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September 5, 2019

VIA EMAIL AND OVERNIGHT U.S. MAIL

Office of the Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
rule-comments@sec.gov

RE: **Administrative Proceeding File No. 3-15982**

Dear Sir or Madam:

I write on behalf of my client, the Federal Home Loan Mortgage Corporation (“Freddie Mac”), in response and in opposition to the June 28, 2019, comment letter from the Financial Guaranty Insurance Company (respectively, the “Comment” and “FGIC”) regarding the Securities and Exchange Commission’s (the “Commission”) Proposed Plan of Distribution (the “Plan”) of the fair fund (the “Fair Fund”) resulting from the settlement (the “Settlement”) with respondents Morgan Stanley and Co. LLC (f/k/a Morgan Stanley and Co. Incorporated), Morgan Stanley ABS Capital I Inc., and Morgan Stanley Capital Holdings LLC (collectively, “Morgan Stanley”) in Administrative Proceeding File No. 3-15982 (the “Proceeding”).¹

In June of 2007, Freddie Mac was an initial purchaser of all of the Class A-1 Certificates in the securitization of the MSAC 2007-NC4 Trust (respectively, the “NC4 Securitization” and the “NC4 Trust”) from Morgan Stanley, and Freddie Mac continues to hold those certificates to this day. Thus, Freddie Mac is both an investor in the NC4 Securitization and an “Eligible Claimant” under the Plan. FGIC, on the other hand, did not invest in the NC4 Securitization, is not a victim of Morgan Stanley’s violations of the securities laws, and has no entitlement to proceeds of the Fair Fund.

FGIC proposes several alterations to the Plan, all of which are misplaced. The Commission instituted this Proceeding against Morgan Stanley “pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”)” and concluded that Morgan Stanley “violated Section

¹ The Federal Housing Finance Agency is Freddie Mac’s Conservator. I am authorized by the Conservator to submit this letter on behalf of Freddie Mac and its conservatorship estate.

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17(a)(2) and (3) of the Securities Act” as a result of the conduct alleged in the Order Instituting Cease-And-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order, Securities Act Release No. 9617 (July 24, 2014 (the “Order”). (Order at 1 & 9 ¶ 40.) Since FGIC did not buy any securities and is not an investor in the NC4 Securitization, FGIC’s requested relief is inconsistent with the Fair Fund’s purpose of enforcing the Securities Act and compensating the victims of Morgan Stanley’s violations of the Act.

Additionally—although it is beside the point since, as a threshold matter, FGIC has no entitlement to the Fair Fund because it is not an investor—FGIC misconstrues its subrogation rights under the Pooling and Servicing Agreement governing the NC4 Trust (the “PSA,” a copy of which is attached hereto as **Exhibit A**). Specifically, FGIC’s subrogation rights, to the extent they exist, are expressly limited to payments of principal and interest from the funds of the NC4 Trust, and do not extend to payments to investors outside the NC4 Trust. Finally, it bears noting that, under a court-approved rehabilitation plan, FGIC is only paying a small percentage of the total amount of the claims submitted to it by the NC4 Trust, leaving the insured senior certificateholders in the NC4 Trust with a shortfall of millions of dollars of unpaid interest.²

The Commission is given significant discretion in crafting a fair fund distribution plan, and FGIC has not shown that the Plan would abuse that discretion. All that is required is that the Plan be “fair and reasonable,” which it clearly is. Accordingly, the Plan should be approved as it was proposed, without alteration.³

² An excerpt of the latest remittance report for the NC4 Trust is attached as **Exhibit B**. On page 4, the report shows that the shortfall resulting from FGIC’s partial payments equals over \$9 million (*see* “Remaining Unpaid Interest Shortfall” column for the Class A Certificates). Since 2014, FGIC has only paid between 17% and 38.5% of claims submitted to it. *See* <http://www.fgic.com/policyholderinfocenter/2018annualcpprevaluationnotice.pdf>; <http://www.fgic.com/policyholderinfocenter/2017annualcpprevaluationnotice.pdf>; <http://www.fgic.com/policyholderinfocenter/2016annualcpprevaluationnotice.pdf>; <http://www.fgic.com/policyholderinfocenter/2015annualcpprevaluationnotice.pdf>; <http://www.fgic.com/policyholderinfocenter/2014annualcpprevaluationnotice.pdf>.

³ Freddie Mac did not have any comments on the Plan, so it did not make a submission by the Commission’s July 1, 2019 deadline for comments. FGIC submitted its Comment on June 28, 2019—one business day prior to the expiration of the comment period—making it infeasible for Freddie Mac to respond to FGIC’s Comment by July 1. Freddie Mac respectfully requests that the Commission consider this letter, which is not a comment on the Plan but rather a response to FGIC’s Comment, so that it is fully informed with respect to the issues raised by the FGIC Comment. In light of the Commission’s order extending the deadline for the Commission to enter an order approving or disapproving the Plan until November 30, 2019, and 17 C.F.R. § 201.1104, which provides for, in the Commission’s discretion, republishing for additional comment the Plan if it is “substantially modified,” Freddie Mac submits that it would be most efficient to consider this letter now in conjunction with its consideration of the FGIC Comment.

I. The Plan Appropriately Distributes the Fair Fund to Investors and Does Not Represent an Abuse of the Commission's Discretion

In view of Morgan Stanley's violations of the Securities Act, "[t]he Order created a Fair Fund, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, so the penalty, along with the disgorgement and interest, could be distributed to **harmed investors.**" (Plan ¶ 3 (emphasis added).) That is entirely appropriate. The law is clear that Section 308 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, codified at 15 U.S.C. § 7246, "'establishe[s] the ability of courts [and the Commission] to create Fair Funds for monies from disgorgement and civil penalties' so that those sums can 'be distributed to investors.'" *Cont'l Cas. Co. v. Duckson*, 826 F.Supp.2d 1086, 1097-98 (N.D. Ill. 2011); see 15 U.S.C. § 7246(a)." *Sec. & Exch. Comm'n v. J.P. Morgan Sec. LLC*, 266 F. Supp. 3d 225, 229 (D.D.C. 2017) ("*SEC v. JPM*") (emphasis added). The Commission's Rules of Practice Governing Fair Funds and Disgorgement Plans follow that principle. For example, 17 C.F.R. § 201.1100 authorizes the Commission to "order that the amount of disgorgement and of [a] civil penalty[] ... be used to create a fund **for the benefit of investors who were harmed by the violation.**" (Emphasis added). Similarly, 17 C.F.R. § 201.1101(b)(6) provides that "a plan for the administration of a Fair Fund or a disgorgement fund **shall** include ... [p]rocedures for the administration of the fund, including selection[] ... of a fund administrator to ... , subject to the approval of the Commission, make distributions from the fund **to investors who were harmed by the violation[.]**" (Emphasis added).

However, "the primary purpose of the distribution still is not compensation of victims but rather remains punishment of the individual violator and deterrence of future violations." *SEC v. JPM*, 266 F. Supp. 3d at 229 (quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. Sec. & Exch. Comm'n*, 467 F.3d 73, 81 & 83 (2d Cir. 2006) (other citations omitted) (internal quotation marks omitted)). Accordingly, courts will approve a Fair Fund, "so long as it proposes a fair and reasonable allocation of recovered funds **to investors.**" *SEC v. JPM*, 266 F. Supp. 3d at 229 (bolded emphasis added) (citation omitted). Notably, "[s]ome investors will invariably be excluded" from a Fair Fund. *SEC v. JPM*, 266 F. Supp. 3d at 229. Thus, "[t]he SEC may engage in the kind of line-drawing [that] inevitably leaves out some potential claimants." *Id.* (quoting *WorldCom*, 467 F.3d at 83, and *Sec. & Exch. Comm'n v. Wang*, 944 F.2d 80, 88 (2d Cir. 1991)) (other citation omitted) (internal quotation marks omitted) (second brackets in original).

While the case law recognizes the right of the SEC to decide which investors to include and which investors to exclude from a fair fund, *FGIC is not even an investor* in the NC4 Securitization and thus has no right whatsoever to receive a distribution from the Fair Fund.⁴

⁴ Consistent with the Commission's determination that Morgan Stanley "violated Section 17(a)(2) and (3) of the Securities Act[]" (Order ¶ 40), the "Eligible Certificates" under the Plan are "securities," 15 U.S.C. § 77q(a), and Morgan Stanley "obtain[ed] money and property" from

The Plan satisfies the requirements of the Commission's Rules of Practice Governing Fair Funds and Disgorgement Plans and governing law by making distributions to the investors harmed by Morgan Stanley's violations of the Securities Act that are the subject of the Commission's Order. *See, e.g.*, 15 U.S.C. §§ 77q(a)(2) & (3); 17 C.F.R. § 201.1100; *id.* § 201.1101(b)(6); *SEC v. JPM*, 266 F. Supp. 3d at 229. Standing on its own, the Plan is fair and reasonable and it should be approved without alteration.

II. FGIC's Proposed Alterations to the Plan Are Unwarranted and Improper

FGIC requests that the Commission radically alter the Plan in three ways: by making FGIC an Eligible Claimant; by reducing the face value of Eligible Certificates under the PSA in the amount of the investors' recovery from the Fair Fund; and by allocating the Fair Fund according to all collateral losses in the NC4 Trust and the MSAC 2007-HE7 Trust (the "HE7 Trust").

FGIC's proposed changes to the Plan are flawed because they focus on the contractual relations of FGIC with Deutsche Bank National Trust Company in its capacity as the trustee of the NC4 Trust (the "Trustee"), instead of on the Commission's findings regarding Morgan Stanley's violations of the Securities Act. FGIC's proposal is premised on a fundamental misunderstanding of the Commission's duties and the purpose of a fair fund distribution, and the Comment should be rejected in its entirety.

A. FGIC Should Not Receive a Distribution From the Fair Fund

FGIC argues that "the Plan should be amended to state expressly that guarantors of Eligible Certificates (including a financial guarantor such as FGIC) shall be considered Eligible Claimants, and the successors in interest to the initial purchasers of those Eligible Certificates." (Comment at 2.) But, as set forth above in Section I, FGIC is not—and does not claim to be—an investor in the NC4 Securitization. Accordingly, FGIC is not entitled to a distribution from the Fair Fund under the Commission's Rules of Practice Governing Fair Funds and Disgorgement Plans and 15 U.S.C. § 7246. *See, e.g.*, 17 C.F.R. § 201.1100; *id.* § 201.1101(b)(6); *SEC v. JPM*, 266 F. Supp. 3d at 229.

SEC v. JPM is instructive. In that case, a certificateholder urged the court to amend a fair fund distribution plan so that it would more closely follow the contractual "waterfall prioritization that is 'fundamental to the structure, value and risk of the Certificates.'" 266 F. Supp. 3d at 230. The court rejected the argument, explaining that it "need not strictly adhere to

the Eligible Claimants, *id.* § 77q(a)(2)—*i.e.*, the investors who are "the purchaser[s]" of those Eligible Certificates, *id.* § 77q(a)(3). In contrast, FGIC is not a "purchaser[]" of the Eligible Certificates, *id.*, and Morgan Stanley did not "obtain money and property" from FGIC, *id.* § 77q(a)(2).

the underlying investments' priority structures[]” because “[t]here is ‘no indication in the Fair Fund provision’ that the SEC must abide by the underlying ‘claim priorities when developing a distribution plan.’ *WorldCom*, 467 F.3d at 84–85” *SEC v. JPM*, 266 F. Supp. 3d at 230 (other citation omitted).

So too here: As set forth in the complaint FGIC filed against Morgan Stanley (*see Exhibit C* (“Complaint”)), FGIC’s claims are all contract based and relate to the PSA, the “Insurance Policy” referenced in FGIC’s Comment (*see Exhibit D*) and the related Insurance and Indemnity Agreement (the “I&I Agreement,” attached hereto as *Exhibit E*). FGIC’s contractual claims against Morgan Stanley have no bearing on a fair fund distribution.

Moreover, FGIC’s assertion that it is subrogated to all rights of the “Insured Certificateholders” is simply not true. In that regard, *Ambac Assurance Corp. v. EMC Mortg. Corp.*, No. 08CIV9464RMBTHK, 2010 WL 11595698 (S.D.N.Y. Dec. 16, 2010) (“*Ambac I*”), *report and recommendation adopted in part sub nom. Ambac Assur. Corp. v. EMC Mortg. Corp.*, No. 08 CIV.9464 RMB THK, 2011 WL 566776 (S.D.N.Y. Feb. 8, 2011) (“*Ambac II*”), is directly on point.⁵

Ambac was, like FGIC, “a guarantor of an asset-backed” security and asserted claims under Sections 10(b) and 20 of the Securities Exchange Act of 1934 (the “Exchange Act”), despite the fact that Ambac, like FGIC, “did not purchase (or sell) any of the debt securities at issue” in the case. *Ambac I*, 2010 WL 11595698 at *10. Because that fact precluded Ambac’s attempt to assert its claims under the Exchange Act, *see id.*, Ambac argued that it was contractually and equitably subrogated to the holders of the notes (*i.e.*, the investors). *See id.* at *10-12.

The *Ambac I* court rejected Ambac’s argument in full. *See id.* at *10-15. With respect to contractual subrogation, *Ambac I* found that while the “transaction documents make clear that Ambac is, indeed, subrogated to certain of the rights of the Noteholders to receive payments **from the Trusts,**” Ambac was subrogated “only to the extent of Ambac’s advances, and **only insofar as those rights and recoveries are available to the Trusts to extend to the Noteholders – specifically, the right to receive payments of principal and interest from sources available to the Trusts.**” *Ambac I*, 2010 WL 11595698 at *10 (emphasis added). Beyond that, the court found that Ambac was not contractually subrogated to the investors because it “ha[d] not entered into any agreements with the Noteholders directly.” *Id.* at *11. Ambac therefore lacked “privity of contract with the Noteholders,” and so “**the exclusive sources of contractual subrogation available to Ambac are through its agreements with the Trusts only.**” *Id.* (emphasis added).

⁵ The *Ambac I* case was decided under New York law, which governs the PSA (Section 12.03), Insurance Policy (p. 4) and I&I Agreement (Section 6.04). *See Ambac I*, 2010 WL 11595698 at *11 n.3.

The court rejected Ambac's claim that it was entitled to equitable subrogation for essentially the same reasons that it rejected Ambac's claim to contractual subrogation. "[T]he 'insureds'" under the relevant policies "were the Trusts," which "d[id] not have standing to bring Section 10(b) claims," and "such standing [had not] been assigned to the Trusts by the Noteholders." *Id.* at *13. "[B]ecause the Trusts [could not] recover on alleged violations of Section 10(b), Ambac, 'standing in the shoes' of the Trusts, [was], similarly, unable to assert such claims." *Id.*

In *Ambac II*, Judge Berman agreed and adopted the relevant portion of the Report and Recommendation that makes up *Ambac I*. In so doing, he held that "'Ambac d[id] not obtain standing [to assert securities law claims] by virtue of its status as a guarantor of an asset-backed note[]'" and did not have "'the right ... to allege federal securities fraud claims on behalf of third parties who are neither signatories to, or the insureds under, the underlying [A]greements[.]'" *Ambac II*, 2011 WL 566776 at *3 (citations omitted).

The result is the same here as in *Ambac I* and *II*. FGIC has no contractual privity with any certificateholder because the Insurance Policy and the I&I Agreement—the only documents signed by FGIC—both insure the Trust, not the certificateholders. The certificateholders did not sign the Insurance Policy or the I&I Agreement, nor did they agree to be bound by them. The only agreement that binds the NC4 certificateholders is the PSA. (*See, e.g.*, PSA at Ex. A of the PSA (Form of Class A, Class M and Class B Certificate), p. 176 of the pdf ("This Certificate is issued under and is subject to the terms, provisions and conditions of the [PSA], to which [PSA] the Holder of this Certificate by virtue of the acceptance hereof assents and by which such Holder is bound.")) But the PSA, like the trust indentures for the transactions in *Ambac I*, only subrogates FGIC to the right to receive payments of principal and interest from the NC4 Trust.

Subrogation is addressed in Section 4.08 of the PSA, titled "Effect of Payments by the Certificate Insurer; Subrogation." Specifically, Section 4.08 provides that

(a) to the extent the Certificate Insurer makes payments, directly or indirectly, on account of principal of or interest on the Class A Certificates to the Holders of such Class A Certificates, the Certificate Insurer will be fully subrogated to, and each Class A Certificateholder, the Servicer and the Securities Administrator hereby delegate and assign to the Certificate Insurer, to the fullest extent permitted by law, **the rights of such Holders to receive such principal and interest from the Trust Fund**, including, without limitation, any amounts due to the Class A Certificateholders in respect of securities law violations arising from the offer and sale of the Class A Certificates, and (b) the Certificate Insurer shall be paid such amounts **from the sources and in the manner provided herein for the payment of such amounts and as provided in this Agreement.**"

(Emphasis added.) This language is essentially the same as the language of the trust indentures that *Ambac I* held subrogated Ambac only to "the right to receive payments of principal and interest from sources available to the Trusts." *Ambac I*, 2010 WL 11595698 at *10; *cf. also id.*

“(i) to the extent [Ambac] makes payments under the Policy on account of principal of, or interest on, the [Notes], [Ambac] will be fully subrogated to the rights of such [Noteholders] to receive such principal and interest from the [Trust], and (ii) [Ambac] shall be paid such principal and interest but only from the sources and in the manner provided herein and in the [I&I Agreement.]” (quoting SACO 2006-8 Indenture) (emphasis added) (other alterations in original)). Moreover, because there is no “specific and express assignment of [securities law] claims in” the PSA, it would be improper to “imply an assignment of the [NC4 certificateholders’] independent securities law claims to the [NC4] Trust[]—and, in turn, to [FGIC].” *Ambac I*, 2010 WL 11595698 at *12. Thus, while FGIC may be entitled to receive reimbursement from the NC4 Trust under certain circumstances, it is not subrogated—contractually or equitably—to certificateholders with respect to any money they may receive outside of the Trust, including any distribution from the Fair Fund.⁶

FGIC’s Comment fails to make any mention of Section 4.08 of the PSA. That omission is particularly notable because Section 4.08 makes clear that FGIC is subrogated with respect to payments “in respect of **securities law violations** arising from the offer and sale of the Class A Certificates[]” **only** where those payments would constitute payments of “principal and interest from the Trust Fund[.]” (Emphasis added.) In other words, FGIC is only subrogated to certificateholders with respect to payments related to violations of securities laws where the payment is made from the NC4 Trust, which has no application here.

Perhaps recognizing that Section 4.08 of the PSA is fatal to its argument, FGIC instead quotes from Section 5.07 of the PSA, a provision that does not even address subrogation and is instead directed at the “**Voting Rights** of the Certificate Insurer,” as its title states. (Emphasis added.) And even if Section 5.07 did address subrogation, it would, by its own terms, apply only to those “rights[] ... which the Holders of the Class A Certificates are entitled to **exercise under this Agreement.**” (Emphasis added.) That plainly does not reach a certificateholder’s securities law claims or the Commission’s Fair Fund distribution, which are not rights exercised under the PSA.

In sum, FGIC’s first proposed alteration to the Plan should be rejected both because FGIC is not an investor in the Trust and because FGIC’s subrogation rights do not apply to the Fair Fund.⁷

⁶ FGIC at least seems to recognize that, to the extent it is equitably subrogated, it is only to the Trust, but inexplicably dismisses that fact as something “not relevant here[.]” (Comment at 2 n.1.) As *Ambac I* and *II* both demonstrate, that is simply not true. FGIC’s lack of equitable subrogation to certificateholders in the NC4 Trust results from the same underlying facts that limit FGIC’s contractual subrogation to only payments of principal and interest paid from the NC4 Trust. (*Cf.* PSA § 4.08.)

⁷ For the same reasons, FGIC is neither a “recipient” of Eligible Certificates by “operation of law” nor a “donee,” as even FGIC appears to concede in the Comment. (Comment at 2 n.2.)

B. FGIC's Request to Alter the PSA Is Baseless

FGIC's second proposal may be more extraordinary than its first by asking the Commission to amend the Plan "to provide that any amounts paid to Eligible Claimants who are still holders of Eligible Certificates **will reduce dollar-for-dollar any Stated Amount (as defined in the PSA)** of those Eligible Certificates." (Comment at 2 (emphasis added).)

The thrust of FGIC's proposal seems to be that the "Certificate Balance" of an Eligible Certificate should be reduced by the amount of any distribution received under the Plan.⁸ This request should be denied because it effectively asks the Commission to mandate an amendment to a contract between private parties, which is far beyond the scope of the Commission's duties and in conflict with the amendment provisions of the PSA.

The term "Certificate Balance" is defined in the PSA as,

[w]ith respect to any Class of Certificates[] ... at any date, the maximum dollar amount of principal to which the Holder thereof is **then entitled hereunder, such amount being equal to** the Denomination thereof minus all distributions of principal previously made with respect thereto and in the case of any Subordinated Certificates, reduced by any Applied Realized Loss Amounts allocated to such Class of Certificates pursuant to Section 4.05[.]”

(PSA § 1.01 (definition of "Certificate Balance").)⁹ The PSA provides that the payment of principal by the Trust to the certificateholders reduces the Certificate Balance of the certificates. (See *id.*; *id.* §§ 4.02(a), (c), & (d).) The Fair Fund does not involve the payment of principal and is not distributed by or to the NC4 Trust. Rather, the Fair Fund is comprised of monies from Morgan Stanley's disgorgement and payment of prejudgment interest and a civil penalty and is distributed by the Commission to the investors harmed by Morgan Stanley's violations of the securities laws. (Plan at 2.) Distributions from the Fair Fund thus have no impact on the Certificate Balance.

⁸ It is not entirely clear what FGIC proposes because it asked the Commission to reduce the Eligible Certificates' "Stated Amount (as defined in the PSA)," but that is not a defined term in the PSA. Indeed, the term is only used once in the PSA—without capitalization—to describe the "stated amount" that the NC4 Trust's Master Servicer must specify in an Officer's Certificate regarding nonrecoverable advances. (See PSA § 9.01(a).)

⁹ The "Denomination" of any Certificate under the PSA is, "[w]ith respect to each Certificate, the amount set forth on the face thereof as the 'Initial Certificate Balance of this Certificate'" (PSA § 1.01 (definition of "Denomination").)

Moreover, the PSA has a method for amending the PSA and it requires the further agreement of “the Depositor, the Servicer, the Master Servicer, the Securities Administrator and the Trustee,” and, in some cases, “the consent of ... the Holders of Certificates evidencing Percentage Interests aggregating not less than 66(2)/3% of each Class of Certificates affected” by the amendment.¹⁰ (PSA § 12.01.) Accordingly, the PSA cannot be amended by order of the Commission.

FGIC’s proposed amendment should be rejected for prudential reasons as well. Notably, the Certificate Balance is the main driver of the Plan’s Recovery Cap. (*See* Plan ¶ 63 (c).) For those who continue to hold the Eligible Certificates, the Recovery Cap is

measured as the difference between (1) the original face value of the Eligible Certificates, and (2) the sum of (i) principal distributions received as of and including the date of the Summary Notice Publication, and (ii) the face value of the Eligible Certificate as of the date of the Summary Notice Publication, multiplied by the closing price of the Eligible Certificate on that date as determined by the Fund Plan Administrator.

(*Id.*) By including the principal received and the market price of the Eligible Security, the Recovery Cap incorporates all payments received by investors from FGIC and the market’s expectation of any future payments by FGIC. As a result, to the extent it is even relevant, contrary to FGIC’s contention, investors will not receive a “double recovery” on their investment. In contrast, FGIC seeks full subrogation to the rights of the insured certificateholders, notwithstanding that it has no basis to do so, while also seeking recoveries directly from Morgan Stanley through its Complaint.¹¹

For all of the above reasons, FGIC’s request that the Commission order that the Certificate Balance of the investors be written down is without basis and should be rejected.

¹⁰ In addition, no amendment can “reduce in any manner the amount of, or delay the timing of, payments required to be distributed on any Certificate without the consent of the Holder of such Certificate.” (PSA § 12.01.)

¹¹ FGIC’s proposed reduction of the Certificate Balance of the Class A certificates could also have the perverse effect of benefitting Morgan Stanley by allowing the Fair Fund distribution to reduce Morgan Stanley’s potential liability to FGIC. As noted above, FGIC is seeking recoveries directly from Morgan Stanley through its Complaint. However, Morgan Stanley is potentially liable to FGIC only for amounts that FGIC pays to the NC4 Trust. Thus, reducing the Certificate Balance of the Eligible Claimants’ certificates will reduce what FGIC has to pay, which will in turn reduce Morgan Stanley’s potential liability to FGIC. That result would undermine the punitive and “deterrent effect of the civil penalty[]” imposed by the Commission (Order at 10), which is the “the primary purpose” of the Fair Fund distribution, *SEC v. JPM*, 266 F. Supp. 3d at 229 (citation omitted) (internal quotation marks omitted).

C. The Allocation of the Fair Fund Should Not Be Altered

FGIC's final request is that the Commission change the allocation between the NC4 and HE7 Trusts to reflect the total collateral losses of each trust. (Comment at 3.) While Freddie Mac would benefit from FGIC's third proposed alteration of the Plan, it cannot say that the Plan is either unfair or unreasonable in this respect.

FGIC bases its proposed allocation of the Fair Fund on the total collateral losses in each Trust as compared to each Trust's total collateral. (*See id.*) FGIC appears to claim that the Commission intended to follow FGIC's allocation scheme, but made a mathematical error. However, the Plan clearly proposes distributing the Fair Fund "in proportion to the actual and projected losses of the **misrepresented previously or currently delinquent loans** contained in each Trust[.]" (Plan ¶ 59 (emphasis added).) The losses attributable to the misrepresented previously or currently delinquent loans at the time of the issuances are spelled out in the Commission's Order. (*See* Order ¶¶ 21, 26, 28, & 29.)

The Commission's approach fairly and reasonably looks at the actual and projected losses related to the loans that are the subject of the misstatements that form the basis of the findings in the Commission's Order. The Commission's focus on the loans underlying the Commission's findings is not, as FGIC argues, an "arithmetical error" (Comment at 3.) It is a principled choice that is within the Commission's discretion to make. Thus, there is no need to alter the Plan's allocation of the Fair Fund between the HE7 and NC4 Trusts.

FGIC is neither an investor in the NC4 Securitization nor subrogated to the Eligible Claimants' claims under the Plan. Accordingly, FGIC is not entitled to any distribution from the Fair Fund. At bottom, FGIC is not a victim of Morgan Stanley's violations of the Securities Act. FGIC's proper remedy is the one it has already sought in its litigation against Morgan Stanley. As discussed above, FGIC's proposals would run afoul of the fair fund distribution rules and regulations and unfairly deny recoveries to investors who were the victims of Morgan Stanley's violations of the Securities Act. Accordingly, FGIC's Comment should be rejected and the Plan should be approved without alteration.

Respectfully submitted,



Kyle A. Lonergan

Attachments

cc: Henry J. Ricardo, Esq. (via hand delivery, with attachments)