercial Mortgage Securities Association