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# United States Senate

WASHINGTON, DC 20510

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CHAIRMAN'S CORRESPONDENCE

The Honorable Tim Geithner
Secretary
Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Geithner:

I am writing to you in your capacity as Chairman of the Financial Stability Oversight Council (FSOC) to stress the importance of a provision distinguishing commercial real estate loans that was unanimously approved in an amendment I offered to the risk retention section of *The Wall Street Reform and Consumer Protection Act* (Dodd-Frank). I share your view that financial policymakers should consider the appropriate way to strengthen underwriting and align the interests of lenders, bond issuers and investors in the asset-backed securities (ABS) market and the commercial mortgage-backed securities (CMBS). At the same time, regulations must be carefully promulgated to promote the flow of credit that is critical to a recovery of the U.S. economy, particularly in the commercial real estate sector that is very different and has been hit hard by the prolonged recession and the shutdown of our credit markets.

Today, there are significant challenges ahead in commercial real estate, especially in the small end of the market. Key indicators such as unemployment and vacancy rates remain high, while the value of properties has fallen considerably at a time when over $1 trillion in loans will mature in the next several years. Fortunately, there are some promising signs of life in the commercial real estate finance market. In fact, after an extended dormant period, the CMBS market – which is essential to addressing the refinancing wave – experienced several deals in 2010, while press reports suggest that there could be as much as $50 billion in new CMBS lending in 2011. However, economic conditions and uncertainty related to changing regulation – including risk retention rules and other initiatives – are the primary obstacles to resurgence in the credit markets that are needed to fuel a recovery in commercial real estate and our overall economy.

With a pronounced focus on the residential market, many of us remain concerned about the creation of a "one-size-fits-all" retention rule that could stifle a commercial real estate recovery before it can occur. Despite congressional direction, our concerns are elevated by the looming April deadline for final joint rules, as required by Dodd-Frank, when no proposals have been issued for Congress or market participants to review, and discourse has shifted from risk retention to the consideration of a national servicing standard in the residential mortgage market. Further, while the regulators must jointly

produce retention rules under Dodd-Frank, there already have been several *ad hoc* rules from individual regulators that simply blanket a single retention framework broadly across all asset classes.

Accordingly, I wish to stress the commercial real estate provision that I authored in Dodd-Frank to ensure that its intent is both understood and followed in any proposed rules. Specifically, with respect to commercial mortgages, the provision mandates that there are several specific options for, as well as alternatives to, a percentage risk retention to strengthen the CRE market and support a recovery, including: 1) adequate underwriting standards and controls; or 2) adequate representations and warranties and related enforcement mechanisms; or 3) a percent of the total credit risk of the asset held by the either the securitizer, originator *or* a third party investor. It follows that regulators construct a joint rule that effectuates these options for use in the market to support a commercial real estate recovery.

In this regard, two reports mandated by Dodd-Frank have reinforced the commercial mandate for risk retention. Specifically, the Federal Reserve's October 2010 study cautioned that retention is not a panacea, and that if rules are not implemented carefully by asset class, credit availability could be disrupted at a time when it is desperately needed. The Federal Reserve report also suggested that regulators consider alternative ways other than retention to align interests, including existing solutions such as the "B piece" buyer feature, which is unique to CMBS. Likewise, the FSOC study on risk retention noted that there are several ways to accomplish retention for CMBS, including retention by a third-party investor, which the commercial provision recognizes as a viable option.

To support credit availability, regulators must deliberately follow the statutory mandate to structure reforms for each unique asset class (including commercial real estate, home loans, automobile and student loans, credit cards, among others). Further, with a phased-in implementation, including two years for CMBS and consumer ABS after final rules, regulators should use the time to consider rules carefully and to better understand their impact on access to credit. Any review should also include an extensive examination of how the market is evolving and consideration of other developments – such as the creation of market standards and other safeguards in the commercial real estate finance market – that could assist regulators in their rulemaking.

Ultimately, we need rules that are strong enough to protect our economy and align the economic interests of differing parties, but that can adapt changing market conditions to promote credit availability and spur job growth for millions of Americans. I urge you to oversee the creation of a rule that strictly follows the retention options for commercial real estate loans, as mandated by Dodd-Frank, to support a recovery in this sector.

Sincerely,

Cc: The Honorable Ben Bernanke
The Honorable Mary Schapiro
The Honorable Sheila Bair
Acting Comptroller John Walsh