CRE Finance Council
WHERE CAPITAL AND IDEAS MEET

February 7, 2011

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

Re: Credit Rating Standardization Study, File Number 4-622

Dear Ms. Murphy:

On behalf of the Commercial Real Estate ("CRE") Finance Council, we appreciate the opportunity to provide comments to inform the Commission's study, pursuant to §939(h) of the Dodd-Frank Wall Street Consumer Protection Act of 2010, of the feasibility and desirability of standardizing several aspects of the credit rating process, including credit ratings terminology, the market stress conditions under which ratings are evaluated, and the correspondence of ratings to a range of default probabilities and expected losses, in addition to studying whether to require a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress.[1] The CRE Finance Council is the collective voice of the entire $3.5 trillion commercial real estate finance market, including portfolio, multifamily, and commercial mortgage-backed securities ("CMBS") lenders; issuers of CMBS; loan and bond investors such as insurance companies, pension funds and money managers; servicers; rating agencies; accounting firms; law firms; and other service providers.

Our principal missions include setting market standards and providing market information and education to all constituencies and at all levels (including market participants, legislators, and regulators) on pertinent issues. The CRE Finance Council has worked closely with policymakers in an effort to ensure that legislative and regulatory actions do not negate or counteract economic

[1] Credit Rating Standardization Study, Request for Comment, Release No. 34-63573; File No. 4-622, 75 Fed. Reg. 80866 (Dec. 23, 2010) (hereafter, "CRA Study Release").

recovery efforts in the CRE finance market. A guiding principle in our work is the need for adequate transparency and regulatory certainty, and for this reason, we have long advocated efforts to strengthen our credit rating system in order to provide investors with information to make sound investment decisions.

It is with this perspective that we offer these initial observations from the CRE finance industry regarding the Commission's inquiries. At this preliminary stage of studying these standardization questions, we urge the Commission to bear in mind that investors have raised other, and more fundamental, concerns about credit ratings than standardization. Many of these concerns relate to transparency, consistency, and accountability, and are issues Congress sought to address in the credit rating reform provisions adopted in Dodd-Frank.

And while we recognize that Dodd-Frank §939(h) directs the Commission to study standardization issues, we believe it would be very premature for the Commission to propose specific credit rating standardization requirements before the numerous Dodd-Frank credit rating reform requirements take effect, and regulators and the markets have had an opportunity to understand how the new requirements affect or enhance transparency, consistency and accountability. For example, a critical area of concern relates to disclosure of the substance and limitations of credit rating agencies' methodologies. Dodd-Frank §932(a)(8) (adding new Exchange Act §15E (s)(3)) requires the Commission to adopt rules on disclosure of information related to construction of the ratings methodologies, limitations of the ratings, and information on uncertainty.

It is important to focus on critical areas of concern such as these, rather than divert attention at this point to concepts such as standardization that are of questionable merit from a practical perspective. In this regard, the Commission should be aware that the process of credit rating has inherently subjective elements that cannot (and probably should not) be completely eliminated through a standardization campaign. For example, standardization of market stress conditions under which ratings are evaluated would be unworkable and undesirable, particularly for commercial mortgages, because commercial real estate is so strongly influenced by local conditions. Standardizing market stress conditions (or other parts of rating methodology, for that matter) will prevent CRAs from innovating, and will also make it difficult for CRAs to improve the rating process. One of the reasons investors look for multiple ratings is because they want multiple view points. Therefore, standardizing market stress conditions or any part of rating methodology will reduce the value of obtaining multiple ratings. Instead, as discussed above, enhanced transparency, consistency, and accountability should be the avenues of focus for ratings reforms.

A final aspect of the Commission's standardization inquiry that we wish to address is the use of separate credit rating terminology and symbols for certain asset classes, such as structured finance.[2] The Commission previously considered adopting such a regime, and did not do so due to extraordinarily negative feedback from all market participants. As we informed the Commission in

[2] CRA Study Release at 4-5.

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that proceeding, ratings differentiation is an overly simplistic and broad proposal that provides little value or information about credit ratings.[3]

As investors presently understand credit ratings, a CRA's particular rating is comparable across asset classes[4] because the underlying assessment is the same regardless of asset class – that is, 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. In fact, the use of ratings symbols (such as "AAA.SF") would suggest that any modifier actually changes the meaning or nature of the rating, or falsely implies a revised level of safety. In addition, given the very different risk profiles and underwriting mechanics for each individual asset class, imposing a single differentiated rating scheme or reporting requirement across the entire range of asset classes within "structured finance" would provide investors with no useful information or value, resulting in less, rather than more, investor confidence in ratings. Further, the imposition of a new and differentiated rating structure also could impede the ability of state and federally regulated financial institutions, as well as institutional investors, to invest in structured finance products, because it would be unclear whether the differentiated ratings satisfy these investors' mandates. The confusion and the widespread costs to modify and update the statutory and regulatory requirements for these investors would likely cause the structured finance markets to remain at a standstill for what could be a lengthy transition period, which would cripple recovery efforts to utilize the securitized credit markets to provide liquidity and facilitate lending.

Such concerns have prompted overwhelming opposition to differentiation from a broad coalition of market participants – including issuers, investors, and borrowers seeking access to credit – because it will only serve to increase confusion and implementation costs, while decreasing confidence and certainty regarding ratings.[5] Significantly, it has been well documented that market participants, particularly the investor community, have rejected proposals to differentiate ratings

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[3] *See* comments submitted by the Commercial Mortgage Securities Association (now the CRE Finance Council) in response to Proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC File No. S7-13-08 (available at http://www.sec.gov/comments/s7-13-08/s71308-10.pdf). The CRE Finance Council recognizes that some CRAs have adopted the (.sf) modifier for structured finance products in response to European regulations. Nevertheless, we do not recommend that the Commission mandate differentiated ratings, for the reasons explained herein.

[4] While a particular rating (e.g., AAA) is generally understood to be comparable across asset classes, any comparisons of ratings across rating agencies may be more easily facilitated for investors through transparency in reports accompanying ratings. This transparency will aid investors' understanding of what an AAA (or other top) rating means to a particular agency. If the Commission reaches the point of considering specific standardization proposals once it has fully addressed the more fundamental issues identified in Dodd-Frank, the issue of consistency and transparency with respect to the characteristics of particular ratings across CRAs is one area that should be explored.

[5] For example, in a June 9, 2008 letter to the House Financial Services Committee, the CRE Finance Council (then known as the Commercial Mortgage Securities Association), American Securitization Forum, Mortgage Bankers Association, NATIONAL ASSOCIATION OF REALTORS®, and The Real Estate Roundtable, expressed their opposition to using separate ratings symbols, citing unintended consequences that would increase costs for investors and further erode liquidity that is critical to the extension of credit for borrowers.

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each time such proposals have been advanced.[6] For these reasons, the CRE Finance Council does not support adoption of separate credit rating terminology for structured finance. Rather, a more productive approach is to support initiatives designed to ensure that investors have the information they need to make informed investment decisions. In this regard, we note, as we have previously informed the Commission, that the CRE industry is working on several of its own initiatives to enhance transparency, including enhancements to the CRE Finance Council's "Annex A" initial disclosure package regarding underlying assets, and the Investor Reporting Package™ for ongoing reporting regarding assets.

We appreciate your consideration of our comments regarding the Dodd-Frank § 939(h) CRA study. Please contact Brendan Reilly or Mike Flood at (212) 509-1844 if you have questions or would like additional information.

Sincerely,

Lisa Pendergast
Managing Director
Jeffries & Company; and
President
CRE Finance Council

John D'Amico
Chief Executive Officer
CRE Finance Council

[6] For example, see the results of Moody's Request for Comment: "Should Moody's Consider Differentiating Structured Finance and Corporate Ratings?" (May 2008). Moody's received more than 200 responses, including from investors that together held in excess of $9 trillion in fixed income securities. In their responses, market participants overwhelmingly rejected the idea of a separate ratings scale. Moody's and other CRAs that considered differentiation at that time did not adopt the proposals.

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