

March 17, 2011

Via e-mail to RegComments@FHFA.gov

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA40
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552

File No.: RIN 2590-AA40

Re: Realpoint¹ Response to Request for Comment² under Section 939A³

Although “each Federal agency . . . [must: (a)] “review (1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings[; and] (b) . . . modify any such regulations . . . to remove any reference to or requirement of reliance on credit ratings,”⁴ this review should not be undertaken without simultaneous consideration of the other, numerous credit-rating initiatives and reforms under Subtitle C.

Among its many credit-rating initiatives and reforms, Subtitle C increased: (i) accountability, and potential liability, of NRSROs;⁵ (ii) SEC enforcement authority with respect

¹ Realpoint LLC, Morningstar company (“Realpoint”), is a Nationally Recognized Statistical Ratings Organization (“NRSRO”), as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(62)), and presently primarily specializes in commercial mortgage-backed securities (“CMBS”) securities ratings, research, surveillance services, and data. Realpoint’s comments herein are primarily made in the context of CMBS issuances but are equally applicable to residential mortgage-backed securities and other forms of asset-backed securities (“ABS”).

² Advance notice of proposed rulemaking; request for comment, Alternatives to Use of Credit Ratings in Regulations Governing the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal Home Loan Banks, Federal Housing Finance Board; Federal Housing Finance Agency; and Office of Federal Housing Enterprise Oversight regulatory information number (RIN) 2590-AA40, 75 Fed. Reg. 62718 (January 31, 2011) [herein, the “Request for Comment”].

³ References to “Section 939A” mean and refer to Section 939A of Subtitle C, Improvements to the Regulation of Credit Rating Agencies, of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”) and references to “Subtitle C” mean and refer generally to Subtitle C of the Act.

⁴ Section 939A.

⁵ Subtitle C increased the accountability, and potential liability, of NRSROs by, for example: (i) clarifying that securities laws that prohibit the regulation of the substance of a rating are not a defense to antifraud liability; (ii) repealing the exemptions, provided by SEC Rule 436(g), from expert liability for ratings in registration statements, and by Regulation FD, for credit rating agencies; (iii) specifying that statements made by credit rating agencies are not forward-looking statements and are subject to liability in the same manner as those of accounting firms and securities analysts; and (iv) providing that, in a private securities fraud action against a credit rating agency for money damages, the plaintiff need only state with particularity facts which give rise to a strong inference that the agency acted knowingly or recklessly failed to conduct a reasonable investigation with respect to factual elements relied upon by its own methodology for evaluating credit risk or to obtain reasonable verification of such factual elements from sources that the agency considered competent and that were independent of the issuer/underwriter. Subtitle C §§ 932(a)(8), 933(a), (b), 939B, 939G.

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to NRSROs; and (iii) NRSRO transparency and disclosure requirements. These additional requirements include having independent directors, board oversight of policies and procedures,⁶ increased internal controls,⁷ an annual internal controls report,⁸ the development of credit analyst training and experience standards⁹ and increased transparency of ratings, rating procedures and methodologies¹⁰ and ratings performance.¹¹

In furtherance of the intent of the initiatives and regulations related to transparency, NRSROs are expected to, among other things, disclose various information and data in: (i) a report that must accompany each rating and (ii) their respective Form NRSRO, which is publicly available at the NRSRO's website. Combining increased transparency and other reforms with the existing and continuing depth of analysis provided by NRSROs in assessing both quantitative and qualitative factors on a deal by deal basis, it is not feasible, without significant resources, time, expertise, models and market depth and experience in particular types of assets, to replicate or replace credit ratings of the quality provided by independent NRSROs.

Further, Subtitle C requires additional studies by the SEC and the Comptroller General. The SEC is required to study the feasibility and desirability of the system contemplated under Subtitle C by which NRSROs are assigned to determine ratings of structured finance products,¹² and the Comptroller General is required to study compensation models¹³ and whether to create an independent professional organization for rating analysts employed by NRSROs.¹⁴

Given these numerous credit-rating initiatives and reforms, each Federal agency may wish to consider recommending that references in regulations to credit ratings be replaced by credit ratings issued by Requisite NRSROs.¹⁵ With respect to ABS, the definition of Requisite

⁶ E.g., Subtitle C § 932(a)(8), codified at 15 U.S.C. §§ 78o-7(r), 78o-7(t)(2)(A), (C), (t)(3).

⁷ E.g., Subtitle C Section 932(a)(2)(B), codified at 15 U.S.C. § 78o-7(c)(3)(A); Subtitle C § 932(a)(4), codified at 15 U.S.C. § 78o-7(h)(3), (4), (5); and Subtitle C § 932(a)(5), codified at 15 U.S.C. § 78o-7(j)(2),(4), (5).

⁸ Subtitle C § 932(a)(2)(B), codified at 15 U.S.C. § 78o-7(c)(3)(B).

⁹ Subtitle C § 936.

¹⁰ Subtitle C § 932(a)(8), codified at 15 U.S.C. § 78o-7(s)(1), (2), (3).

¹¹ Subtitle C § 932(a)(8), codified at 15 U.S.C. § 78o-7(q).

¹² Subtitle C § 939F of the Act, 15 U.S.C. § 78o-9(b)(2), requires the Commission to study "the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns [NRSROs] to determine the credit ratings of structured finance products." *Id.*

¹³ Subtitle C § 939D.

¹⁴ Subtitle C § 939E.

¹⁵ Money market funds are regulated under Rule 2a-7 under the Investment Company Act of 1940. 17 C.F.R. § 270.2a-7. Under Rule 2a-7, "Requisite NRSROs" means: (i) [a]ny two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) [i]f only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO. 17 C.F.R. § 270.2a-7(a)(23). "Designated NRSRO" means any one of at least four [NRSROs] that: (i)[t]he money market fund's board of directors: [h]as designated as an NRSRO whose credit ratings . . . will be used

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NRSROs should be amended to provide that at least one of the Requisite NRSROs is an independent NRSRO, meaning, that it was selected to rate the security not by the issuer thereof but by means of an independent system as contemplated under Subtitle C.¹⁶

In amending Rule 2a-7, to “shift responsibility to money market fund boards for deciding which NRSROs they will use in determining whether a security is an eligible security for purposes of the rule,” the SEC noted that “[t]he amendments are designed, among other things, to foster greater competition among NRSROs to produce the most reliable ratings in order to obtain designation by money market fund boards. Accordingly, we believe this approach will improve the utility of the rule’s use of NRSRO ratings as threshold investment criteria.”¹⁷

Similarly, having each Federal agency also utilize credit ratings issued by Requisite NRSROs would further foster competition among NRSROs to produce the most reliable ratings, in this case, towards the goal of obtaining designation or approval by such agency. A Federal agency might select its Requisite NRSROs using an application and interview process similar to that used by the Federal Reserve, in connection with the Term Asset-Backed Securities Loan Facility (TALF), for qualifying NRSROs. That process may include specific consideration of each NRSRO’s track record with respect to the accuracy of its ratings and the timeliness of the accuracy and timeliness of ratings and rating actions, its resources and structure and its ongoing or planned investments in data, models, studies, personnel and other means to increase the accuracy and timeliness of ratings and rating actions or to provide rating outlooks, probability of default, loss given default or other opinions of future trends or performance.

More importantly, each Federal agency would thereby accomplish its mandate, with respect to its regulations, without also eliminating the benefits that independent NRSRO credit ratings may provide to investors and the public interest.

Thank you for the opportunity to respond to the Request for Comment. Please do not hesitate to contact us if you have any questions.

Very truly yours,



Robert Dobilas,
CEO and President,
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by the fund to determine whether a security is an Eligible Security” (as defined in § 270.2a-7(a)(12)); and (ii) meets the other requirements of such definition. § 270.2a-7(a)(11).

¹⁶ See fn. 11 above.

¹⁷ Final Rule, Money Market Fund Reform, Securities and Exchange Commission Release No. IC-29132; File Nos. S7-11-09, S7-20-09 (February 23, 2010), 75 Fed. Reg. 10060, 10068 (March 4, 2010).