



30 Broad Street, 28th floor, New York, NY 10004
Tel: 212.509.1844 Fax: 212.509.1895
www.cmbs.org

September 10, 2008

Via Electronic Mail: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Attn: Florence E. Harmon, Acting Secretary

**Re: Proposed Rule for Security Ratings
SEC File No. S7-18-08**

Ladies and Gentlemen:

The Commercial Mortgage Securities Association (“CMSA”) submits this letter in response to the Securities and Exchange Commission (“SEC”)’s request for comment on its proposed rule regarding the use in SEC rules and forms of nationally recognized statistical rating organization (“NRSRO”) ratings (the “Security Ratings Proposal”).¹

CMSA is an international trade organization whose members represent a broad cross-section of firms and individuals that are actively engaged in commercial real estate capital market finance activities, including 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 credit rating agencies.² CMSA has a global membership of more than 400 firms and 5,000 individuals, and its primary mission is to promote the ongoing strength,

¹ Proposed Rule for Security Ratings, Release No. 33-8940; 34-58071 (File No. S7-18-08), 73 Fed. Reg. 40,106-40,124 (July 11, 2008).

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

liquidity, and viability of commercial real estate capital market finance worldwide. CMSA and its members are the leaders in setting standards and maintaining a favorable investing environment for the more than \$900 billion in outstanding commercial mortgage backed securities (“CMBS”) issuance in the United States, and provides these comments in an effort to further advance these dual objectives.

Extensive information concerning CMSA and the market for CMBS was provided in a letter CMSA filed on July 21, 2008 in response to other SEC proposals regarding NRSRO ratings.³ CMSA will not reprise that background information here, but incorporates its earlier letter by reference herein.⁴

In the Security Ratings Proposal, the SEC seeks to largely remove references to NRSRO ratings in the agency’s rules and forms. This proposal is part of a broader SEC initiative that has the stated purpose of ensuring that credit ratings play an appropriate (but not paramount) role in investment decisions. The issue that the SEC wants to address – concern about over reliance or inappropriate reliance by investors on security ratings – is rooted in circumstances that occurred in the market for residential mortgage backed securities (“RMBS”). But as CMSA has previously pointed out, the SEC’s proposed solutions have consequences that will reach beyond the RMBS market to others, including the CMBS market, that do not share all of the RMBS market’s characteristics. Nevertheless, CMSA has expressed its support for a number of the SEC’s specific proposals in the belief that the rule changes will help improve the NRSRO rating process and provide investors with more informative disclosures about the ratings.⁵ Likewise, where aspects of proposed rule changes would have a significant adverse affect on the CMBS market and are unwarranted given the unique characteristics of the CMBS market, CMSA has addressed these matters in comment letters to the SEC.⁶ Such is the case with one aspect of the Security Ratings Proposal.

³ Proposed Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-57967 (File No. S7-13-08), 73 Fed. Reg. 36,212 (June 25, 2008) (“Substantive NRSRO Proposal”).

⁴ CMSA’s July 21, 2008 comments are attached as well as available at www.sec.gov/comments/s7-13-08/s71308-10.pdf.

⁵ See CMSA’s July 21, 2008 Comments.

⁶ Briefly, among other matters, CMSA advised in its previous comments that the proposal to require NRSROs to create a unique rating symbology for structured finance products would create undue confusion for investors, as the rating methodologies are premised on the principle that like ratings are comparable across asset classes since the underlying assessment is the same, and that the alternative proposal for special reports by NRSROs to accompany their structured product ratings would be a more workable course; that the proposed rule requiring public disclosure of all information relied upon by an NRSRO in rating determinations should be clarified to ensure that the public release of proprietary information is not required by the rule; and that the proposal to prohibit NRSROs that issue ratings from making recommendations to issuers does not bar NRSROs from responding to “what if” questions posed by issuers during the rating process. *See id.*

The Security Ratings Proposal would delete “investment grade” rating by an NRSRO as a criterion that qualifies an asset-backed securities (“ABS”) offering for registration using SEC Form S-3 and Rule 415. The Proposal would replace the rating criterion with others based on investor characteristics and sales denominations. The Proposal asks whether such a change would be appropriate, and seeks comment on how the change would impact the liquidity of ABS and the cost of capital for ABS sponsors.

CMSA believes that the proposed change would, at a minimum, drive up the costs of registration for ABS, including CMBS, without providing a corresponding benefit. More importantly, the change would diminish the pool of available investors for CMBS. A smaller investor pool would create a ripple affect that negatively impacts the commercial real estate market as a whole. CMSA therefore urges the SEC not to adopt the proposed changes to Form S-3 and Rule 415 eligibility. Instead, the SEC should leave the eligibility requirements unaltered.

CMSA takes this view because, assuming that the SEC goes forward with the substantive reforms it has proposed for the NRSROs, and incorporates CMSA’s specific suggestions for increasing transparency for the structured finance market, there will be more information available regarding the development and meaning of ratings, and the limitations of ratings.⁷ These improvements will address the issue of undue or inappropriate reliance by investors on ratings because investors would have more specific information about, for example, the procedures and methodologies NRSROs use and any conflicts of interest they have. Investors could therefore make more informed decisions about the value of NRSRO ratings, and in turn, about the investments themselves. Consequently, CMSA believes the investment grade rating requirement for Form S-3 and Rule 415 registration would continue to be a reasonable way to identify those securities that are appropriate for streamlined registration.

1. Proposed Changes to Form S-3 Eligibility

Under the SEC’s current rules, issuers of ABS, including CMBS, may use Form S-3 to file a shelf registration statement for the public offering of securities on a delayed basis if, among other requirements, the securities are rated as “investment grade” (i.e., in one of the four highest rating categories) by at least one NRSRO at the time of offering. The Security Rating Proposal would remove the rating criterion for Form S-3 eligibility and replace it with two others: (a) both initial sales and subsequent resales must be made in minimum denominations of \$250,000, and (b) initial sales must be made only to qualified institutional buyers (as defined in Rule 144A(a)(1)) (“QIBs”).

CMBS issuers rely on Form S-3 registrations to sell these securities to the public. However, CMBS offerings are not always made in denominations greater than \$250,000, nor are the purchasers always QIBs. It follows that if the ability to use shelf registrations depends on sales of \$250,000 or more to QIBs, CMBS issuers will lose some ability to take advantage of shelf registrations and would be forced to resort to long form registrations on Form S-1 or the private placement market. Either of these alternatives would drive up the cost of the offering without a corresponding benefit.

⁷ See generally Substantive NRSRO Proposal, 73 Fed. Reg. 36,212-36,252.

As mentioned, CMSA believes that the SEC's substantive proposals regarding NRSROs would provide adequate and appropriate safeguards against inappropriate reliance on security ratings for the CMBS marketplace. If adopted, investors would have, for example, additional information about how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments,⁸ and more information about any NRSRO conflicts of interest. Investors could therefore make more informed decisions about the value of NRSRO ratings, and in turn, about the investments themselves.

The Security Rating Proposal would also shrink the pool of available investors in CMBS. Given the typical marketing schedule for CMBS offerings, in which the loan pools are created before the bonds are registered, Form S-3 registration is the most practical means of registering CMBS for a public offering in a workable manner. If future public offerings of CMBS can only be made to QIBs purchasing denominations greater than \$250,000, then logically, the pool of investors meeting these criteria will be smaller than it currently is.

To counteract this reduction of the investor pool, more issuers would resort to the private placement market. But moving more CMBS offerings to private placement would not necessarily be good for issuers or investors. CMSA believes that added reliance on private placements would further erode CMBS liquidity and issuers' ability to raise capital. And if more CMBS offerings are made through private placements, fewer investors would enjoy the benefit of the disclosures and reporting required for public offerings.

2. Proposed Changes to Securities Act Rule 415 Eligibility

Currently, certain "mortgage related securities," including mortgage-backed debt, may be eligible for shelf registration by meeting the requirements in Securities Act Rule 415. Rule 415 has permitted such securities to be offered on a continuous or delayed basis even if the offering does not meet the eligibility requirements of Form S-3. "Mortgage related securities" are defined by Section 3(a)(41) of the Exchange Act as ones that are "rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization."

Under the Security Ratings Proposal, sales of mortgage related securities pursuant to Rule 415 would be conditioned on the same QIB and minimum denomination requirements that are proposed for Form S-3 eligibility, regardless of mortgage related securities' NRSRO rating. Because the Proposal would apply the same prerequisites for a Rule 415 offering as are proposed

⁸ *See id.* at 36,235. In its July 21, 2008 comments CMSA suggested revisions to the specific proposal concerning special reporting to differentiate credit ratings for structured finance products, to make these reports more meaningful to investors, and suggested that there be expanded reporting by NRSROs on certain issues. *See* CMSA July 21, 2008 Comments at 11-12. As previously noted, CMSA does not support the SEC's alternative proposal to require NRSROs to use a different rating symbology for structured finance products, as this would create significant confusion for investors, eliminate liquidity in the structured finance market, and add significant costs with no appreciable benefit. *See id.*

for Form S-3 eligibility, CMSA has the same concerns here as it has with the proposed Form S-3 changes discussed above.

Moreover, CMSA notes that Rule 415 was amended to allow certain mortgage related securities to use the shelf registration process consistent with the purposes of the Secondary Mortgage Market Enhancement Act of 1984 (“SMMEA”). SMMEA was designed to increase liquidity in the mortgage backed securities markets. The proposed change to Rule 415 eligibility would have the opposite effect and thus, would be inconsistent with the intent of Congress in enacting SMMEA.

* * *

In conclusion, CMSA believes that the SEC’s concerns regarding inappropriate investor reliance on credit ratings would be addressed by the substantive reforms proposed to improve disclosures and information about the ratings. Consequently, there is no need to change the eligibility requirements for Form S-3 and Rule 415 registration to eliminate references to NRSRO ratings. In this context, investment grade ratings continue to be a reasonable way to identify those securities that are appropriate for streamlined registration.

CMSA appreciates the opportunity to offer the foregoing comments regarding the SEC’s Security Ratings Proposal. If you have questions regarding the matters discussed in this letter, please contact Stacy Stathopoulos, Government Relations Managing Director at 212-509-1950.

Sincerely,



Dottie Cunningham
Chief Executive Officer
Commercial Mortgage Securities Association