DiMuroGinsberg PC
ATTORNEYS AT LAW

August 2, 2010

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-08-10
Comment on SEC Rel. 33-9117

Dear Ms. Murphy:

Thank you for allowing me to bring to the Commission's attention that the one method allowed for determining the risk retention amount stated in SEC Rel. 33-9117, more specifically, proposed regulation 17 C.F.R. § 239.45(b)(1)(i), is not equivalent to Art. 122a(1) of the EU Capital Requirements Directive 6006/48/EC ("EU CRD"), and, therefore, may give a competitive financial advantage to European sponsors and their customers.

Recommendation

Until the EU amends Art. 122a(1) of the EU CRD to conform to the single method stated in the proposed SEC regulation, the SEC should avoid regulatory arbitrage and ensure that no competitive advantage is given to European markets by amending 17 C.F.R. § 239.45(b)(1)(i)(B) to incorporate the following additional method in those offerings which do not involve a revolving master trust:

> retention of randomly selected exposures, equivalent to no less than 5 % of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is no less than 100 at origination.

Express Differences in proposed Regulatory Text

Proposed SEC Regulation 17 C.F.R. § 239.45(b)(1)(i) differs from Art. 122a(1) of the EU CRD, as approved on May 6, 2009, because the proposed SEC regulation allows sponsors of non-revolving master trust offerings only one method to meet the 5% risk retention amount, which is to retain "five percent of nominal amount of each of the tranches sold or transferred to investors, …" (SEC Rel. 33-9117 at p. 506 [new 17 C.F.R. § 239.45(b)(1)(i)(B)]). This method

908 King Street, Suite 200
Alexandria, Virginia 22314

TEL: 703.684.4333 FAX: 703.548.3181 WEB: WWW.DIMURO.COM

is equivalent to Art. 122a(1)(a) of the EU CRD which requires sponsors of non-revolving master trusts in the EU to retain "no less than 5% of the nominal value of each of the tranches sold or transferred to the investors ... ."

However, the Art. 122a(1) of the EU CRD allows sponsors of offerings which do not involve revolving trusts to use the following alternative methods to determine which assets they must hold:

(c) retention of randomly selected exposures, equivalent to no less than 5 % of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitized exposures is no less than 100 at origination; or

(d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5 % of the nominal value of the securitised exposures.

These methods are not equivalent to Art. 122a(1)(a), nor the proposed SEC regulation.

Art. 122a(1)(c) will allow foreign sponsors to structure the pools of loans/assets for given issuing entities so that the 5% risk retention amount will have a lower average risk rating than those loans or assets held under the proposed SEC regulation. This result, as explained below and in the attached report, can be achieved because the method used to select which loans are held back under Art. 122(1)(c) does not depend on the risk level of the loans selected. Thus, European sponsors can obtain lower transactions costs under Art. 122a(1)(c) which can then be passed through to foreign manufacturer/ borrowers.

Art. 122(1)(d) is not of concern because it will result in higher transaction costs by requiring sponsors to retain those tranches with the highest risk levels.

Staff comments also demonstrate that the proposed SEC Regulation is not equivalent to the EU CRD

SEC Rel. 33-9117 states at page 353 that "the EU and U.S.-issued shelf registered ABS ... would then have comparable risk retention features, or propose self a legibility condition should not cause a reduction in U.S. competitiveness from the status quo that existed prior to the current EU regulations." However, that conclusion is refuted by the following staff comment at page 56 of the April 7, 2010 Release:

> We considered but are not proposing an alternative way to satisfy the risk retention shelf eligibility condition based on retention of randomly-selected exposures. **We are**

> **concerned about the ability to subsequently demonstrate the randomness of the random selection process, including for purposes of monitoring or auditing.** Should we include this alternative? Are there any mechanisms that we could adopt that would ensure adequate monitoring of the randomization process if such an alternative were permitted? For example, would our concerns be addressed if the sponsor was required to provide a third party opinion that the selection process has been random and that retained exposures are equivalent (i.e., share a similar risk profile) to the securitized exposures? Would this be sufficient? Would this opinion resemble a credit rating, raising the same issues that rule reliance on credit ratings has had? If this approach were taken, should we impose any requirements on the characteristics of such a third party? Should that third party be considered an expert for purposes of the registration statement?

(**emphasis added**.)

The following findings demonstrates that the Committee of European Banking Supervisors also knew that the risk retention methods under Art. 122a(1)(a) and (c) are not equivalent and can be "gamed" by sponsors:

> In terms of determining what constitutes an "equivalent" exposure, it is currently envisaged that a random selection process of assets to be securitised will ensure that there is no abuse of the concept of equivalence. If a truly random process is used within a sufficiently large and granular pool (so that one can assume a pool of homogeneous assets in terms of quality), this should ensure equivalence. The question arises of who should confirm that the selection process has been truly random – the firm itself, the auditor of the loan file, the competent authority, or another party. Furthermore, it needs to be ensured that the randomness captures all potential parameters that can impact credit quality; for instance, if vintage was not such a parameter an originator could originate and distribute 100% of poorly underwritten new loans from recent vintages while retaining its 5% in better underwritten seasoned loans from earlier vintages.

(Committee of European Banking Supervisors, Call for Technical Advise on the Effectiveness of a Minimum Retention Requirement for Securitizations at p. 22, para. 61 (30 Oct 2009).)

The attached report demonstrates that the EU capital requirements directive can be used to disadvantage US-Based entities operating under proposed SEC Regulation

The attached report was prepared by Richard Flood, Frank Batten Professor of Business, and Deborah Hewitt, Clinical Associate Professor of Business at the William & Mary Mason School

of Business in Williamsburg, Virginia,[1] for the limited purpose of demonstrating that securitisers acting under Art. 122a(1)(c) can assemble pools of loans allocated to particular issuers so that the average credit rating of the assets held back to meet the 5% risk retention amount is above that offered to investors and that held by sponsors under the proposed SEC Regulation.

Conclusion:

I observed the April 7, 2010 Open Meeting for this Release as Chairman of the Securities Law Committee of the Bar Association of the District of Columbia, but submit this comment in my personal capacity out of concern for others in our general economy.

US-based employers and manufactures may face higher costs of capital than their European competition because sponsors operating under the European Union Capital Requirements Directive can pass through lower transaction costs by electing to use a method not available to U.S. sponsors to determine which assets are held back to meet the 5% risk retention amount. By placing larger nominal amount loans with high credit ratings with smaller nominal amount loans with lower credit ratings, credit institutions and sponsors in the EU may reduce the cost of capital to higher risk borrowers.

While the degree of this disparity is beyond the scope of research supporting this comment, the attached report makes clear that regulatory arbitrage can be avoided by amending proposed regulation 17 C.F.R. § 239.45(b)(1)(i)(B) to conform to Art. 122a(1) of the EU Capital Requirements Directive.

Respectfully submitted,

Ford C. Ladd
Of Counsel

Enclosure
cc: Prof. Richard Flood
Prof. Deborah Hewitt

---

[1] Professor Flood heads econometric studies in the William & Mary Graduate School of Business. Professor Hewett is a Clinical Professor of Economics and Finance, and is also an auditor with the Virginia Retirement System.

WILLIAM & MARY
MASON
SCHOOL of BUSINESS

We were asked by Ford Ladd, Chair of the Securities Law Committee for the Bar Association of the District of Columbia, to analyze the EU document Art. 122a of their Capital Requirements Directive 2006/48/EC. We were to do a statistical analysis of the procedures used to insure that banks would face the same risk as their customers when issuing an SIV. The results indicate that the banks can easily bias the risk in their favor since they control the population of mortgages that go into the SIV.

Consider a situation where the population is 100 mortgages, all the same size, of which 80 are low risk and 20 are high risk. The bank needs to randomly select 5 to meet the requirements of the directive. The probability (using the hypergeometric distribution) that they will get 4 or 5 of the low risk mortgages is 74%. This means their portfolio has a lower risk than the entire population. If the population had 70 low risk and 30 high risk mortgages, the probability is 53%. The banks' ability to select the population allows them to control their own risk. If the banks were to increase the dollar size of the low risk set and decrease the dollar size of the high risk set, they could face even smaller risk. This results from the requirement that they retain 5% of the face value of the mortgages.

Sincerely,

Richard Flood
Frank Batten Professor of Business

Deborah Hewitt
Clinical Associate Professor of Business