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TO: Commercial Real Estate Finance  
Council

FROM: Scott A. Sinder  
Rhonda M. Bolton

RE: Amendment

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You have asked for a summary of an amendment to the Senate's financial regulatory reform bill offered by Senator Al Franken (D-MN) and passed yesterday by a vote of 64 to 35. The amendment (SA 3991) would create a new independent board that would assign credit rating agencies (CRAs) to conduct initial ratings of structured finance products, eliminating the current practice of issuers directly retaining CRAs to conduct an initial rating. The stated purpose of the amendment is to address conflicts of interest between CRAs and issuers, and the perceived problem of an issuer "shopping around" for a CRA that will give it the best score.

In terms of specifics, the amendment would direct the SEC to set up a special "Credit Rating Agency Board," a self-regulatory agency with jurisdiction over credit rating of structured finance products, which would have the power to select nationally recognized statistical rating organizations (NRSROs) "qualified" to rate these products by product category.

The number of Board members is to be determined by the SEC and Board members are to be “selected from the industry,” with a majority of the members being “representative of the investor industry who do not represent issuers,” at least one member each representing the issuer industry and CRAs, and one “independent” member.

Issuers desiring an initial rating would be required to go to the Board, which would then select one of the Board-qualified NRSROs to do the rating. The selection could be done randomly or on a rotating basis, as the Board deems appropriate. Senate Banking Committee Chairman Chris Dodd has criticized this aspect of the amendment in particular, noting that different CRAs have different abilities and that assigning those doing the ratings randomly may be an imperfect solution to concerns about ratings shopping and conflicts of interest.

An issuer could still seek other ratings, but any public communications the issuer makes about the security must indicate whether a rating was done by a Board-qualified NRSRO or by another CRA. Ratings done independently by other CRAs will also be permitted, so long as such CRAs are not retained or paid by the issuer to do the rating. The amendment does not address what would happen if an issuer disagrees with a Board-qualified NRSRO’s rating; at a minimum, however, it appears this new process would increase costs if an issuer feels compelled to seek one or more additional ratings.

The Board is authorized, but not required, to determine what compensation is “reasonable” for issuers to pay for a qualified NRSRO to do a rating. The Board is also authorized to levy fees on qualified NRSROs to fund the Board’s operation.

Qualified NRSROs will be subject to annual evaluation by the Board, based in part on the accuracy of the ratings they issue. The Board is also directed to do a study of “the securitization and rating process” and provide recommendations to the SEC. Finally, the SEC is directed to

make a recommendation to Congress after five years regarding the continuation or modification of the Board.

Having been approved by the Senate, this amendment is now part of the Senate's version of the financial regulatory reform bill. The fate of the amendment will now be determined as part of the process of reconciling the Senate's version with the House version of the legislation, in conference.