



**Statement of John A. Courson**

**President and Chief Executive Officer**

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**for the Record of the**

**Subcommittee on Capital Markets, Insurance and  
Government Sponsored Enterprises**

**Committee on Financial Services  
United States House of Representatives**

**Hearing on  
“Enhanced Accountability and Transparency in Credit  
Rating Agencies Act”**

**September 30, 2009**

The Mortgage Bankers Association (MBA)<sup>1</sup> appreciates the opportunity to provide this statement for the record of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises' hearing on the Enhanced Accountability and Transparency in Credit Rating Agencies Act (Agencies Act).<sup>2</sup> The Agencies Act proposes to amend the Securities Exchange Act of 1934 to increase the oversight and transparency of nationally recognized statistical credit rating agencies (rating agencies). MBA commends Representatives Kanjorski, Kilroy and Kosmas for addressing this important topic.

### **MBA Position**

MBA recognizes the pivotal role that rating agencies play in the real estate finance system by making assessments about financial services providers and financial instruments used in the secondary mortgage market.

Because of the high degree of sensitivity associated with credit ratings, MBA believes rating agencies and their ratings methodologies must be held to exacting standards. Therefore, MBA 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.

MBA used these fundamental principals to evaluate the Agencies Act, and we offer the following perspectives. Presented first is a summary of the relevant section of the Agencies Act followed by paragraph(s) that address MBA's position.

- 1. Review of Internal Processes for Determining Ratings (Sec. 2 (3))** – The Securities and Exchange Commission (SEC) would review the extent to which each rating agency follows its own rating methodology, internal controls, and due diligence procedures.

While strongly supporting competent rating agency determinations, MBA has

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 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](http://www.mortgagebankers.org).

<sup>2</sup> September 30, 2009.

concerns that such a process would be duplicative with existing requirements for rating agency compliance officers to submit annual reports regarding these same issues. We believe that the intent of this proposal can be accomplished through enhanced rating method and data disclosure which will allow market participants to access the accuracy of credit ratings and provide the opportunity for other rating agencies to provide alternative ratings.

Moreover, the SEC rating agency evaluation would only address whether the rating agencies were following their prescribed methodologies, internal controls, and procedures and would not assess the accuracy or quality of the ratings models or methodologies themselves. Consequently, the SEC would not have authority to take action on ill-conceived rating models if the rating agency followed its prescribed methodologies, controls, and procedures.

- 2. Designation of a Compliance Officer (Sec. 2 (h))** – The compliance officer would report directly to the Board of Directors and be prohibited from performing ratings. The compliance officer would also be required to establish procedures for addressing complaints and issuing an annual report.

MBA supports these measures to enhance the accountability and authority of rating agency compliance officers.

- 3. Transparency of Credit Rating Methodologies and Information Reviewed (Sec. 2 (s))** – Rating agencies would be required to disclose information about assumptions made during the ratings process as well as the rating methodology employed. Potential shortcomings of the rating must be disclosed. The rating agency also must disclose if a third party due diligence provider was used to analyze data that was used in developing a rating. Rating agencies must disclose factors relating to the volatility of the rating and the circumstances that will result in a rating change.

MBA supports increased rating agency transparency including the disclosures specified in Sec. 2(s).

- 4. Prohibition - Advisory Service Activities (Sec. 2 (t)(1)(A)(iii))** – Rating agencies that are rating a security would be prohibited from also providing risk management advisory and consulting services to the issuer.

MBA supports this restriction on rating agencies providing advisory or consulting arrangements with firms whose securities they rate. MBA notes the rating agencies themselves have publicly supported this prohibition.

**5. Issuer Disclosure of Preliminary Ratings (Sec. 5)** – Rating agencies would be required to disclose preliminary ratings.

This is intended to address past problems with “rating shopping,” i.e., commissioning the rating agency that provided the most favorable preliminary rating. However, with increased transparency in the ratings process under this legislation, which would enable investors to compare unsolicited ratings to commissioned ratings, this problem is largely resolved. Moreover, since the term “preliminary rating” is not defined and may be interpreted too broadly, the legislation may present unintended consequences.

In the case of commercial mortgage-backed securities (CMBS), the pool of loans that receives a preliminary rating is often significantly altered (new loans are added and some loans that were part of the preliminary rating are taken out of the loan pool) by the time that the CMBS is issued. Consequently, examining preliminary ratings can be misleading because they may not represent the characteristics of the loan pool once it has been securitized. Because of these three considerations, MBA does not support the disclosure of preliminary ratings and opposes this provision.

**6. Credit Ratings Methodology - Unique Identifier for Structured Securities (Sec. 2 (r)(E))** – Rating agencies will have to adopt rating symbols that distinguish among structured products, non-structured products, corporate offers, municipal offers, and such other products the SEC deems appropriate.

The Agencies Act would require the new rating symbol to be attached to all structured securities regardless of their recent or long-term performance. Such a symbol would brand all structured securities as a single asset category, despite the fact that different structured securities exhibit markedly different performance characteristics (e.g. CMBS, RMBS, and securities backed by credit card debt or automotive loans). We are concerned that this approach could spawn greater investor confusion because a wide variety of securities would be lumped into an equally broad investment category.

The performance of a security is primarily attributable to the performance of its underlying assets, not its structure. The use of a structured ratings symbol could be perceived as a broad cautionary signal when in fact the underlying assets determine the securitization’s risk parameters. As a consequence, such a symbol would potentially steer investors away from security types that have demonstrated very strong performance records, such as CMBS during the current credit crisis.

If enacted, this provision could force institutional investors to modify their lists of permissible investments. The provision would also necessitate amendments to

federal and state laws, regulations and supervisory guidance in order for them to comport with the new ratings framework. This provision is also likely to instigate unnecessary short-term disruptions as institutional investors determine how to apply the new ratings framework to their existing holdings. This, in turn, could further depress liquidity in the market for structured products.

An additional concern is that this component of the Agencies Act is redundant with the additional ratings methodology and data disclosure requirements. As mentioned above, the Agencies Act requires rating agencies to disclose information they use to assign and monitor credit ratings, including their rating methods. MBA believes these disclosure requirements obviate the need for a separate ratings symbol.

For these reasons, MBA strongly opposes the inclusion of a requirement for such an identifier in this legislation. Such an approach would stigmatize a wide category of securities and create compliance burdens for bond holders.

**7. Removal of Statutory References to Credit Ratings (Sec. 7) -** The Agencies Act removes reliance on ratings in federal statutes where references to ratings are made.

MBA supports a more harmonious reliance, on credit ratings, in the various rules and regulations of regulatory agencies in order to create a consistent standard and to avoid regulatory conflict between the different regulatory agencies. Unfortunately, this provision would lead to unintended consequences. For example, state statutes governing insurance companies that include references to ratings would not be impacted. In addition, international risk-based capital conventions to which the United States subscribes, such as Basel II, maintain references to ratings to determine risk-based capital requirements for certain structured securities. Consequently, the removal of reliance on ratings in federal regulations would create a potential conflict with state laws and international conventions. The latter could enable regulatory arbitrage opportunity for multi-national financial institutions. Therefore, MBA recommends that this provision be removed from the legislation.

**Conclusion**

MBA supports those provisions of the Agencies Act that promote ratings transparency, accuracy and reliability. However, at the same time, MBA believes that portions of the Agencies Act requiring rating agency reviews by the SEC, a unique identifier for structured securities, disclosure of initial ratings, and removal of the reliance on ratings in federal statutes would have unfortunate and potentially severe unintended consequences.