

To CMSA's Members and Friends:

Commercial Mortgage Securities Association is actively engaged in discussions surrounding yesterday's Obama Administration regulatory reform proposal, reviewing every facet of the plan and forming its initial reactions. Having said this, CMSA believes it important to be judicious but also forthright in some of its immediate concerns.

The regulatory changes proposed by the Administration include, most significantly, risk retention requirements; measures to align compensation with long-term performance of securitized assets; accounting rule changes to eliminate the immediate recognition of "gain on sale" requirements relative to consolidation on originators' balance sheets; changes in regulation of credit rating agencies, including ratings differentiation; and disclosure and reporting requirements, including document standardization requirements. It should be noted that many of the Administration's references cite the residential market, so, as the legislative process takes its course, it is important for CMSA to regularly differentiate and communicate the cited references from its own market.

While CMSA is encouraged by the Obama Administration's steps to address the ongoing capital markets and liquidity crisis that continues to affect our greater economy, we must begin by strongly re-stating our long-standing opposition to any plan that includes credit rating differentiation for structured products.

The association always has advocated some checks-and-balances for rating agencies to avoid conflicts of interest, and has strongly supported the need for additional transparency in ratings and the methodologies used by the rating agencies, but we strongly oppose differentiation of ratings described in the White House provisions which, we feel, causes both confusion and implementation issues. Indeed, the issue of ratings differentiation reopens a previously settled debate, a debate that will greatly delay and exacerbate market recovery. Investors have been very clear that imposing differentiation across structured finance does not enhance the understanding of certain ratings – it only creates more confusion and more uncertainty.

The Administration yesterday proffered a plan that would require loan originators (or sponsors) to retain five percent of the credit risk of the securitized exposures, noting that proposed regulations would prohibit the originator of the loan from otherwise hedging or transferring the risk it is required to retain. While we agree conceptually with the issue of "skin in the game," CMSA believes that – with CMBS – the structure already includes a third party credit-check with the B-piece (first loss) buyers who have skin in the game; B-piece buyers conduct extensive credit analysis of each loan before buying the highest risk piece in a CMBS securitization and most always are buy-and-holders, the long-term investor who underwrites the risk and holds it.

Also, it should be noted that, when viewing construction lending where financial institutions had 100% of their "skin in the game," many of these loans failed. This, we feel, puts in question the relationship of the current credit crisis to this five percent risk retention requirement.

We do recognize that the long-term return-based concept of the holding of risk may be valid, but, for CMBS, this concept does in fact apply to the holders of the non-investment grade bonds. We support the need for sufficient disclosure and sufficient representations and warranties to properly transfer the risk, but a true sale should be permitted where risk is properly being transferred to a third party, such as these B-piece bond holders.

We need to let originators have gain on sale treatment to let the market work, and have the long-term-return-based concept apply to the holders of the non-investment grade bonds. While aligning compensation with long-term performance of securitized assets would appear to be appropriate, it's very difficult for regulators and accountants to determine if a loan default is due to poor underwriting, due to changes in market condition, or due to poor business practices by borrower and tenants.

The Administration's provisions for issuers of asset-backed securities are to include new reporting requirements which would include loan-level data. CMSA notes that the CMSA Investor Reporting Package (CMSA IRP®), in effect since 1994 for the CMBS industry, and currently being used by the industry in its Fifth Version, continues to be reviewed and updated on an ongoing basis. Monthly, the CMSA IRP provides not only bond level information such as updated bond balances, amount of interest and principal received on the bonds and bond ratings, but also loan level as well as property-level information.

The residential securitized marketplace is currently developing a residential reporting package modeled on CMSA's successful IRP. The success of the CMSA IRP in the U.S. has also led to the adoption of similar standards for CMBS in Europe and in Japan.

In sum, CMSA believes it must continue to distinguish the commercial market from residential, and to continue to educate policymakers on the safeguards that the commercial market already has in place – safeguards that should obviate the need for some of the high level of regulation the Administration proposed June 17.

CMSA remains actively committed to communicating all its views to policymakers, to lawmakers and the press and will keep its members apprised on a regular basis as we move forward toward market recovery.

Thank you.

Patrick C. Sargent
President, Commercial Mortgage Securities Association
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