September 5, 2008

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

Re: (1) Reference to Ratings of Nationally Recognized Statistical Rating Organizations, File Number S7-17-08
(2) Security Ratings, File Number S7-18-08
(3) Reference to Ratings of Nationally Recognized Statistical Rating Organizations, File Number S7-19-08

Dear Assistant Secretary Peterson:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on the above-referenced proposed rules (Proposals)[2] issued for comment by the Securities and Exchange Commission (SEC) addressing the use of security ratings (ratings) in the SEC's rules and forms by nationally recognized statistical rating organizations (NRSRO). In the Proposals, the SEC proposes to amend various rules and forms as they relate to NRSROs in the Securities Act of 1933, the Securities Exchange Act of 1934, Investment Company Act of 1940, and the Investment Advisors Act of 1940. This action is being proposed due to SEC concerns that references to NRSRO ratings in SEC rules and forms may have contributed to undue reliance on these ratings by market participants during the recent downturn in the subprime credit market. Although we commend the SEC for undertaking this important effort, MBA recommends that the SEC withdraw the Proposals from active consideration until such time that the SEC has

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[1] **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 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. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.**

[2] 73 Fed. Reg 134; 40088-40106 (July 11, 2008); 73 Fed. Reg 134; 40106-40124 (July 11, 2008); 73 Fed. Reg 134; 40124-40142 (July 11, 2008).

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coordinated with other regulatory agencies to prevent the Proposals from conflicting with existing or proposed regulations of other financial service industries.

Recommendation

The SEC should carefully coordinate the Proposals with domestic and international banking and insurance regulatory agencies to ensure that the SEC's Proposals will not have a deleterious impact on other industries that have regulatory requirements that specify reliance on NRSRO ratings.[3] Accordingly, all of the regulatory agencies that have regulations that specify reliance on NRSRO ratings should reach consensus regarding the appropriate role for NRSRO ratings in their respective regulations. This will allow existing rules, regulations, and policies to be modified through a joint rule making process that will ensure that various regulatory agencies do not have inconsistent or even conflicting rules and regulations regarding NRSRO ratings reliance. Such a process would allow changes to NRSRO ratings reliance to be considered and implemented consistently and concurrently by all of the federal regulatory agencies. This interagency consensus-seeking process is not apparent in the Proposals.

Background

The Proposals were developed to address recent capital market events. Beginning in 2007, the dramatic increase in delinquency and foreclosure rates for subprime mortgage loans in the United States created turmoil in the markets for residential mortgage-backed securities (RMBS) backed by such loans and collateralized debt obligations linked to such securities. This turmoil rapidly spread into the commercial mortgage-backed securities market (CMBS), when the sharp drop-off in investor and borrower demand curtailed the amount of CMBS issuance despite the strong performance of commercial and multifamily mortgages. As the performance of subprime securities continued to deteriorate, their credit ratings were downgraded by the NRSROs most active in rating them. The NRSROs' performance in rating these structured finance products raised questions regarding the accuracy of their credit ratings as well as the integrity of the ratings process as a whole. However, such questions were not raised for other categories of structured securities, including CMBS and asset-backed securities (ABS) whose ratings were primarily stable or improving over this timeframe.

MBA has been actively engaged with the SEC throughout its extensive review process of NRSRO ratings. The Proposals represent the third and final set of SEC proposed rules. Prior to the Proposals, on June 16, 2008, the SEC published for notice and

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[3] Federal agencies with regulatory or federal funds interest rate policy authority for financial institutions include: the SEC, Commodities Futures Trading Commission (CFTC), Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). The insurance industry is regulated at the state level by state insurance regulatory agencies.

comment two rulemaking initiatives.[4] The first initiative proposed additional requirements for NRSROs that were intended by the SEC to reduce conflicts of interest in the credit rating process, foster competition and comparability among credit rating agencies, and increase transparency related to the credit rating process. The second initiative was intended by the SEC to improve investor understanding of the risk characteristics of structured finance products. MBA strongly opposed the proposed requirement for structured securities to have a unique identifier or a supplemental explanatory report detailing the risk characteristics of structured securities. However, MBA is generally supportive of efforts to increase ratings transparency.

On July 11, 2008, the SEC released for notice and comment three proposed rules which comprise the Proposals. The Proposals set forth the results of the SEC's review of the requirements within its rules and forms that rely on credit ratings by an NRSRO. The SEC is considering whether the inclusion of requirements related to ratings in its rules and forms has, in effect, placed an ''official seal of approval'' on ratings that could adversely affect the quality of due diligence and investment analysis. The SEC intends for the Proposals to reduce undue reliance on credit ratings and result in improvements in the analysis that underlies investment decisions. This is accomplished by modifying or eliminating the requirements for NRSRO ratings that would be used to determine issuer eligibility for certain SEC forms and rules.

SEC Rule and Form Evaluation Changes

The SEC performed a comprehensive review of 44 of its rules and forms with references to credit ratings and recommended changes to 38 of them. Specifically, the SEC recommended the elimination of any reference to credit ratings in 11 rules and forms. The SEC recommended the substitution of a standard based on a clearly stated regulatory purpose or other concept in 27 rules and forms. Finally, the SEC recommended leaving the reference unchanged in 6 rules and forms.

The Proposals reflect a fundamental policy shift that involves the reliance on NRSRO ratings to determine the eligibility of issuers to utilize certain forms and rules to a framework of alternative methods for determining this eligibility. Because the number of proposed rule and form changes contained in the Proposals are too numerous to comprehensively address on an individual basis, presented below are illustrative examples of proposed rule and form changes that demonstrate this policy shift:

- **Form S-3 Eligibility for Offerings of Asset-Backed Securities (ABS)**
  Existing Rule: Investment grade (AAA, AA, A, BBB) securities that meet certain other conditions are eligible for Form S-3.
  Proposed Rule: Eliminates references to investment grade and changes Form S-3 eligibility requirements to address the following: (1) initial sales and subsequent resales are made in denominations of $250,000; (2) initial sales are

[4] 73 Fed. Reg. 123; 36212-36252 (June 25, 2008).

only made to qualified institutional buyers (as defined by Rule 144A(a)(1); and, (3) delinquent assets don't comprise more than 20 percent of the asset pool.
Analysis: This proposed form change indicates a shift from an NRSRO rating-based approach to determine Form S-3 eligibility to a volume-based factor, the sophistication of the purchaser, and the quality of the asset pool.

- **Form S-3 Primary Offering of Non-convertible Securities**
  Existing Rule: One transaction requirement permits registrants to register primary offerings of non-convertible securities if they are rated investment grade by at least one NRSRO.
  Proposed Rule: Instructions in the form would no longer refer to NRSRO ratings as a transaction requirement. Instead, the form would be available to register non-convertible securities if the issuer has issued more than $1 billion in non-convertible securities, other than common equity, over the past three years.
  ***Analysis*:** This proposed form change indicates a shift from an NRSRO rating-based approach to determine Form S-3 eligibility to large issuers of convertible securities. This will raise concerns by small issuers who will no longer be eligible for Form S-3.

- **Rule 2a-7 Operation of Money Market Funds**
  Existing Rule: Limits money market funds portfolio investments to securities that have received an NRSRO rating in one of the two highest short-term rating categories or comparable unrated securities.
  ***Proposed Rule**: Eliminates the requirement for NRSRO ratings to determine the purchase eligibility for portfolio investments and requires that the money market fund's board of directors determine that each portfolio investment presents minimum credit risk and verify that the security is a "First Tier Security" or "Second Tier Security" for the purposes of the rule. The board could then rely on its internal analysis or that of an outside source, including an NRSRO rating, if it determines the rating to be credible, to make the determination if the security was in the First or Second Tier.
  Analysis: This proposed rule modification requires the management of money market funds to make their own determination relating to the credibility of the NRSRO ratings and if they should be used in the analysis process for identifying First and Second Tier Securities. This requires management to affirm an NRSRO rating versus using it as a qualification test.

Reports from Domestic and International Regulatory Coordination Bodies

In the Proposals, the SEC indicated that its proposed rule and form changes address recent recommendations pertaining to reliance on NRSRO ratings in regulatory agency rules and regulations that were published in reports by the President's Working Group on Financial Markets (PWG), the Financial Stability Forum (FSF), and the Technical

Committee of the International Organization of Securities Commissions (IOSCO).[5] The PWG is an intergovernmental coordination body consisting of the Department of Treasury, Board of Governors of the Federal Reserve System, Securities and Exchange Commission, and the Commodity Futures Trading Commission. The FSF is an international regulatory agency coordination body that promotes international financial stability. Finally, IOSCO is an international coordination body for regulatory agencies responsible for security's regulations.

Neither of the IOSCO reports addressed the role that the reliance on NRSRO ratings should play in regulations. However, the PWG report indicated that "Regulators should review the current use of ratings in regulation and supervisory rules".[6] In addition, the report also recommends, "The PWG member agencies will reinforce steps taken by the CRAs through revisions to supervisory policy and regulation, including regulatory capital requirements that use ratings".[7]

In its report, FSF provides the following recommendations:[8]

> Authorities should check that the roles that they have assigned to rating in regulations and supervisory rules are consistent with the objectives of having investors make independent judgment of risks and perform their own due diligence, and that they do not induce uncritical reliance on credit ratings as a substitute for that independent evaluation….Authorities are aware, however, that credit ratings play an important role in investment and risk management frameworks. The transitional implications of any changes to regulations and supervisory rules should thus be carefully considered.

MBA strongly agrees that the "transitional implications" of any proposed changes to the regulatory framework related to how NRSRO ratings are addressed by regulatory agencies are a vital concern. However, these transitional implications are not limited to just the industry that the regulatory agency supervises.

MBA notes that one topic that was not addressed in all of the reports is the interagency coordination efforts for developing a consistent and uniform policy for how all domestic regulatory agencies and international regulatory agency coordination bodies address the reliance on NRSRO ratings in their respective regulations. While two of the reports

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[5] These organizations issued the following reports: (1) *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*, Financial Stability Forum, April 7, 2008; (2) *The Role of Credit Rating Agencies in Structured Finance Markets*, Technical Committee of the International Organization of Security Commissioners, May 2008; (3) *Report of the Task Force on the Subprime Crises,* Technical Committee of the International Organization of Security Commissioners, May 2008; and, (4*) Policy Statement on Financial Market Developments*, The Presidents Working Group on Financial Markets, March 2008.

[6] *Policy Statement on Financial Market Developments*, The President's Working Group on Financial Markets, March 2008, page 6.

[7] *Policy Statement on Financial Market Developments*, The President's Working Group on Financial Markets, March 2008, page 15.

[8] *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*, Financial Stability Forum, April 7, 2008, pp 38-39.

recommend that each agency on an individual basis review its regulations regarding NRSRO ratings, the reports do not address the larger issue of regulatory agency coordination efforts. Consequently, even if the regulatory agencies perform this internal review, without interagency coordination, the policies that different regulatory agencies develop regarding the reliance on NRSRO ratings could potentially lead to inconsistent or even conflicting rule making. As will be further examined in the "Conflicting Regulatory Proposals Regarding Reliance on NRSRO Ratings" section of this letter, this is a realistic concern.

A project that is underway by the FSF is a "stocktaking" initiative involving the compilation by each member organization of its uses of ratings in their regulation of the banking, securities, and insurance sectors. Participating countries anticipate finalizing their submittals by year-end 2009. FSF has not established a publication date for the results of this effort. However, the status of the stocktaking initiative indicates that the SEC could have not taken into consideration the impacts of the Proposals on other industries when it developed the Proposals. By not viewing the impacts holistically, potential conflicts with existing and proposed rules issued by regulatory agencies of other financial service industries could not have been considered when developing the Proposals. Such potential regulatory conflicts will require the already fragile capital markets to digest an additional uncertainty.

Intertwined Financial Services Industries

It is important that the regulatory agencies for different industries closely coordinate policy regarding NRSRO ratings reliance in their respective regulations. The reason for close coordination in policy creation can be best understood by examining the evolution of the products and services offered by financial services companies. Over the years, participants in the banking, insurance, and securities industries have evolved from monoline businesses and have adopted an interconnected business model. This level of interdependency has only increased as organizations in these three industries have effectively crossed territorial boundaries and offered products in these other industries. For example, some life insurance companies are now issuing CMBS backed by loans that they originate, which places them in both the insurance and securities industries.

Most importantly, as recent events have indicated, instability in one industry either domestically or internationally, drives instability in other industries. For example, the residential subprime crises quickly impacted prime residential lending; reduced investor demand for residential and commercial-mortgage-backed securities; spawned a worldwide pullback in capital availability for all industries, which was a contributing factor to the stock market decline. In fact, this interconnectivity was recognized by

Treasury Secretary Paulson as the reason for initiating a major regulatory reform effort. When introducing the *Blueprint for Regulatory Reform*, Secretary Paulson stated: [9]

> Our current regulatory structure was not built to address the modern financial system with its diversity of market participants, innovation, complexity of financial instruments, convergence of financial intermediaries and trading platforms, global integration and interconnectedness among financial institutions, investors and markets. Moreover, our financial services companies are becoming larger, more complex and more difficult to manage.

Conflicting Regulatory Proposals Regarding Reliance on NRSRO Ratings

On July 29, 2008, the federal banking regulatory agencies[10] issued a joint notice of rulemaking for the *Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Approach* (RBC Proposal).[11] The RBC Proposal was based upon the *International Convergence on Capital Measurement and Capital Standards: A Revised Framework (New Accord)* released by the Basel Committee on Banking Supervision. The RBC Proposal would be available on an optional basis to banks, bank holding companies and savings associations that apply the general RBC rules. The RBC Proposal generally follows the New Accord proposal and is intended to harmonize RBC rules for participating countries.[12] The RBC Proposal continues the banking regulatory agencies' existing practice of allowing external ratings to be used to establish risk weights. The RBC Proposal permits a banking organization to use external ratings to determine risk weights for a broad range of exposures, including sovereign, bank, corporate and securitization exposures.

The RBC Proposal recognizes the benefits and limitations of ratings in the following statement:[13]

> While the agencies believe that the uses of ratings proposed in the NPR (RBC Proposal) can contribute to a more risk-sensitive framework, they are aware of the limitations associated with using credit ratings for risk-based capital purposes and thus, are particularly interested in comment on the use of such ratings for those purposes.

While the banking regulatory agencies recognize the potential limitations of ratings for assigning RBC, their proposed position of continued reliance on external ratings for assigning RBC is remarkably different from the position taken by the SEC to reduce

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[9] Remarks by Secretary Henry M. Paulson, Jr. on *Blueprint for Regulatory Reform*, March 31, 2008, document - hp-897, (http://www.treas.gov/press/releases/hp897.htm).
[10] Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Department of Treasury - Office of Thrift Supervision (OTS),
[11] 73 Fed. Reg 146; 43982-44060 (July 29, 2008).
[12] The most notable departure of the RBC Proposal from the New Accord is that RBC weights for residential loans are stratified by loan to sales price percentages.
[13] 73 Fed. Reg 146; 43982-44060 (July 29, 2008), p. 43985.

reliance on NRSRO ratings in its rules and regulations. These contradictory approaches, create the potential for the SEC and the banking regulatory agencies to promulgate final rules that are inconsistent or even contradictory in their approaches regarding reliance on ratings. Because the RBC Proposal is based upon the New Accord, a departure from the reliance on external ratings would represent a significant shift from the international RBC framework that the banking regulatory agencies are considering adopting and have been promoting for years.

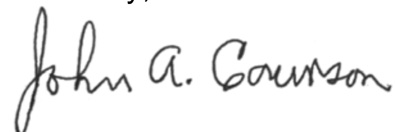
Conclusion

MBA believes NRSROs and their ratings methodologies must be held to exacting standards and endorses efforts to increase transparency, reduce misrepresentations, improve investor access to underlying mortgage pool characteristics and securities' performance data, and reduce potential conflicts of interest among rating agencies and others in the industry.

However, in the Proposals, the SEC is proposing significant and substantive changes to its rules and forms that have the potential for widespread market impacts. Given these potential impacts, the SEC's consideration of such changes should be postponed until the securities, banking, and insurance regulatory agencies have teamed to develop a coordinated, consistent, and comprehensive regulatory framework for the reliance on NRSRO ratings.[14]

Please contact George Green, Associate Vice President of Commercial/Multifamily Policy to further engage MBA on these issues. Mr. Green can be reached by phone at (202) 557-2840 or email at ggreen@mortgagebankers.org.

Sincerely,



John A. Courson
Chief Operating Officer

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[14] The banking and securities industries are primarily regulated at the federal level. The insurance industry is primarily regulated at the state level through state insurance regulatory agencies. However, federal securities and banking regulatory agencies have a long history of close cooperation with the National Association of Insurance Commissioners (NAIC). NAIC's membership includes state insurance commissioners and their staff that comprise Committees and Working Groups that develop Model Bulletins which serve as consensus insurance regulatory templates that are widely adopted by state insurance regulatory commissions. Consequently, federal regulatory agency staff could effectively coordinate with the NAIC policy development for NRSRO ratings reliance in regulations that each organization addresses.