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## Treasury Notes

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### Treasury Brings Greater Clarity to the Credit Rating Process

By: **Michael Stegman** 2/5/2015

One of President Obama's key housing principles is to put private capital at the center of the housing finance system. To help advance that goal, [Secretary Lew announced](#) that Treasury would launch a [Private Label Securities \(PLS\) initiative](#) in June 2014 to help restart a responsible, sustainable, non-government guaranteed mortgage market.

Treasury sought [public comments](#) from investors, securitizers, market participants and stakeholders about the development of a responsible PLS market. Treasury also held a roundtable with institutional investors, and met with issuers, trustees, and due diligence firms to evaluate the most effective methods for ensuring investor protections, implementing necessary market reforms, and enforcing standards.

However, Treasury also recognized that the PLS market has been dormant since the financial crisis partly because of a "chicken-and-egg" phenomenon between rating agencies and originator-aggregators. Rating agencies will not rate mortgage pools without loan-level data, yet originator-aggregators will not originate pools of mortgage bonds without an idea of what it would take for the bond to receive a AAA rating.

Using our convening authority, Treasury invited six credit rating agencies to participate in an exercise over the last several months intended to provide market participants with greater transparency into their credit rating methodologies for residential mortgage loans.

By increasing clarity around loss expectations and required subordination levels for more diverse pools of collateral, the credit rating agencies can stimulate a constructive market dialogue around post-crisis underwriting and securitization practices and foster greater confidence in the credit rating process for private label mortgage-backed securities (MBS). The information obtained through this exercise may also give mortgage originators and aggregators greater insight into the potential economics of financing mortgage loans in the private label channel and the consequent implications for borrowing costs.

The development of a healthy and responsible PLS market is an important component of a reformed, safe, and sustainable housing finance system that will complement the enactment of comprehensive housing finance reform legislation consistent with the President's core principles released last August.

To view the exercise, click [here](#)

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