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November 18, 2010

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Elizabeth M. Murphy, Secretary

Re: General Comments on ABS-Related Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Ladies and Gentlemen:

We greatly appreciate the receptiveness of the staff (the "Staff") of the Securities and Exchange Commission (the "Commission") to comments on upcoming rulemaking required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). In particular, we appreciate the time the Staff spent with us both during our meeting on October 14, 2010, and in our subsequent conversations. At our meeting, the Staff invited us to submit written comments articulating our views. This letter is the first of several that we anticipate submitting on the topics we discussed.

Securitization has been a vital component of consumer and commercial lending in the United States and around the world. However, the recent financial crisis has severely impaired the ability of lenders to obtain funding from the capital markets. Excluding government-sponsored and government-guaranteed (or agency) residential mortgage-backed securities ("RMBS"), the issuance of asset-backed securities ("ABS") has decreased by over 90% since its peak in 2005.[1] While we do not necessarily advocate for securitization to again become as ubiquitous as it was in 2005, a recovery in the securitization markets is crucial to restoring lending activity and reviving the overall U.S. economy. We recognize that some aspects of securitization can be improved upon, based on lessons learned during the financial crisis. But we have studied this issue carefully, and we are convinced that a key factor in the performance of securitizations – of whatever asset type – has been the quality of assets being securitized, not flaws in any typical ABS transaction structure or any inherent defect in the concept of securitization itself. Investment grade ABS of most types have performed well, considering the adverse economic environment.

[1] *See* Chart 1 below.

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In our view, the securities that have performed unexpectedly poorly share one defining characteristic: they were backed by poor quality assets that inherently involved more credit risk. It is by focusing on asset quality that the Commission and other federal regulatory agencies can do the most to help protect investors and to re-start the securitization markets.

In our view, the passage of the Dodd-Frank Act demonstrates that Congress has already come to the same conclusion. As described further below, in mandating that the Commission and other federal agencies adopt regulations that require securitizers and originators to retain a portion of the risk associated with securitizations, the Dodd-Frank Act requires the establishment of separate underwriting criteria for discrete asset classes. Therefore, in transactions involving asset classes that generally demonstrate lower credit risk, credit risk retention should not be required. Investment grade ABS backed by most asset classes did not (and are not expected to) incur any losses, even in the midst of the longest recession since World War II,[2] so it would be counterproductive to constrain the availability of credit to American consumers and businesses who did not contribute to the financial crisis. In our view, overbroad regulatory approaches will serve only to deprive the U.S. economy of the lending capacity that we urgently need to promote growth and stimulate the economy, while providing no material benefit to investors.

We agree with the view expressed by the Commission in its recent proposal to revise its rules relating to ABS and other structured finance products (the "2010 ABS Proposal") that a borrower's ability to repay is an important element of investors' analyses of securitized assets.[3] However, we also believe that the policy rationale for encouraging the origination and securitization of high quality assets is so important that, in addition to exemption from credit risk retention requirements, securitizations of high quality assets also warrant less stringent disclosure and reporting requirements. In our view, where pool assets meet clearly established regulatory standards for the origination of high quality receivables, investors' analyses will not require the same level of detailed asset disclosure and reporting that would be important to an analysis of lower quality receivables.

The Importance of the Securitization Markets

As noted by the Commission in the 2010 ABS Proposal, "[m]any of the problems giving rise to the financial crisis involved structured finance products, including mortgage-backed securities" and other ABS.[4] However, securitization was and remains a vital means of increasing the availability of credit and lowering its cost to both businesses and individual consumers. The Board of Governors of the Federal Reserve System (the "Federal Reserve") acknowledged these and other benefits of securitization in its recent report to Congress regarding credit risk retention (the "Federal Reserve Report"), which was submitted as required by Section 941(c) of the Dodd-Frank Act, stating that "securitization provides economic benefits that may lower the cost of

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2 National Bureau of Economic Research.
3 Asset-Backed Securities, SEC Release Nos. 333-9117, 34-61858, 75 Fed. Reg. 23328, 23355 (May 3, 2010).
4 *Id.* at 23330.

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credit to households and businesses."[5] As noted by Federal Reserve Chairman Ben Bernanke with regard to mortgage loans, "[t]he ability of financial intermediaries to sell the mortgages they originate into the broader capital market by means of the securitization process serves two important purposes: [f]irst, it provides originators much wider sources of funding than they could obtain through conventional sources, such as retail deposits; second, it substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks associated with holding mortgages to maturity, thereby reducing the overall costs of providing mortgage credit."[6] The chief executive officer of a major institutional investor put it much more bluntly: "For 30 years, mortgage securitization saved American homeowners 250 basis points [on their mortgages]."[7]

This tremendous cost savings explains the explosive growth in securitization. As described in Exhibit A to this letter, for example, the share of private nonfinancial debt outstanding that was intermediated through the securities markets increased from approximately 31 percent in 1980 to approximately 57% percent in 2007, increasing only slightly more to approximately 58 percent year to date in 2010. During the same periods, the share of such debt intermediated through depository institutions decreased from approximately 46 percent in 1980 to approximately 29 percent in 2007, decreasing only a bit more to approximately 28 percent year to date in 2010.[8]

While the share of securitized debt has remained relatively constant even during the financial downturn, as demonstrated by Chart 1 below, absolute volumes of securitization issuance have declined precipitously and the types of ABS issued have shifted dramatically toward government-guaranteed securities. At the height of the market in 2005, approximately $1.5 trillion of ABS were issued, of which only approximately $333 billion were agency RMBS, approximately $293 billion were various types of consumer ABS, and approximately $736 billion were non-agency RMBS. These levels of issuance remained relatively steady through 2007. After the credit crisis began, total securitization volume declined sharply. Year to date in

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[5] Federal Reserve, "Report to the Congress on Risk Retention," at p. 8. These benefits come from a reduction in the cost of funding that arises in several ways. "First, firms that specialize in originating new loans and that have more difficulty funding existing loans may use securitization to access more-liquid capital markets for funding. Second, securitization can also create opportunities for more efficient management of the asset–liability duration mismatch generally associated with the funding of long-term loans, for example, with short-term bank deposits. Third, securitization allows the structuring of securities with differing maturity and credit risk profiles from a single pool of assets that appeal to a broad range of investors. Fourth, securitization that involves the transfer of credit risk allows financial institutions that primarily originate loans to particular classes of borrowers, or in particular geographic areas, to limit concentrated exposure to these idiosyncratic risks on their balance sheets." *Id.* at pp. 8-9.

[6] Federal Reserve Board Chairman Ben S. Bernanke at the UC Berkeley/UCLA Symposium: The Mortgage Meltdown, the Economy, and Public Policy, Berkeley, California, October 31, 2008, available at http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm

[7] Laurence Fink, Chairman and Chief Executive of BlackRock Inc., from the Wall Street Journal article "BlackRock's Fink: Forget 'Bubble'," November 11, 2009.

[8] As noted on Exhibit A, we calculated these percentages based on Federal Reserve Flow of Funds Accounts.

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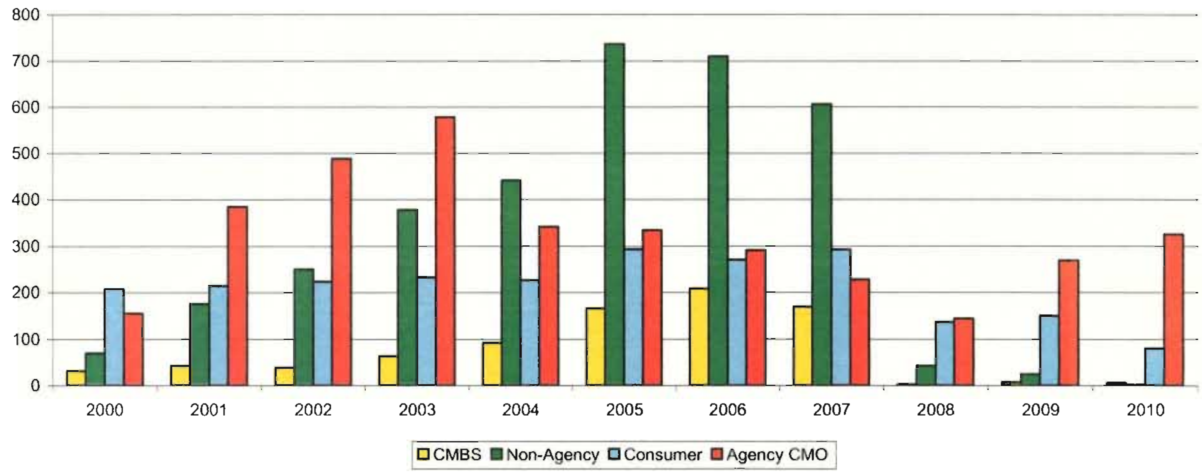
2010, total securitization issuance volume has recovered slightly, but non-agency RMBS issuance has been essentially nonexistent at only approximately $1.1 billion.[9]

Chart 1: Securitization Issuance by Year and Product Type



Source: SIFMA, TREPP, Bloomberg, Commercial Mortgage Alert, Morgan Stanley

As noted by the International Monetary Fund, "[g]iven that securitization has had such a positive impact in the past on increasing the availability and lowering the cost of credit, and in light of the current constraints on lending capacity, restarting securitization could help get credit growth moving again."[10] The key is to restore securitization as a source of lending while specifically addressing the aspects of the securitization process that may have contributed to the financial crisis.

For all these reasons, it is important that regulation of the securitization process be carefully calibrated in order to avoid damaging these markets. In particular, we ask the Commission to consider that adding a risk retention requirement to transactions in which securitization sponsors and their affiliates frequently already have significant investments and risks[11] would adversely affect the economics of securitization, which could in turn affect the cost and availability of credit to consumers and businesses. Risk retention should be required only

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[9] As noted on Chart 1, we derived these numbers from the following sources: for CMBS issuances, TREPP database (2000-2009) and Commercial Mortgage Alert CMBS Deal Database (2010); for non-agency issuances, SIFMA Research and Statistics: US Mortgage-Related Issuances (net of CMBS issuances as described above); for consumer issuances, SIFMA Research and Statistics: US ABS Issuance; and for agency RMBS, Bloomberg (ICMO screen).

[10] International Monetary Fund (IMF) Global Financial Stability Report: Navigating the Financial Challenges Ahead, Chapter 2, October, 2009.

[11] In many securitizations the sponsor or its affiliate already, without regard to any required risk retention, retains a first loss or other subordinated interest. Overcollateralization features and reserve accounts represent significant costs of securitization.

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where necessary and appropriate, and not applied in a blanket, formulaic way to transactions in which the pool assets are of relatively high credit quality.

The Significance of Pool Asset Quality

Section 941 of the Dodd-Frank Act attempts to address the role of ABS in the financial crisis, in part, by mandating that within 270 days after enactment the Commission, together with the federal banking agencies[12] and other specified federal agencies,[13] issue regulations requiring securitizers or originators to retain an economic interest in a portion of the credit risk of any securitized asset. These regulations "shall establish asset classes with separate rules for securitizers of different classes of assets" which "shall include underwriting standards . . . that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." Specifically, the Dodd-Frank Act mandates risk retention lower than the five percent baseline for ABS backed by assets that meet the prescribed underwriting criteria. We believe that this focus on the quality of credit underwriting for specific asset classes is the key to resolving the problems with securitization that have been cited as contributing most strongly to the financial crisis.

Attached to this letter as Exhibit B is a chart entitled "Performance of Broad Categories of Securitized Products," which illustrates estimated losses to investment grade tranches of various categories of securitized products, using estimates of pool losses and applying a generic capital structure for each category of securitized products.[14] (We believe that investors who purchased non-investment grade tranches should reasonably have expected to sustain losses in an adverse economic environment.) Excluding collateralized debt obligations – which present special issues because they were essentially resecuritizations of a pool of subordinated non-prime mortgage bonds – the only categories of securitized products that show extraordinary estimated losses are two types of non-agency RMBS: those backed by subprime mortgage loans and so-called "alt-A" mortgage loans.[15] RMBS backed by jumbo prime mortgage loans are not anticipated to perform nearly as poorly, nor are commercial mortgage-backed securities. Collateralized loan obligations ("CLOs"), credit card ABS[16] and auto loan ABS are expected to perform even better. In sum, during the longest recession since World War II and during a

[12] The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve.
[13] For residential mortgages only, the Department of Housing and Urban Development and the Federal Housing Finance Agency.
[14] The information on this chart is qualified by the notes, qualifications and disclaimers appearing thereon.
[15] Agency RMBS are projected to have virtually no losses to investment grade tranches, primarily due to explicit or implicit Federal government guarantees.
[16] The 5 percent estimated high-side loss to date for investment grade tranches of credit card ABS reflects losses in one specific securitization.

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period in which unemployment has doubled,[17] investment grade securities of most asset classes did not incur, and are not expected to incur, any losses.

Our conclusions are echoed in substantial part by the Federal Reserve Report, which analyzes credit rating downgrades between 2006 and 2010, and notes a high rate of downgrades of subprime and alt-A RMBS and, to a lesser extent, prime RMBS and CMBS, adding that "in all years the other ABS categories have very few or no securities rated likely to default."[18] The Federal Reserve Report goes on to emphasize the especially poor performance during the downturn of non-agency RMBS, with "[t]he deterioration in performance for . . . alt-A and subprime RMBS" being "considerably more severe."[19] The Federal Reserve Report emphasizes the relatively strong performance of credit card ABS,[20] auto loan and lease ABS,[21] CLOs,[22] equipment loan and lease ABS[23] and dealer floorplan ABS.[24] In the end, the Federal Reserve Report recommends that rulemakers "consider crafting credit risk retention requirements that are tailored to each major class of securitized assets" and "[c]onsider the economics of asset classes" as well as securitization structure in crafting risk retention requirements.[25]

In our view, this confirms that the weaknesses in the securitization markets during the downturn have not been primarily structural – rather, the problems have been focused on the categories of products where the pool assets were inherently risky. Alt-A and subprime mortgage loans were expected to perform worse than prime loans, and that expectation turned out to be correct. We believe that the appropriate solution to the problems in the securitization markets lies in encouraging the origination of higher quality assets that can be securitized without the unduly burdensome and expensive disclosure and reporting requirements that may be appropriate for lower quality assets. We urge the Commission, together with the other federal agencies tasked by Congress under the Dodd-Frank Act, to work together to help restore the availability of credit to quality borrowers by encouraging the origination of higher quality assets. If underwriting standards are properly taken into account in the manner contemplated by the Dodd-Frank Act, we believe that the protective measures it imposes should not overly discourage lending.

Regulatory credit underwriting standards must be clear and objective, and easy to diligence and apply. This means that they should be essentially quantitative in nature, rather

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[17] U.S. Bureau of Labor Statistics.
[18] Federal Reserve Report at p. 49.
[19] *Id.* at p. 52.
[20] *Id.* at pp. 55-56.
[21] *Id.* at pp. 57-59.
[22] *Id.* at pp. 62-63.
[23] *Id.* at pp. 63-65.
[24] *Id.* at p. 65.
[25] *Id.* at p. 83.

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than qualitative and subject to interpretation or opinion. For example, a set of credit-granting standards that includes a requirement for a loan to be in the best interest of the borrower would be impossible to verify with any certainty. This would leave the originator unable to take advantage of any regulatory benefits of complying with that entire package of specified underwriting standards, and more importantly from a public policy standpoint, could discourage originators from undertaking to underwrite to that entire set of standards.

As noted in the Federal Reserve Report, "capital markets are . . . dynamic, and thus periodic adjustments to any credit risk retention requirements [and associated underwriting standards] may be necessary to ensure that the requirements remain effective over the longer term, and do not provide undue incentives to more intermediation into other venues where such requirements are less stringent or do not apply."[26] We agree. In addition, if there is no mechanism to update regulatory underwriting standards over time, we believe that would inhibit valuable innovation in the capital markets.

Where credit risk retention requirements or other rules provide more benefits or flexibility for adherence to specified underwriting standards, we believe it is important to promulgate specific underwriting standards for as many asset classes as possible. Otherwise, asset classes without specified underwriting standards may be unfairly disadvantaged.

Section 941 of the Dodd-Frank excludes ABS backed exclusively by "qualified residential mortgages" from the relevant risk retention requirements, separately from the provisions allowing less stringent risk retention requirements for adherence to specified underwriting criteria. We believe that the exemption of securitizations of qualified residential mortgages from the risk retention requirements of the Dodd-Frank Act should greatly encourage the origination and funding of those loans. However, in considering RMBS, we urge the Commission and the other rulemakers not to rely overly on the qualified residential mortgage concept, and to develop effective, specifically tailored underwriting criteria for residential mortgage loans that still would require some credit risk retention, albeit at levels lower than the five percent baseline provided by the Dodd-Frank Act.

We encourage the Commission to promote the origination of high quality assets by maintaining focus on the quality of credit-granting criteria and processes as it considers other applicable rules, such as the 2010 ABS Proposal. We believe that this approach is fully consistent with investor protection. Just as the Federal Reserve Report concluded that "simple credit risk retention rules, applied uniformly across assets of all types, are unlikely to achieve the stated objective of the [Dodd-Frank] Act,"[27] we believe that imposing extensive disclosure and reporting obligations for all asset types – especially for assets originated to high underwriting standards – would be unnecessarily burdensome to securitizers and unnecessary in order for

[26] Federal Reserve Report at p. 85.
[27] Federal Reserve Report at p. 3.

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investors to make an investment decision. As with credit risk retention, a focus on high underwriting standards could be used to refine disclosure and reporting requirements while still protecting investors. We hope that the Commission and the federal banking agencies will continue to recognize the importance of securitization as a means to provide needed credit to consumers, and therefore balance carefully the effect of imposing greater burdens on securitizers against the utility of providing additional information to investors. The scope of required disclosure should continue to be determined by whether the information is material to investors, not merely whether they might like to receive it.

While Section 942 of the Dodd-Frank Act mandates that the Commission adopt regulations requiring ABS issuers to disclose information regarding the underlying pool assets, asset-level or loan-level data are required to be disclosed only "if such data are necessary for investors to independently perform due diligence . . . ." While we agree that more standardized asset-level disclosure on a broader set of data fields would be a positive development, disclosure of the sheer number of data fields proposed by the Commission in the 2010 ABS Proposal is not necessary for ABS backed by assets that are underwritten to a higher and more consistent standard of credit quality. In our view, the cumulative effect of layering significantly more disclosure requirements into the ABS disclosure and reporting regime will greatly reduce the attractiveness of securitization as a form of financing, leading to a reduction in available credit.

As noted in the Federal Reserve Report, "[w]idespread defaults, in which contractual payments were not made to bondholders, were largely concentrated in ABS backed by real estate."[28] As an additional matter, we ask the Commission to consider that for asset classes consisting of simple, short-term obligations with similar terms, such as auto loans, the breadth of asset-level data proposed to be disclosed under the 2010 ABS Proposal should be unnecessary without regard to the underwriting standards applied. As we expect to address in detail in a future comment letter, auto loans are far less complex than residential mortgage loans. For assets of this type, loan-level granularity should not be required.

Future Comment Letters

We intend to submit additional comment letters to the Commission on these and related topics. We hope to address the foregoing in much greater detail in the overall context of the asset-level disclosure and reporting requirements of the 2010 ABS Proposal and the Dodd-Frank Act.

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[28] *Id.* at p. 2.

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In a subsequent comment letter, we expect to address the form of risk retention that should be required under Section 941 of the Dodd-Frank Act in cases where risk retention is applicable. In general, we support the Federal Reserve Report's recommendation that "rulemakers consider crafting credit risk retention requirements that are tailored to each major class of securitized assets," especially in light of the fact that most asset classes performed well in an adverse economic environment. Credit risk retention should be permitted in many forms and formats, depending upon the asset class of ABS in question.

Also in a subsequent comment letter, we hope to address the rules required by Section 621 of the Dodd-Frank Act regarding conflicts of interest in securitizations. In general, we support the views expressed by the American Securitization Forum in its letter dated October 21, 2010 regarding the implementation of Section 621. We agree that it was Congress's intent to eliminate the obvious conflicts of interest that may arise in the context of a securitization, a result which we believe can be more precisely achieved by specifically banning the objectionable activity. In our view, a broad or ambiguous definition of a prohibited "material conflict of interest" would have serious unintended consequences, reducing the number of underwriters or securitizers from whom investors can purchase securities and therefore limiting access to credit by many American consumers and businesses.

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We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with you or with any member of the Commission staff. Please feel free to contact the undersigned at 212-761-2080, or James Lee at 212-762-6148.

Very truly yours,

Stephen D'Antonio
Managing Director
Morgan Stanley

EXHIBIT A

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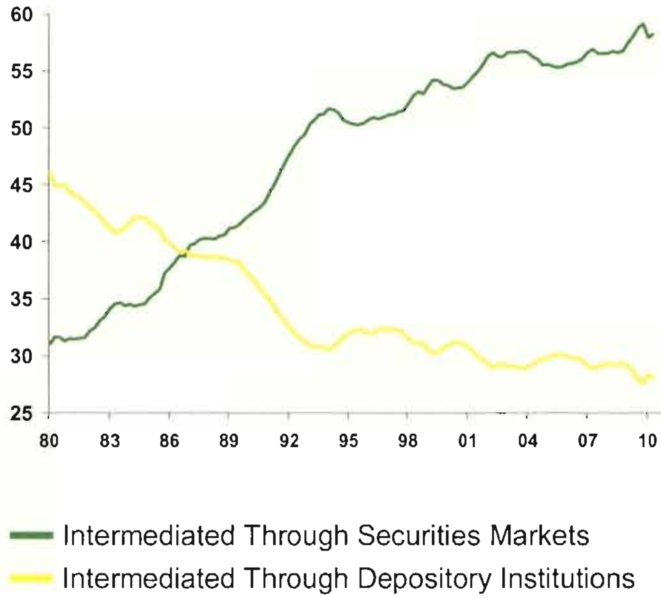
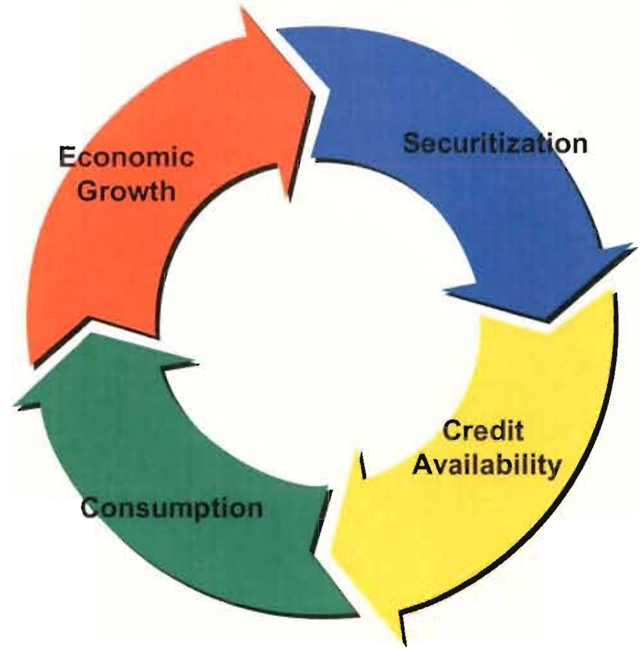
Securitization is an Important Source of Credit Intermediation

Trends in Credit Intermediation

(Share of Private Nonfinancial Debt Outstanding, Percent)





Source: Federal Reserve

Source: Morgan Stanley Research

EXHIBIT B

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Performance of Broad Categories of Securitized Products[1]

	Estimated Losses to Investment Grade Tranches [2]				Outstanding
	To Date		Life time		Market Size [3]
	Low	High	Low	High	(Billion $)
ABS CDO [4]					
- Mezzanine ABS CDO (2005-07 vintages)	60%	70%	75%	90%	80
- High Grade ABS CDO (2005-07 vintages)	30%	35%	60%	70%	170
Non-Agency RMBS					
- Sub prime (2005-07 vintages) [5]	5%	15%	15%	45%	467
- Alt-A (2005-07 vintages) [6]	5%	15%	15%	35%	626
- Jumbo prime (2005-08 vintages) [7]	0%	2%	3%	10%	341
Agency RMBS [8]	0%	0%	0%	0%	6,739
CMBS (2005-2007 vintages)	0%	0%	2%	15%	769
CLO (2004-08 vintages) [9]	0%	0%	0%	1%	319
Credit Card ABS	0%	5%	0%	5%	222
Auto loan ABS	0%	0%	0%	0%	129
Student loan ABS (FFELP)	0%	0%	0%	2%	249
Student loan ABS (Private Credit)	0%	0%	5%	35%	(included above)

Notes:

[1] Losses to investment grade tranches have been calculated using estimates of pool losses and applying a generic capital structure for each category of securitized products.

[2] Investment grade tranches defined as tranches originally rated BBB/Baa and higher.

[3] Outstanding market size for Agency RMBS includes $5,468 billion of pass-throughs and $1,270 billion of agency CMOs as of Q2, 2010. Market size estimates are based on data from SIFMA and S&P for all categories except CLO and ABS CDOs which are Morgan Stanley estimates. 2005-2007 vintage issuance of ABS CDOs were $140 billion and $260 billion for mezzanine and high grade ABS CDOs respectively.

[4] ABS CDO losses are based on Morgan Stanley estimates.

[5] For subprime, pool losses to date are based on ABX 2006-1 for low and ABX 2007-2 for high. Expected life time losses are based on "Subprime RMBS Loss Projection Update: February 2010", Moody's Investors Service, Feb 24, 2010.

[6] For Alt-A, pool losses to date are based on Morgan Stanley proprietary indices - 2006-2 Fixed for low and 2007-2 Hybrid for high. Expected life time losses are based on "Alt-A RMBS Loss Projection Update: February 2010", Moody's Investors Service, Feb 24, 2010.

[7] For Jumbo Prime, pool losses to date are based on PrimeX indices - FRM1 for low and ARM2 for high. Expected life time losses are based on "Prime Jumbo RMBS Loss Projection Update: January 2010", Moody's Investors Service, Jan 20, 2010).

[8] No credit losses assumed due to government guarantees for Agency RMBS. There may be losses in premium bonds due to prepayments.

[9] CLO, credit card, auto and student loan ABS losses are based on Morgan Stanley estimates.