Business Law Section
AMERICAN BAR ASSOCIATION

321 North Clark Street
Chicago, IL 60654
(312) 988-5588
Fax: (312)988-5578
www.ababusinesslaw.org
businesslaw@abanet.org

By Electronic and United States Mail

August 17, 2010

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

Re: File No. S7-08-10
Release Nos. 33-9117; 34-61858
Asset Backed Securities

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities and the Committee on Securitization and Structured Finance (the "Committees") of the Section of Business Law of the American Bar Association in response to the request for comments by the Securities and Exchange Commission (the "Commission") in its April 7, 2010 release referenced above (the "Proposing Release").[1]

The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association (the "ABA"). In addition, this letter does not represent the official position of the ABA Section of Business Law.

I. EXECUTIVE SUMMARY

We have organized this letter into six primary sections. Part II of the letter addresses proposed disclosure requirements in general and the loan-level disclosure requirements for specific asset classes, while Part III focuses specifically on the proposal to include a waterfall computer program in the disclosure and the significant technical and liability challenges we believe this will create for issuers. Part IV addresses the proposals to change the conditions for shelf eligibility and the challenges of replacing ratings-based criteria in the absence of another indicator of credit quality that has been adopted by the markets. Part V discusses the proposals for timing of disclosure, or "speed bumps," and explores the idea of establishing a special class for well-established programmatic issuers to which such speed bumps would not apply. Part VI addresses our concerns with respect to the proposed changes to the Rule 144A and Rule 506 safe harbors, and suggests alternative approaches if the Commission cannot be persuaded to allow the private markets to self-correct. Part VII discusses transition issues.

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1 Asset-Backed Securities, 75 Fed. Reg. 23328 (May 3, 2010) (hereinafter, the "Proposing Release").

The table of contents for the letter is as follows:

We very much appreciate the high degree of research and analysis by the Commission that is reflected in the Proposing Release. The Proposing Release sets forth a very thoughtful approach to some of the critical issues currently facing the securitization markets. We also appreciate that the Commission has acknowledged the importance of the securitization markets to the availability of credit,[2] and the significance of a stable market to the promotion of capital formation and investor confidence.[3] We share those goals. Our approach to the Commission's proposals has generally been to consider them against the backdrop of the existing marketplace, to evaluate whether they are likely to serve the stated goals in a market-efficient manner, and to explain, where we differ, the reasons for such differences.

There are numerous aspects of the proposals that we believe represent positive developments for securitization. We support, for example, the idea that asset-backed securities ("ABS") should have their own registration forms as reflected in the proposals for new Forms SF-1 and SF-3, and we support pay-as-you-go registration fees, which we believe will mitigate some of the concerns we might otherwise have had regarding the proposal to limit each registration statement to one depositor and one asset class. In addition, we support many of the proposed disclosure enhancements for securitization offerings registered under the Securities Act, especially those for residential mortgage-backed securities ("RMBS") and commercial mortgage-backed securities ("CMBS"). We support the requirements for loan-level data for RMBS, subject to specific points we discuss, and we support more granular data for all asset classes, again subject to comments on the specific proposals.

That being said, we believe strongly that disclosure enhancements, especially for asset classes that do not include mortgage loans or other assets related to real estate, should provide investors with meaningful additional data but neither make securitization too expensive to be a viable funding alternative for some sponsors nor require information that is so extensive and competitively sensitive as to make it untenable for others. We do not believe the proposed rules will achieve the appropriate balance unless modified significantly. The proposals, if adopted in their current form, would vastly expand the amount of information sponsors would be required to provide and would require sponsors to update such information frequently. In many instances, the proposals would require sponsors to gather and present data in ways that differ from the manner in which they maintain and evaluate data using their own internal processes. Among other things, the preparation of such information would likely impose upon sponsors systems and

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2 *See* Proposing Release at 23329-30. As we and others have discussed elsewhere, securitization is an important financing tool that has expanded the availability and lowered the cost of obtaining consumer credit, enhanced liquidity in the corporate loan markets and provided an inexpensive source of funding for many mainstream U.S. businesses that use it to borrow against their trade receivables. *See also* "Securitization in the Post-Crisis Economy: An ABA Business Law Section White Paper," A.B.A. Sec. & Structured Fin. & Banking Law Comms. (Jan. 25, 2010), *available at* http://www.abanet.org/buslaw/committees/CL112000pub/materials/2010/buslawabalettertocongressassetsecuritizationreportjan252010.pdf; Dr. Faten Sabry & Dr. Chudozie Okongwu, "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," NERA Econ. Consulting (June 17, 2009), *available at* http://www.nera.com/extImage/PUB_ASF_Report_June_2009.pdf.

3 *See* Proposing Release at 23330.

auditing costs and management oversight burdens that we believe the Commission has significantly underestimated.

The disclosure requirements of Regulation AB as adopted in 2004, which codified and expanded decades of market guidance that had been developed as a result of continual dialogue between the Commission and market participants, continue to be substantially appropriate for many registered securitization transactions involving asset classes other than RMBS and CMBS. New issuances securitizing credit cards and auto loans and leases, for instance, have revived without significant market-driven changes to the disclosure package. For these asset classes, more incremental expansions of existing disclosures could provide as much additional *useful* information as would be provided through the Commission's proposed disclosure requirements, with less cost and competitive burden to issuers and fewer privacy concerns for the underlying obligors. As we discuss in Part II of this letter, as the number of assets in a securitized pool increases and the size of each individual asset declines, we believe investors will generally have to aggregate and stratify asset-level data to use it, rather than evaluate individual loans. Indeed, particularly for securitizations with a large number of assets, we believe loan-level disclosures are not necessary for investors to conduct their own due diligence, nor can they practically support analysis at the level of the individual loan. In such circumstances, we believe the Commission should require more extensive and layered aggregate data and pool stratifications, rather than loan-level disclosures. In this regard, the suggestions of the American Securitization Forum in its comment letter to the Proposing Release[4] with respect to credit card securitizations, which built upon the Commission's proposal but would present aggregate and grouped asset data in ways that would facilitate a more granular and layered risk analysis, may provide a useful model for other asset classes as an alternative to loan-level disclosures.

We have a significant degree of respect for the operation of market forces. The markets are now aware of the weaknesses that were exposed in the crisis, and are in the process of responding to these issues. Investors in securitization transactions are requiring greater transparency and disclosure where needed, and issuers and sponsors are aware that their ability to successfully structure and market securitization transactions depends upon their demonstrating their credibility to their investor base, and undertaking the additional efforts required to gain that credibility. This process tends to be dynamic; investors, issuers and sponsors have an interest in identifying the information that is most material to the transaction, and in seeking to obtain and present it in a cost-effective manner. In our view, an overly robust series of amendments to Regulation AB could undermine the development of market-driven solutions, lead to inefficiency and inhibit capital formation.

We also note that the scope of the proposed changes potentially would have effects well beyond the securitization market, especially to the extent the proposals challenge core precepts regarding the appropriate restrictions on private market transactions, and we have considered these proposals in light of the capital markets as a whole. We have serious concerns about extending the reach of the revised Regulation AB disclosure proposals to the private markets by

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4 Comment letter, dated August 2, 2010, of Tom Deutsch, Executive Director, American Securitization Forum, *available at* http://www.sec.gov/comments/s7-08-10/s70810-70.pdf ("ASF Comment Letter")

conditioning the availability of important regulatory safe harbors on commitments to provide information equivalent to that for a registered public offering. Moreover, we are concerned that these proposals would create uncertainty about the availability of resale safe harbors for a large range of securities that are not traditional asset-backed securities, potentially harming liquidity in the private markets. As we discuss in more detail in this letter, we urge the Commission to reconsider this proposal, and we offer some suggestions as to how the Commission can use its significant influence to foster enhanced disclosures in the private markets without impairing the regulatory safe harbors.[5]

Securitization reform requires a careful balance. Changes should be sustainable for issuers, enhance investor confidence, support prudent asset origination and work in tandem with the new Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[6] and other regulatory initiatives, such as the proposed revision of the Federal Deposit Insurance Corporation's regulatory safe harbor for asset transfers. In addition, neither the interests of all issuers nor the interests of all investors are, or can be, perfectly aligned. Transaction sponsors for conventional asset classes that have performed well through the financial crisis, such as credit cards, auto loans, equipment leases and student loans, have suffered from the increased costs and loss of funding options for their sectors that have arisen largely because of problems in the residential mortgage loan sector. They are now struggling to argue, without joining in the condemnation of RMBS, that they should be treated differently under new regulations. We perceive also that there is tension within the investor community among some investors who want to see mandated enhanced disclosures in both the public and private markets and other investors—particularly those who invest in smaller private market offerings where the cost challenges of Regulation AB compliance become more significant—who are concerned that the proposed expansion of public disclosure requirements to the private markets will preclude smaller private offerings in which they usually invest and for which they believe they already have the ability to negotiate the level of disclosures appropriate for the securities. Navigating among the competing interests of issuers, investors and other market participants to achieve the right set of regulations for securitizations is a difficult and delicate task for the Commission. We stand ready to assist in this process in any way we can. Our thoughts with respect to this task are set forth below.

II. PROPOSED DISCLOSURE REQUIREMENTS

We agree with the Commission's view that developments in the securitization markets over the past few years require an analysis of the adequacy of the current ABS disclosure requirements. The Commission's view is clearly consistent with that of Congress which, in Section 942 of the Dodd-Frank Act, directs the Commission to require that issuers of registered, publicly offered asset-backed securities "disclose asset-level or loan-level data, if such data are

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5 We believe, for a number of reasons, that the Commission's proposals should not be extended to non-asset-backed securities. We strongly encourage the Commission to tailor any final rules as narrowly as possible and not to view any changes in the asset-backed securities market as a template for possible future application to the non-asset-backed market.

6 Pub. L. No. 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act").

necessary for investors to independently perform due diligence." It is important, however, to recognize the broad range of products within the scope of asset-backed securities. Although the securitization industry has reached broad consensus that loan-level data is necessary and appropriate for securitizations of residential and commercial mortgage loans,[7] no such consensus exists for other asset classes. We believe that loan-level data would not be necessary to facilitate such due diligence for most asset classes.

Mortgage-backed securitizations ("MBS") differ from other securitizations in a number of ways. Most significantly, products involving mortgage loans involve many fewer discrete assets of much larger per-asset size than transactions involving most other asset classes. The Commission notes, for instance, that credit card securitization transactions may include as many as 20 to 45 million accounts.[8] By contrast, the Sequoia Mortgage Trust 2010H-1 transaction, which was notable as the first private label RMBS transaction issued since 2008, securitized a portfolio with an outstanding principal amount of approximately $238 million but included only 255 loans.[9] Fewer assets make loan-level analysis more feasible, and larger asset size helps justify the cost of such analysis. It might, for instance, be commercially reasonable to incur $1,000 of due diligence costs to evaluate the loan file for a $1,000,000 mortgage loan but it would not be economically feasible to do so for a $500 credit card receivable or a $5,000 auto loan.

For many asset classes, such as auto loan and lease securitizations, requirements to provide asset-level data will deter securitizations, restrict capital formation and eliminate market access for some issuers without supporting meaningful additional due diligence by investors or otherwise providing a benefit to investors that justifies these outcomes. We believe greater transparency can be achieved in less burdensome ways and still be consistent with the Congressional mandate set forth in the Dodd-Frank Act. We would ask the Commission, in evaluating these and other comments, to consider whether the proposed disclosures would facilitate fundamental analysis of the structure and risk of the securitization or whether they instead only support incremental pricing distinctions—noting that we appreciate that the latter as well as the former are important to investors.

In reviewing the proposed disclosure requirements, we first address the considerations applicable to all asset classes, and then discuss the considerations that apply to specific classes of assets.

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7 *See, e.g.*, ASF Comment Letter at 3 and Attachment III; Proposing Release at 23367 (noting that the ASF's Project RESTART recommends that issuers provide a loan-level reporting package for outstanding RMBS.

8 Proposing Release at 23360.

9 Prospectus Supplement of April 23, 2010 for Sequoia Mortgage Trust 2010-H1, *available at* http://www.sec.gov/Archives/edgar/data/1176320/000114420410022414/v182145_424b5.htm.

A. <u>The Proposing Release raises several issues affecting multiple asset classes.</u>

1. *The required disclosure of "soft" data points presents reliability issues that raise significant concerns under the liability standards of the federal securities laws.*

In general, the asset level data points identified in the proposed rules can be divided into two groups—the first group involves empirically verifiable data, such as outstanding balances, scheduled payments, interest rates and pre-payment penalties, and the second group involves subjective judgments and factual representations that, as a practical matter, may not be possible for an issuer or sponsor to verify. The "soft" data points include information that is often self-reported by obligors, cannot be verified by issuers at a reasonable cost, cannot be comforted by auditors, may not be consistent with (or comparable to) information obtained or presented by other issuers and may reflect subjective judgments. These soft data categories vary by asset class and include property appraisals, residual value estimates, status of occupancy of property, source of down payments, existence and status of other outstanding debt, borrower occupation and borrower income verification.[10] We understand that soft data may be important to investors, especially for RMBS, and that many of the Commission's proposals for such data for RMBS derive from the ASF's Project RESTART disclosure package. However, issuers may have a difficult time subjecting soft information to the disclosure controls and internal control over financial reporting required under the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act")[11] because those data points are often produced or collected by entities not under the control of the issuer, including loan originators and third-party data providers. Where soft data is available for a fee from a third-party data provider, issuers may determine not to purchase data for any of their assets, may purchase data for a small sample of their assets or may not refresh the data when purchased. The information made available from third parties may be subject to qualifications and limitations that restrict any meaningful reliance on such information and limit the legal liability of the provider with respect to such information. Issuers may also make judgments about the reliability of purchased data that would not meaningfully translate into loan-level disclosure tables. In addition to the potential securities law liability issues involved in an issuer disclosing such information without also disclosing all applicable caveats, any such information may not be within the scope of the issuer's own internal control systems, and third-party information providers may be unwilling to perform, or to permit a third party to perform, a SAS 70 audit of such information.

Many of the soft data points are measured at the time of origination and hence, even if they were accurate at that time, may be inaccurate by the time the data points would be disclosed in connection with a securitization. For example, property values may have changed significantly since the appraisal date and borrower income data at the time of origination may no

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[10] With respect to borrower income verification, we appreciate that there is a process, involving the filing of a Form 4506-T with the IRS, that can be used to obtain an obligor's as-filed tax returns. This process, however, is expensive, slow, may provide stale data and is not commonly used for most asset classes other than residential mortgage loans.

[11] Pub. L. No. 107-204, 116 Stat. 745 (2002).

longer be accurate if the borrower has changed jobs, become unemployed or become subject to disabling health issues. Many of these "point-in-time" data points are used to calculate other soft data points such as loan-to-value ratios and income-to-expense ratios. Accordingly, inaccuracies in one soft data element may lead to errors in numerous other soft data points. We do not believe issuers can refresh such data without undue effort and expense.

At a minimum, the Commission should not require an issuer to disclose information where the issuer has no reasonable basis to confirm whether the information is materially correct. Moreover, the proposed list of data points includes very brief descriptions of the items, which may not be entirely consistent with the information actually obtained from obligors or comparable to other similarly styled information. In the context of owner occupancy, for instance, the customary representation relates to the borrower's intentions about occupancy as stated in the loan application. The representation does not specify who actually occupies the property on the date of application, at the time of the loan closing, or as of a later date. Other data points may refer to various criteria in ways that differ from each other in nuanced ways, depending on how the parties have elected to allocate risk. Therefore, issuers should be able to provide narrative analysis of soft data in order to assure that their disclosure is meaningful and not misleading.

Another form of soft data includes estimates, valuations and appraisals. For example, property appraisals involve a substantial level of subjective input by the appraiser, especially when property values are increasing or decreasing at significant rates. While the appraisal industry has adopted standards and guidelines that govern appraisals, they are not comparable to generally accepted accounting principles ("GAAP") requirements such as FASB ASC 820, Fair Value Measurements and Disclosures, and ASU 2010-6, Improving Disclosures about Fair Value Measurement. Residual value estimates for asset classes such as auto lease receivables and equipment lease receivables raise similar issues, and further, as we discuss below, may involve competitively sensitive proprietary data. Some companies take a very conservative approach to residual values, and book residuals at the low end of the possible recovery range, while others may look to expected values. In general, this category of soft data is qualitatively different from the GAAP-derived information included in prospectuses and periodic reports of publicly reporting entities.

Although the Commission has attempted to address many of these soft data issues by including verification codes in the required data files, we do not believe that all such issues have been addressed. One example is Item 2(a)(1) of Schedule L-D, requiring the issuer to state the reason for a delinquent payment and listing two dozen possible reasons, including marital difficulties and too much other debt, that seem to us in many instances to be both highly subjective and unverifiable.

We believe the Commission should provide issuers the discretion to include or exclude soft data from their disclosures. Where such data is included, we believe it should be described as information obtained from third parties as to which the issuer is permitted to disclaim liability (absent, of course, actual knowledge by the issuer that such information is materially incorrect), and should not be considered to be part of the prospectus or registration statement as to which the issuer retains liability. Such information is comparable to the information covered by the forward-looking statement safe harbor and should be treated similarly for liability purposes. Moreover, we believe the rules the Commission may adopt should authorize issuers that elect to provide soft data to use qualifying, risk factor language to alert investors as to the unverified nature and potential lack of timeliness of the asset level soft data and to point out the limitations inherent in using any such data in predicting future performance of the assets.

2. *The materiality of individual data points and liability for inaccuracies in data files need to be determined on an aggregate basis across the entire asset portfolio, rather than at the level of the individual loan.*

We do not believe it is feasible for even the most diligent issuers, their auditors or their lawyers to verify the accuracy of each of the hundreds of thousands, or millions, of hard data points that would be required under the Commission's proposed rules. Based on our experience, the data will include typographical errors, information entered incorrectly (or not at all) into the files and other errors. Issuers and their auditors will rely on sampling techniques designed to test the overall accuracy of the disclosures, but these sampling techniques will not identify every error. Accordingly, we believe that errors in the data points—even if material to an individual loan—should not be viewed as material misstatements unless the aggregate effect of such errors is material to the security as a whole.

We are aware, of course, that loan-level representations and warranties are commonplace in the operative documents for many securitizations. Representations and warranties are not, however, assertions of fact, and although transaction parties strive to make them as accurate as possible, in many instances they are intended to reflect the allocation of risk of inaccuracies rather than assertions of verified facts. For some statements—for example, that the borrower has not committed fraud in completing a loan application—it is impossible to know with certainty whether the representation is correct. For other statements, the cost or difficulty of determining the accuracy of the representation with complete certainty may outweigh the potential exposure for an inaccuracy.

Contractual remedies for breaches of representations might include repurchase of the loan by the depositor or indemnification for losses that result from the breach. Thus, the potential contractual liability for an error in a loan-level data point generally ranges from zero, if the error does not affect the value of the loan, up to the full loan amount, if the error undermines the entire loan and the lender does not hold any security of value. By contrast, when a disclosure document contains a material misstatement or omission, the issuer may be required to make a rescission offer to investors for the entire amount raised. Where errors in loan-level data are not material to the security as a whole, we believe investors should rely on contractual remedies rather than rescission rights.

We believe the Commission should clearly state in any adopting release that any securities law liability for incorrect data points (that are not deemed excluded from the prospectus or registration statement, as recommended above) should be determined based on their aggregate materiality in the context of the entire asset pool, the full offering disclosures and whether the securitization structure and documentation provide adequate remedies. The final regulation should state clearly that the materiality of the asset-level disclosure requirements should be assessed by considering Schedule L or Schedule L-D to be a single disclosure item, rather than by considering each individual data point within the schedules to be a separate, material disclosure. Realistically, few if any of the individual loan-level data items would be material to the transaction as a whole for RMBS and most other asset classes. Indeed, if loan-level data had been considered material to a transaction as a whole, it would have been disclosed under the current regulatory regime. An error, even if material to the value of a particular loan, should not give rise to a securities law violation and remedy. Only errors in disclosures of facts that are material to the transaction as a whole should carry remedies under the securities laws.

3. *Although we support enhanced disclosures related to underwriting standards for RMBS, such disclosures create numerous issues for other asset classes and deviations from underwriting standards may be difficult to identify where underwriting standards permit the exercise of discretion.*

We appreciate that declining underwriting standards for residential mortgage loan origination likely was a critical contributing factor to the financial crisis. We agree that enhanced disclosure relating to underwriting standards for residential mortgage loans is appropriate, and, subject to our concerns expressed below with respect to the disclosure of exceptions to underwriting criteria, we support the enhanced disclosure relating to underwriting criteria for RMBS included in the Proposing Release. For other asset classes, we are concerned that the level of specific disclosure proposed may be both difficult to produce and competitively sensitive. For all asset classes, we believe that the role of discretionary authority in the underwriting process, and underwriting guidelines that include alternative criteria that compensate for other criteria that cannot be met, may complicate compliance with these disclosure proposals.

With respect to underwriting criteria, the Commission has proposed both a general disclosure item, Item 1111(a)(3) of Regulation AB, and loan-level disclosure in Schedule L. Proposed Item 1111(a)(3) would require:

> A description of the solicitation, credit-granting or underwriting criteria used to originate or purchase the pool assets, including any changes in such criteria and the extent to which such policies and criteria are or could be overridden. Disclosure on the underwriting of assets that deviate from the disclosed criteria, must be accompanied by data on the amount and characteristics of those assets that did not meet the disclosed standards. If disclosure is provided regarding compensating or other factors, if any, that were used to determine that those assets should be included in the pool, despite not having met the disclosed underwriting standards, describe those factors and provide data on the amount of assets in

> the pool that are represented as meeting those factors and the amount of assets that do not meet those factors.[12]

In addition, proposed Schedule L would require, in Item 1(a)(19), an indicator as to whether a loan as made was "as an exception to a defined and/or standardized set of underwriting criteria."

With respect to underwriting criteria, the residential mortgage loan market has unique features that provide industry-wide standards against which deviations can be measured. In particular, Fannie Mae and Freddie Mac, by establishing specified underwriting criteria that must be satisfied in order for loans to be eligible for purchase by them, have played an important role in defining standards for the industry. We believe the role of Fannie Mae and Freddie Mac as the dominant purchasers of residential mortgage loans has given them an unusual ability to influence industry standards. Even in the case of Fannie Mae and Freddie Mac, though, there are multiple product types and alternative standards applied such that the similarity of standards and even terminology should not be overstated. We are not aware of any similar common underwriting standards for other asset classes. On the contrary, underwriting standards for other asset classes are considered highly proprietary and confidential, and portfolio-wide changes in underwriting criteria are more significant than any individual credit decision. In the context of commercial real estate, many lenders may not have formal written underwriting standards—the asset may be underwritten based on a unique evaluative process for each mortgaged property.

As the Commission notes in the Proposing Release, underwriting standards often contain certain elements of discretionary authority for an underwriter to vary from stated criteria in certain cases, particularly when there are strong positive compensating factors. Where this discretion exists, we believe that originators consider underwriting decisions made in the exercise of this discretion to fall within their underwriting criteria, rather than constituting exceptions to those criteria.

We believe that, other than possibly in the context of RMBS, it would be preferable to permit textual disclosure of originators' trends in underwriting standards and risk-management activities than to require disclosure of proprietary standards. Required disclosure of proprietary information may make the securitization markets unattractive to issuers and would not facilitate side-by-side comparison with other originators. Even within the context of RMBS, any side-by-side comparison would necessarily require textual disclosure to explain its elements. This information would be supplemented by the pool characteristic information, grouped or loan-level data, and historical performance data that is included in the disclosure. Requiring more specific disclosure may lead to less specific underwriting standards, which would neither lead to an improvement in overall underwriting nor to additional meaningful disclosure to investors.

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[12] Proposing Release at 23421-22.

4. *Because providing loan-level data and grouped asset data may allow competitors to derive proprietary pricing and credit evaluation information, with significant adverse consequences for the sponsor and its affiliates, sponsors may decide to exit the securitization markets rather than disclose this data in this format.*

The Dodd-Frank Act will require the disclosure of loan-level data "if such data are necessary for investors to independently perform due diligence."[13] In our view, loan-level data (or, for credit card transactions, grouped asset data) would not be material for asset classes other than RMBS and CMBS. As we note in the Executive Summary to this letter, we believe that as the number of assets in a securitized pool increases, investors will increasingly use asset-level data not to analyze the risks of individual assets but to create additional pool stratifications and more layered analyses of aggregate data. Where this would be the result, we believe that requiring issuers to expand their presentation of aggregate data through additional pool stratifications will better manage the cost issues associated with increased disclosures and will provide investors with robust, granular data to allow them to perform their own evaluations of the pool.

We have heard consistently across asset classes the concern that the combination of disclosures, both in Schedule L and in the grouped asset data presentation proposed by the Commission, may allow competitors to reverse engineer proprietary pricing and underwriting models, which could cause significant competitive harm.[14] We understand anecdotally that some issuers who have been deeply committed to securitization believe this will compromise their business models and may decide to exit the market if the data requirements are not restructured to mitigate the risk of revealing sensitive information and facilitating reverse engineering. Groups of investors and issuers for certain asset classes, such as credit cards and autos, have been working together to reach consensus views on the appropriate levels of disclosures that will meet investor needs while supporting continued participation by issuers, and we encourage the Commission to give strong weight to such consensus views, as it has for RMBS. Consistent with our earlier discussion of cost-benefit analysis, we also ask the Commission to consider both the competitive cost to issuers of providing expanded information, the cost of the lost funding opportunities for those issuers who determine they cannot continue to securitize their assets if reporting obligations are not consistent with the protection of their proprietary business models, and the possible correlative effects on the availability of consumer and business credit.[15]

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[13] Dodd-Frank Act, Section 942(b).

[14] We understand that credit card issuers and investors have recently agreed on a more limited set of grouped asset data than that proposed by the Commission that would not raise these concerns.

[15] In Part II.B of this letter, we discuss in more detail in the sections relating to particular asset classes some of the reasons for our conclusion that this data is not material and not required for investors to independently perform due diligence. We will also discuss some alternative means of presenting additional data that may be more feasible for issuers while nonetheless furthering the Commission's goal of enhancing transparency in this market.

5. *Asset-level data requirements may raise privacy issues for consumer borrowers, thus conflicting with consumer privacy protections provided by other federal and foreign laws, and may disclose identifiable and competitively sensitive information for corporate borrowers of securitized obligations.*

We appreciate that the Commission's goal is to provide for disclosure of asset-level data in a manner that does not identify individual obligors. This goal may not be attainable, however, in circumstances in which non-aggregated information is released to the public, as the Commission has proposed. It is exceedingly difficult, if not impossible, to guarantee the anonymity of non-aggregated data even in circumstances in which the information does not contain traditional identifiers such as an individual's name, address, Social Security number, or driver's license number. Sophisticated data mining and correlation techniques combined with the vast amounts of information (both legitimate and stolen) available to the public make the identification of individuals to whom asset-level data pertains increasingly likely. With respect to the asset-level disclosures of the proposed rule, such disclosure would potentially result in release to the public of detailed nonpublic personal financial information (as defined in Title V of the Gramm-Leach-Bliley Act ("GLB")[16]) as well as consumer report information (as defined in the Fair Credit Reporting Act ("FCRA")[17]). Although Congress in the Dodd-Frank Act does contemplate that the Commission will require loan-level data in securitizations as necessary for investor due diligence, there is no indication that that requirement is intended to override privacy laws.

In the U.S., the definition of "personal information" that the FTC has applied in its privacy and information security enforcement actions under Section 5 of the FTC Act[18] includes information that is from or about an individual including: (i) a persistent identifier, such as a customer number held in a "cookie" or processor serial number, that is combined with other available data that identifies an individual; or (ii) any information that is combined with (a) a first and last name, (b) a home or other physical address, including street name and name of city or town, (c) an email address or other online contact information, such as an instant messaging user identifier or a screen name, that reveals an individual's email address, (d) a telephone number, (e) a Social Security number, (f) credit or debit card information, including card number, expiration date or data stored on the magnetic strip of a credit or debit card, (g) checking account information, including the ABA routing number, account number or check number, or (h) a driver's license, military or state identification number.[19] It is important to note that the FTC's definition is objective. In determining whether information is personal, the FTC

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16 15 U.S.C. § 6801, et seq.

17 15 U.S.C. § 1681(a)–(b).

18 *See* 5 U.S.C. § 45. It is important to note that, in addition to its authority to enforce privacy violations under Section 5 of the FTC Act, the FTC enforces compliance with GLB by entities that are not subject to the jurisdiction of federal banking regulators. The FTC also has primary responsibility for the enforcement of the FCRA, including with respect to entities that are otherwise subject to the jurisdiction of the Commission.

19 *See, e.g.*, Agreement Containing Consent Order at 2, *In re Dave & Buster's Inc.*, No. 0823153 (F.T.C. Mar. 25, 2010).

generally does not take into account whether the specific entity in the possession of the information uses the information to identify the individual. Rather, the information is deemed personal if *any* entity or individual could use the information to identify the individual to whom the information pertains. This, for example, explains why the FTC's definition includes a credit card number and bank account number.

It is far from certain that omitting certain subsets of the proposed asset-level requirements would be sufficient for the other asset-level data to, in turn, be deemed not "personal." Technological advancements that allow the public to gather and combine various data elements from many sources make it difficult, if not impossible, to establish a finite set of asset-level data that can safely be disclosed without compromising an individual obligor's identity and privacy. In fact, the FTC's view of what information may be deemed "personal" is constantly evolving. The FTC recently acknowledged the challenge of defining the scope of personal information in the agency's self-regulatory principles for online behavioral advertising,[20] explaining that the traditional notion of what constitutes personally identifiable information versus non-personally identifiable information is becoming less and less meaningful and, therefore, should not, by itself, determine how the information should be protected.[21]

Therefore, regardless of whether asset-level data contains specific identifiers, it may be deemed "personal" information because it could be combined with other asset-level disclosure or publically available information to identify individuals to whom the information pertains. There are numerous documented examples of disclosure of seemingly anonymous information through which an individual was subsequently identified."[22]

Furthermore, with respect to the asset-level disclosures currently proposed by the Commission, the information at issue likely would be highly desirable to various financial and marketing organizations, creating a strong incentive for such entities to identify the individuals to whom the information pertains. One of the primary goals of Title V of GLB is to preclude disclosure of personal financial information to third parties for those parties' marketing purposes without giving individuals an opportunity to opt out. Public disclosure of asset-level data that is deemed personal would be inconsistent with GLB because it would make such information available to any third party for use for any purpose, while depriving individuals of any control

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20 FTC, FTC Staff Report: Self-Regulatory Principles for Online Behavioral Advertising (Feb. 12, 2009) at 20-25, *available at* http://www.ftc.gov/os/2009/02/P085400behavadreport.pdf.

21 *See id.*

22 For example, Paul Ohm observes in a recent article that "computer scientists have recently undermined our faith in the privacy-protecting power of anonymization, the name for techniques for protecting the privacy of individuals in large databases by deleting information like names and Social Security numbers." Ohm has documented how scientists have demonstrated they can often "reidentify" or "deanonymize" individuals hidden in anonymized data with astonishing ease. Specifically, the article describes how scientists used publicly available data to re-identified ostensibly anonymous record-level, non-aggregated information that did not contain individual identifiers that Netflix and AOL released regarding their subscribers. *See* Paul Ohm, "Broken Promises of Privacy: Responding to the Surprising Failure of Anonymization" (Aug. 13, 2009). University of Colorado Law Legal Studies Research Paper No. 09-12, *available at* SSRN: http://ssrn.com/abstract=1450006.

over the use of such information. In addition, public disclosure of "personal" information arguably could result in such information being deemed outside the scope of GLB's definition of "nonpublic personal information," and, consequently, deprive it of GLB's privacy protections. Similarly, public disclosure of "personal" information would contradict the FCRA's goal of precluding disclosure of consumer report information (*i.e.*, "personal" information) for improper purposes and disclosure of such information to the public would negate the FCRA's privacy protections over such information.[23]

The concerns about disclosing sensitive and identifiable information are not limited to the transactions that securitize consumer assets. For example, with floor plan obligations, we understand that this will be an immediate concern, as geographic data may immediately identify the relevant dealers and allow the derivation of their proprietary pricing information. There are similar immediate concerns about equipment finance transactions, especially given the proposed combination of zip code and business sector data. Although these disclosures may not trigger privacy concerns under the GLB or other statutes, they may breach confidentiality obligations and pose a risk of real competitive harm.

We appreciate that the Dodd-Frank Act gives the Commission a clear mandate to require loan-level data where necessary for investors to conduct their own due diligence, and we believe that some degree of loan-level information is unavoidable at least for RMBS offerings if the market for those securities is to be restored. At the same time, given the difficulty of anonymizing data, we believe that regardless of the composition of the proposed asset-level data requirements, at a minimum, the Commission should work with other federal agencies, such as the FTC, to evaluate the risk that the asset-level information the Commission currently proposes making public is "personal" and could ultimately aid in the inappropriate identification of individual obligors and to ensure that issuers disclosing loan-level data do not by doing so subject themselves to liability for breach of the federal privacy laws.

Foreign data protection requirements often differ considerably from similar U.S. laws in both scope and application. Unlike in the U.S., where there are myriad laws that may contain privacy provisions applicable to certain types of entities or certain types of personal information, many of the foreign privacy and information security laws apply to any organization that processes *any* personal information. In addition, foreign privacy laws often define "personal information" much more broadly than such term is defined under U.S. federal law. Member countries of the European Union (the "EU"), for example, take a comprehensive view of privacy law and thus apply a uniform definition of "personal information". The EU Data Protection Directive 95/46/EC defines "personal information" broadly to include any information (i) relating to an individual or (ii) that can be used to identify an individual "directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his

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[23] To the extent asset-level information is deemed "personal," the Commission may also have its own data protection obligations under the Privacy Act of 1974, which governs certain aspects of the collection, maintenance, use, and dissemination of personal information by federal agencies. It is unclear to us how existing laws restricting the use of personal nonpublic information intersect with the asset-level disclosures mandated by the Dodd-Frank Act.

physical, physiological, mental, economic, cultural or social identity."[24] As a practical matter, in the EU, asset-level data that relates to individuals is deemed personal unless it is impossible to link such information to the specific individuals. It is likely, therefore, that the proposed asset-level data requirements could be deemed "personal" within the meaning of EU data protection law. Consequently, the processing of such information, including its collection, use and disclosure, would require an issuer to establish an appropriate legal basis for such collection, use and disclosure either (i) by obtaining the consent of the individuals to whom the information pertains, or (ii) pursuant to an exception to the consent requirement.[25]

It is important to note that EU member states interpret the above exceptions to the consent requirement very narrowly. As a result, in circumstances in which an entity seeks to process personal information without the related individual's consent, , the feasibility of relying on the exceptions to establish the basis for processing the information requires an exacting, fact-specific analysis. Consequently, we do not believe it is possible to say with any certainty whether disclosure of any "personal" information pursuant to the proposed rule would have a legal basis sufficient enough for the disclosing entity to be exempt from EU privacy laws. Therefore, we would ask that the Commission consider the possible unintended result of imposing asset-level data disclosure requirements on issuers that such issuers could be subject to liability under EU privacy laws for doing so.

6. *For actively managed or revolving pools, loan-level data and grouped asset data have little predictive value and cannot be used in a meaningful way in predictive models such as the "waterfall computer program" the Commission has proposed.*

For a residential mortgage loan that is a term loan (i.e., not an equity line of credit), the scheduled monthly payment provides relevant information about the amount and timing of payments that can be expected on that loan, as well as the portion that constitutes interest and the portion that constitutes principal. The scheduled monthly payment is not perfectly predictive, and does not reflect credit quality—homeowners may prepay in whole or in part, or they may default—but it provides a meaningful baseline with respect to the *timing* of payments. A cash flow model can begin with the assumption that all monthly payments are made as scheduled, and can then vary that model to assume prepayments, defaults, changes in the property value and other changes from the baseline information about scheduled contractual payments. Over time,

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24 *See* EU Data Protection Directive 95/46/EC, Article 2.

25 Specifically, an individual's consent is not required in circumstances in which the processing is necessary (i) for the performance of a contract to which the individual is party or in order to take steps at the request of the individual entering into a contract, (ii) for compliance with a legal obligation (this exception is limited to requirements imposed pursuant to EU law or international treaties), (iii) in order to protect the vital interests of the individual, (iv) for the performance of a task carried out in the public interest or in the exercise of official authority by a "data controller" or a third party to whom the data are disclosed (this exception applies only to public interest and official authority in the EU), or (v) for the purposes of the legitimate interests pursued by the data controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests or fundamental rights and freedoms of the data subject. *See* EU Data Protection Directive 95/46/EC, Article 7.

the model can be adjusted to reflect actual performance of the loans. Because the asset pool does not change, other than through payments and defaults, there are a finite number of variables that can be applied to determine whether and how the asset will ultimately be paid and to predict cash available for distribution.

By contrast, for a revolving line of credit, there is likely to be no scheduled payment that can be used as a baseline assumption. The balance of the loan may go up as well as down, borrowings paid within a grace period may not accrue interest or finance charges, and a borrower may remain in good standing by paying, in any month, any amount ranging from a minimum payment that is a fraction of the outstanding balance to the full balance of the account. For actively managed asset pools, the timing of trading activity may also have a significant, and unpredictable, effect on available cash. For all asset classes that have these features—which include credit card receivables, floorplan receivables, home equity lines of credit, trade receivables and many CDOs—we do not understand how the proposed asset data files could be used to predict cash flows.[26]

Fundamentally, no cash flow model can make predictions as to credit quality. The best it may be able to do is incorporate assumptions about the timing and severity of losses. For an amortizing pool of loans, the credit decision for each loan has been made and is not revisited. For revolving or actively managed assets, new credit decisions are made every day. Active credit management of the assets means that loss assumptions based on more granular data about the loans will always be missing essential information about the changing credit risk of the portfolio. This, too, makes the value of predictive models that incorporate assumptions derived from loan-level data for these asset classes and structures highly doubtful. These types of structures generally include provisions that trigger early repayment, additional reserve account funding or other mechanisms designed to protect investors from deterioration of asset quality.

7. *Where outstanding ABS are used to collateralize new ABS, the Commission's proposed rules requiring loan-level data for the assets in the underlying ABS may effectively preclude securitization of these legacy ABS.*

On the effective date of new disclosure rules relating to securitizations, very few, if any, ABS issued before that date will be in compliance, or capable of being brought into compliance, with the new rules. The Commission is aware of this issue in the context of resecuritizations of RMBS, noting in the Proposing Release that the ASF's Project RESTART "recommends that issuers provide the loan-level reporting package for outstanding RMBS."[27] The ASF's recommendation is aspirational more than it is practical, however—for most outstanding RMBS, there are neither available resources to develop reporting beyond that contemplated at issuance of the deal, nor parties who would be in a position to take this on. We believe it is highly unlikely that any outstanding securities, other than those issued through master trusts, will have

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26 For credit card securitizations, pool-wide historical payment rate information provides a useful input for predicting available cash and is already disclosed in the pool data provided by credit card issuers.

27 Proposing Release at 23367.

reporting that is brought into compliance with the Commission's new rules. If the Commission proceeds with its proposed extension of these rules to the private markets, we are concerned that it may effectively preclude resecuritizations of RMBS and CMBS (as well as other asset classes, where applicable) and eliminate manager flexibility to include a small percentage of ABS in CLOs backed primarily by conventional corporate loans, in addition to precluding CDOs of RMBS. The proposal also would preclude reliance on Rule 144A and Rule 506 for any ABCP conduit already holding such assets. We are concerned that the proposed look-through requirement will limit the ability of entities holding outstanding ABS to manage their risks and reduce liquidity for a broad swath of outstanding ABS securities, including many that will have been issued wholly in compliance with the Commission's then-existing rules for registered, publicly offered securities.

8. *Lack of clarity around disclosure requirements for private offerings will create significant uncertainty about the availability of the regulatory safe harbors.*

The Commission has proposed intricately detailed disclosure requirements for the categories of ABS that are frequently issued through registered public offerings, but has provided far less guidance for other types of structured finance products. For example, the Proposing Release states:

> For offerings of structured finance products where the securities fall outside the Regulation AB definition, the requirements of Form S–1 would apply. In the latter case, the issuer would be required to provide information required under Regulation AB regarding the assets and parties as well as additional information required under Regulation S–K. For a managed CDO offering, we would expect disclosure regarding the asset and collateral managers, including fees and related party transaction information, their objectives and strategies, any interest that they have retained in the transaction or underlying assets, and substitution, reinvestment and management parameters. For a synthetic CDO offering, we would expect, among other things, disclosure of the differences between the spreads on synthetic assets and the market prices for the assets, the process for obtaining the credit default swap or other synthetic assets, and the internal rate of return to equity if that was a consideration in the structuring of the transaction.[28]

These generalized descriptions do not contain the specificity or clarity we are accustomed to seeing in Commission disclosure rules. Similarly, the Commission has noted that the Staff has worked with issuers to tailor disclosures for securities that have characteristics of ABS but do not fit within the Commission's definition of asset-backed security, a process that will not occur for

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[28] Proposing Release at 23396 (references omitted).

exempt offerings. We are concerned that, in the absence of more specific guidance, it will be difficult for market participants to know how to test whether the conditions for Rule 144A and Rule 506 reliance have been satisfied. At the same time, we do not believe it is possible to establish line-item disclosure rules for private market offerings that would not effectively stifle the development of new types of securities and structures. As we discuss in Part VI of this letter, we have numerous policy concerns about the proposal to require a commitment to provide Regulation AB disclosures as a condition to reliance on the Rule 144A and Rule 506 safe harbors. Certain of our suggestions in Part VI for alternative approaches to the private markets would assist the Commission in establishing clear disclosure requirements for these transactions. We are concerned that, as a practical matter, in the absence of further guidance from the Commission, the meaning of those requirements in the context of exempt offerings of structured finance products will introduce sufficient ambiguity to defeat the purpose of the regulatory safe harbors.

B. The proposed disclosure requirements also raise class-specific issues, as we discuss below.

1. *Residential mortgage-backed securities*

a. *RMBS required disclosures should be based, as the Commission has done, on the industry standards developed in Project RESTART, but should also consider the general issues discussed in Part II.A of this letter, such as soft data and privacy issues, as well as the possibility that producing the extensive data called for by these proposals may prove too onerous for issuers.*

The Commission notes that the proposed disclosure and ongoing reporting data points for RMBS in Schedules L and L-D, respectively, of the Proposing Release relating to RMBS are based on the information already typically provided by sellers to Fannie Mae and Freddie Mac or likely to be collected by participants in the American Securitization Forum's Project RESTART.[29] Our review of the RMBS data points suggests that they are in fact substantially similar to those contained in the Project RESTART disclosure and reporting packages, and we commend the Commission for seeking input from industry sources and thoughtfully amalgamating them into Schedules L and L-D. Although some of our general concerns with respect to the data points discussed above apply to RMBS, particularly with respect to soft data, the materiality of individual data points, liability for inaccuracies and privacy matters, we are reluctant to comment on individual data points that in large measure either represent information already provided by sellers or result from the industry consensus garnered by Project RESTART.

With some 137 separate data points for disclosure and 151 data points for periodic reports for RMBS, however, we urge the Commission to continue to work with the industry — sellers, sponsors and investors alike — to reach consensus on the right balance of disclosure and

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29 Proposing Release at 23361 and 23367.

reporting for RMBS.[30] We note, as well, our understanding that the reporting data points reflected in Project RESTART are aspirational and, of course, cannot be mandated by the ASF. Although Project RESTART may have a stated "effective date" of February 2010, we are not aware of any RMBS transaction pursuant to which the disclosure or ongoing reporting complies with Project RESTART.

2. *Commercial mortgage-backed securities*

CMBS transactions, particularly involving securitizations of large loans or loans where the underwriting is based on the credit of tenants, due to the concentration of borrowers or tenants in the transaction, may be more acutely affected by the issues identified above and, in addition, may be subject to additional concerns.

a. *The disclosure data points for CMBS should be identical to those contained in the CRE Finance Council's Investor Reporting Package.*

We appreciate that the Commission's proposed data points for CMBS are based in part on the disclosure data points developed and published by the CRE Finance Council (formerly known as the Commercial Mortgage Securities Association) in the form of its Investor Reporting Package ("IRP").[31] Those data points were thoroughly vetted by members of the CRE Finance Council and we believe provide the best guide as to the appropriate data points for CMBS. To the extent that the data points contained in Schedules L and L-D for CMBS do not closely adhere to those contained in the IRP, which has enjoyed long-standing acceptance in the securitization market, we recommend that the Commission use the IRP data points in establishing the disclosure and reporting data points for CMBS in the final amendments to Regulation AB.

We note, however, that pools of commercial mortgage loans are not as uniform in nature as smaller receivables such as credit card receivables, auto loans or even residential mortgage loans. In fact, many CMBS transactions involve a very small number of very large balance mortgage loans. Moreover, commercial mortgage loans comprise many different types of properties, such as hotels, office buildings and shopping malls, with some properties being

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[30] For example, a number of the RMBS data points on Schedule L-D relate to modifications of mortgage loans pursuant to the Treasury's Home Affordable Modification Program ("HAMP"). Project RESTART's reporting package was developed during a time when HAMP loan modifications were being implemented by a growing number of servicers with respect to thousands of delinquent mortgage loans. However, by its terms and unless it is extended, HAMP applies only to certain residential mortgage loans that were originated prior to January 1, 2009. Consequently, it will not apply to most of the mortgage loans we would expect to be securitized by the time the final amendments to Regulation AB take effect (particularly given the constraints on the inclusion of delinquent assets under the REMIC tax provisions). Accordingly, the capability to report "not applicable" or "N/A" in respect of all HAMP line items should be included in the final version Schedule L-D. There may be other instances in which the ability to indicate that a line item is not applicable may be appropriate, but in keeping with our general intent to leave examination and comment of individual data points to others, we have not attempted to identify them.

[31] Proposing Release at 23363. Addition information regarding the Commercial Real Estate Finance Council and its Investor Reporting Package may be found at http://www.crefc.org/irp/.

occupied by the borrower and some being leased to tenants of the borrower. Accordingly, many data items that may be material for evaluating one type of commercial property may be less material or wholly inapplicable for another type of property. As a result, disclosure cannot effectively be based on a series of predetermined data points. Instead, the need for disclosure should be based on the general concept of materiality, with issuers and underwriters in each transaction working together to determine the information that is likely to be material to the investors with respect to any particular commercial real estate property or mortgage loan and include that information in the offering document. Accordingly, we recommend that, for assets such as commercial mortgage loans, the final amendments to Regulation AB explicitly provide that the Schedules L and L-D data points for CMBS should be used as a guideline but that traditional standards of materiality should be the overriding factor in determining the appropriateness of the disclosure in the offering document.

b. *For CMBS, disclosure of underwriting decisions as exceptions to underwriting criteria may be misleading to investors.*

We are particularly concerned about the proposed requirement to disclose exceptions to underwriting criteria in the context of CMBS transactions. For commercial mortgage loans, underwriting criteria generally are not clearly prescribed, and the underwriting process as a whole is defined more by an evaluation of the special circumstances relating to each loan and commercial property and the judgment of the originator than by an objective test based on established mathematical or financial models. Exceptions to certain mathematical guidelines are common when in fact there are other factors which compensate for the guidelines that cannot be met, and characterizing a commercial loan as one not meeting certain specified underwriting criteria would inappropriately classify the loan as a weaker credit than it is. In fact, since disclosure about individual commercial mortgage properties and their related mortgage loans generally is more complete and elaborate, investors are in a position to rely on the more complete disclosure with respect to commercial mortgage loans and rely less on the originator's identified underwriting criteria for similar types of loans. Depending on the property type, there may be underwriting criteria for certain data items, such as debt service coverage and loan-to-value ratios, that may properly be identified as a data point, but such data items are fairly limited in the context of commercial mortgage loans. Accordingly, we encourage the Commission to require disclosure of exceptions to underwriting criteria only in cases where such criteria are well defined, are fundamental to the credit analysis and are consistently applied.

c. *Disclosure of static pool data is inappropriate for CMBS offerings.*

We understand that it has long been the view of those in the CMBS industry that disclosure of static pool data is not appropriate for CMBS transactions, and may in many cases be misleading, because the nature of the assets in any given CMBS transaction generally varies significantly from the nature of assets in other CMBS transactions. Investors in CMBS are more inclined to judge each pool of assets underlying a CMBS transaction on its own merits, utilizing the extensive loan-by-loan disclosure provided with respect to such assets, rather than relying on performance of unrelated historical pools that generally are very different. The Commission has requested comment on whether static pool data should be required in all offerings, whether or not material. For the reasons stated above, we do not believe that the final amendments to Regulation AB should require disclosure of static pool data for CMBS.

d. *Disclosure of workout strategies may be detrimental to the resolution of defaulted commercial mortgage loans and should not be required to be publicly disclosed.*

Unlike defaulted residential mortgage loans, for which the remedies customarily are fairly limited, servicers of commercial mortgage loans have considerably more flexibility to "work out" defaulted commercial loans. While relevant both to the proposed initial disclosure and ongoing reporting requirements, a particular concern arises in the context of ongoing reporting and the requirement that the servicer's current strategies be disclosed with respect to assets that are subject to a workout. Such disclosures, if required to be made prematurely, may impair the ability of a special servicer to properly conduct the workout, to the detriment of investors. Moreover, in CMBS transactions, the special servicer generally is required to deliver an "asset status report" to the investor most concerned about the conduct of the workout, namely the holder of the security taking the first-loss position, which describes its proposed strategies for each particular defaulted asset. If those workout strategies must be disclosed in a more public format that would be available to the defaulting borrower, however, the negotiating power of the servicer in conducting the workout may be seriously compromised. We believe that any amendments to Regulation AB adopted by the Commission should require disclosure of the workout strategy for a commercial mortgage loan only to the extent that, in the judgment of the servicer, disclosure of such strategy would not adversely affect its conduct of the workout.

3. *Auto loans and leases*

The common issues affecting multiple asset classes described above regarding the proposed expansion of the Regulation AB data requirements apply to ABS backed by automobile[32] loans and automobile leases. With respect to these common issues, automobile issuers have particular concerns regarding the appropriateness of asset-level disclosure, the protection of proprietary pricing and credit evaluation policies, the protection of the privacy of individual obligors and the inapplicability, irrelevancy or unreliability of certain proposed data points.

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[32] Although it is not clear in the Proposing Release, we assume that the asset-class "Automobiles" is intended to include ABS backed by loans and leases of motor vehicles generally, such as light-duty trucks, motorcycles and recreational vehicles in addition to automobiles, and we request clarification from the Commission that this assumption is correct. We note that the asset-class "Equipment" is not defined, although one of the equipment types set forth in Item 6(b)(1) of Schedule L is "Transportation". We understand that the asset-level data requirements for "Equipment" more appropriately reflect the data reporting and risk management activities of certain commercial and government fleet leasing companies than do the asset-level data requirements for "Automobiles", and we believe that it would be appropriate to permit (but not require) an issuer of ABS that is backed in whole or in part by commercial loans and/or leases of motor vehicles to elect to comply with the disclosure and reporting requirements for Equipment rather than for Automobiles if the issuer makes the determination that such disclosure regime more accurately reflects the internal practices of the issuer.

a. *"Pool stratifications" or "pool strats" are more appropriate than asset-level disclosure for ABS backed by automobiles.*

Although there may be limited exceptions, investors in automobile asset-backed securities currently, to our knowledge, only receive pool stratifications and not loan-level data. We understand that rating agencies also generally do not receive asset-level data for automobile transactions and instead refer to pool stratifications provided by or on behalf of the issuer. Unlike a typical RMBS or CMBS transaction, a standard auto deal includes tens of thousands of accounts,[33] which makes loan-level data unwieldy and the affect of each individual loan or lease *de minimis*. We believe formalizing and perhaps expanding or layering the pool stratification requirements for auto-backed ABS would achieve the Commission's goal of ensuring that investors are provided with material information about the assets in a meaningful and easily comparable form while alleviating sponsor concerns that asset-level data would reveal proprietary pricing and credit evaluation policies or would permit violations of privacy laws, as more fully discussed above.

We propose that the Commission standardize the categories of data required to be disclosed by automobile issuers, including applicable ranges of such information where appropriate, rather than requiring asset-level data disclosure.[34] For example, issuers of public asset-backed auto securities currently disclose stratifications of the pool by some or all of the following categories: (i) annual percentage rate; (ii) geographic distribution by state; (iii) FICO® scores; (iv) loan-to-value ratio; (v) original term; (vi) scheduled remaining term; (vii) original outstanding balance; (viii) cut-off date outstanding balance; (ix) vehicle model year; and (x) vehicle make and model. We believe that the Commission should propose specific pool stratification requirements, with appropriate input from issuers and investors, that allow more granular pool-level analysis but do not raise the many issues we discuss in this letter for asset-level data.

Although we believe that pool stratifications provide the most meaningful and easily comparable type of information for auto asset-backed securities, we recognize that the Commission may reject our proposal to standardize pool stratifications and instead require, as proposed, asset-level data disclosure. If the Commission were to do so, we are concerned that it may be potentially misleading and confusing to investors for the Commission to require pool stratification disclosures in addition to asset-level data.

b. *A number of the proposed asset-level data requirements are not relevant to or verifiable for auto assets and a number of the proposed asset-level data requirements are duplicative.*

We understand that the Commission drew heavily from the mortgage market to determine what asset-level data should be requested from auto issuers in the Proposing Release; however, use of data points culled from Fannie Mae and Freddie Mac requirements and from Project

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[33] A typical $1 billion auto ABS offering may include 50,000 to 70,000 individual accounts.

[34] *See* Part II.C.1 for a discussion of standardization.

RESTART neglect to recognize the type of data routinely collected, analyzed and disclosed by auto issuers. If the final rules require asset-level data for auto asset-backed securities, we recommend the removal of a number of the proposed asset-level data requirements because such requirements are not relevant to or verifiable for auto assets or are duplicative of other proposed asset-level disclosure requirements.

Proposed asset-level disclosure regarding servicing fees, servicer advances, servicing transfers and servicing advance methodology,[35] as well as prepayment penalties (paid or waived),[36] are not relevant to auto assets, because servicing fees are not calculated per asset and servicer advances, servicing transfer concepts and prepayment penalties are not typical characteristics of auto loans and leases. Furthermore, the geographic location of the originating dealer[37] does not provide the investor with useful information and the inclusion of such information could detract from the importance of more relevant data, such as the geographic location (in particular, the state) of the obligor. Additionally, disclosure regarding the extent to which an obligor or co-obligor's income, employment or other assets have been verified generally is not available for each asset and, in many cases, may not be verifiable at all.[38]

Finally, some of the proposed asset-level data requirements are effectively duplicative of other proposed data points. For example, asset number types, descriptions and group numbers[39] do not provide investors with information that would be material to their investment decision where the unique identification number of each asset (as required under proposed Item 1(a)(2)) of Schedule L will be disclosed. Similarly, because auto loans typically are fixed interest assets, providing the rate of interest at the time of origination (as proposed under Item 1(a)(10)) is essentially duplicative of proposed Item 1(b)(3) which requires disclosure of the current interest rate. In addition, disclosure about principal and interest adjustments[40] is more appropriately addressed in the total actual amount paid which is required under proposed Item 1(f)(1).

c. *Auto issuers have concerns regarding their proprietary pricing and credit evaluation policies that are absent in asset-classes with an originate-to-sell model.*

Unlike asset classes where the sponsor of a securitization may be an aggregator or consolidator of loans originated by one or more third-parties, most auto securitizations are sponsored by companies who act as originator and servicer of the underlying assets.[41] Because

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35 Proposing Release at 23423 and 23430, Schedule L Items 1(a)(16) through 1(a)(18) and Items 1(g)(1) through 1(g)(9).

36 *Id.* at 23430-31, Items 1(l)(2)(i) through (iii).

37 *Id.* at 23426, Item 4(b)(1).

38 *Id.*, Items 4(c)(7) through 4(c)(14).

39 *Id.* at 23422, Items 1(a)(1) and 1(a)(3).

40 *Id.* at 23430, Items 1(f)(5) and 1(f)(6).

41 We note that some asset-backed securitizations of auto loans have been completed by aggregators, but such transactions have been the exception rather than the rule in the auto ABS market. Even in transactions where

the securitization sponsor is in the auto finance business, the sponsor has a competitive interest in keeping its pricing and credit evaluation policies confidential. By comparison, in the RMBS market, originators are often in the business of originating assets to sell, and routinely provide underwriting and pricing information on individual loans to prospective purchasers. Additionally, servicing of mortgages is routinely assigned from servicer to servicer, leaving little information that is proprietary about the structure and pricing of the related loans. In fact, much of the consensus that has developed around RMBS data points for Project RESTART reflects the very different structure of the market for residential mortgage loans.

For auto loans and leases, the level of competitive sensitivity is much greater. We are particularly concerned that the specific asset-level data points set forth in the Proposing Release, taken together with the limited "ranges" or "buckets" of assets specified and the large number of loans or leases in a single transaction, may provide, in the aggregate, sufficient data to permit a regression analysis that could result in a rough approximation of the credit scoring, underwriting and pricing model of the originator. Derivation of such an approximation, in turn, could materially and irrevocably harm the originator's competitive position, market share and business model. Similarly, ongoing reporting obligations at the asset-level could reveal servicing strategies that issuers believe give them a competitive advantage. Further, in the case of a captive finance company supporting a manufacturer, asset-level data could permit a regression analysis of subvention and other marketing incentives, while disclosure of geographical location, vehicle make and model and other information could harm the competitive marketing position of the manufacturer.

Congress has long recognized the need to protect competitive business information in other contexts. For example, Exemption 4 of the Freedom of Information Act protects the confidentiality of information that, if disclosed, would be likely to cause substantial competitive harm to the submitter of such information.[42] Although auto issuers and sponsors are not compelled to securitize their assets, under the Proposing Release, if they elect to securitize, then they will be compelled to reveal detailed asset-level data regarding both their underwriting and credit process and their ongoing servicing methods and strategy. We understand that, consequently, some auto issuers would feel compelled to explore other sources of financing that, while less efficient, would not require them to reveal asset-level data that could result in inadvertent disclosure of proprietary information. We request that the Commission consider these competitive issues in structuring auto ABS disclosure requirements, taking into account particular areas of sensitivity such as linkages of pricing, credit scores, and other credit related information and/or collateral value. If asset-level data is ultimately required by the Commission,

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the sponsor of the securitization was not the originator and/or the servicer of all the underlying assets, the applicable originator generally was in the auto finance business with a proprietary interest in originating and servicing assets for its own account rather than primarily for the whole loan sale market.

42 "Because competition in business turns of the relative costs and opportunities faced by members of the same industry, there is a potential windfall for competitors to whom valuable information is released under FOIA. If those competitors are charged only minimal FOIA retrieval costs for the information, rather than the considerable costs of private reproduction, they may be getting quite a bargain. Such bargains could easily have competitive consequences not contemplated as part of FOIA's principal aim of promoting openness in government." *Worthington Compressors, Inc. v. Costle*, 662 F.2d 45, 51 (D.C. Cir. 1981).

we suggest that the data points be winnowed, in consultation with issuers and investors, to minimize the ability to reverse engineer competitively sensitive information about the issuers or sponsors and servicers from these disclosures, with sensitive information presented only in pool stratifications.

d. *In addition to the privacy issues described above that affect multiple asset classes, asset-level data requirements raise particular privacy issues for auto asset-backed securities.*

The privacy issues raised above with respect to the asset-level data requirements that affect multiple classes also apply specifically to auto ABS. In circumstances where there are a limited number of vehicles in a specific geographic region, where the location of the dealer is revealed or where a particular vehicle make and model is limited in number, the requirements to provide asset-level data could permit identification of individual obligors. For example, if someone recently purchased the only 2010 Jeep Wrangler in a sparsely populated county, then a person with only limited computer skills could identify with reasonable certainty this particular asset in the publicly available data file, which then would reveal both the financial history and current financial wellbeing of the purchaser through income, FICO score, bankruptcy status, payment history and similar information. Although the Proposing Release suggests in some cases bands of information rather than specific numbers or addresses, we believe that the average obligor would not be comforted by the fact that his neighbor knows that his FICO score categorizes him as subprime or that he failed to make his monthly car payment.

If the Commission determines that asset-level data rather than pool stratifications should be required for auto backed ABS, then we request that the Commission (1) provide that information relating to geographical location be disclosed only at the state level, and that location of the dealer be omitted as a required field (unlike mortgages, the value of the collateral underlying an auto loan or lease is not dependent on physical location of the obligor—because of the commodity nature of the collateral, issuers routinely transport repossessed or returned vehicles to markets where liquidation proceeds will be higher than the obligor's location) and (2) permit an "Other" category for vehicle make, model or year in circumstances where the concentration of vehicles by such make, model or year, as applicable, is too low to permit anonymity (especially when geographic location of the obligor is factored in).[43]

4. *Credit card receivables*

We appreciate that the Commission has attempted to strike a balance between responding to the arguments for asset-level data that have been made for other asset classes as a result of the recent financial crisis and the overwhelming volume of information that would result from

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[43] In order to protect individual or business information, the U.S. Census Bureau uses statistical methods (including data suppression and modification) to shield data that might identify a specific individual or business. *See* U.S. Census Bureau, Data Protection and Privacy Policy, "Statistical Safeguards," *available at* http://www.census.gov/privacy/data_protection/statistical_safeguards.html. We request that the Commission be similarly sensitive to protecting individual information, and that the need for disclosure requested by investors be balanced against the privacy rights of individuals.

mandated loan-level disclosures for credit card ABS[44] transactions. We agree that loan-level data would not be appropriate for credit card ABS. However, we also believe that the Commission's proposal to require grouped asset data for credit card transactions would not provide a viable alternative.

a. *There are important differences between credit card securitizations and securitizations of other asset classes that make the provision of aggregate pool-wide data meaningful and loan-level data irrelevant.*

As the Commission clearly understands, credit card receivables are revolving, not amortizing, assets. Even for those credit card securitization programs where the list of customer accounts that have been dedicated to a credit card trust may change infrequently,[45] the balances of those accounts, and the relative proportion of the receivables in each account to the total pool, change daily. All receivables, and all payments on receivables, related to those dedicated accounts automatically flow into the securitization trust. In addition, credit card receivables are short-term assets, with large numbers of "convenience users" who repay their balances in full every month. As a result, the receivables supporting credit card securitizations generally are repaid at rates much faster than those necessary to repay the investor securities they support. Unlike term securitizations with amortizing structures, however, these payments do not create prepayment risk for investors that affects their yield expectations; instead, the cash proceeds are "reinvested" in new receivables until needed for a scheduled repayment. Consequently, the maturities of the securities issued by credit card securitization programs can easily be structured to meet investor needs and market demand. More significantly, it means that even as investors are repaid, the pool of assets supporting their securities is continually and automatically replenished.

Credit card securitization portfolios typically are far more seasoned than the financial assets securitized in other asset classes. For instance, it is typical for well over half of the accounts dedicated to a credit card master trust to be more than 60 months old. As an account ages, performance problems become decreasingly likely to derive from issues at origination, information provided by the obligor at origination becomes increasingly stale and irrelevant, and

[44] The Proposing Release refers to "credit cards" as including both credit "cards" and charge "cards". It should be noted that certain charge accounts (for example accounts used primarily through internet channels and certain other types of private label accounts) are not represented by a physical card, but otherwise operate identically to a store charge card. Therefore we suggested broadening the "credit card" category to include similar revolving charge accounts, whether or not represented by a physical card.

[45] The Commission has noted in several places in the Proposing Release its belief that any new issuance of securities by a master trust involves the addition of receivables to that master trust. Proposing Release at 23351 and 23389. In credit card securitizations, this is frequently not true. Many card issuers designate new accounts only occasionally, with the intention of having sufficient receivables as a result of the designation to issue a number of new tranches of securities. Further, new accounts may need to be dedicated to the pool only if the securitization program is expanding. In the current economy, where securitization has been a very limited option and existing credit card transactions continue to mature, we have seen little or no growth in master trust portfolios.

the very fact of continuing performance by the account increasingly signifies the credit quality of that account.[46]

In addition, the origination of new receivables in accounts that have been dedicated to the securitization is also actively managed by the originator and servicer of those accounts, with new credit decisions for existing accounts made every day, as discussed below. The originator or its affiliates nearly always retain a significant "seller's interest" in the pool to absorb ordinary fluctuations in pool size and to permit new issuances. The seller's interest generally is entitled to a pro rata share of collections on the receivables, and absorbs a pro rata share of losses, which creates a very strong alignment between the originator and the investors. This feature, like other structural features, in particular ownership of the "excess spread" strip that we discuss below, helps to ensure that the originator and any affiliated servicers have a strong continuing interest in managing the pool effectively. Credit lines and pricing may be reduced or increased based on the customer's behavior (as reflected by account payment history), macro-economic trends and changing credit standards for the aggregate portfolio. As a result, in a well-managed portfolio, the originator and servicer are expected to take action to mitigate developing risks with respect to pool accounts. We do not believe it is possible for predictive models based on pool characteristics to account for the benefits of the active management of pools of credit card receivables.

Aggregate pool performance data is the best indicator of how well the originator is managing the credit risks of the portfolio. As the Commission has noted, many credit card securitizations may include between 20 million and 45 million accounts,[47] and all securities offered in the securitization program are backed by the same pool of assets. Each account is a *de minimis* portion of the total pool, and each investor's exposure to a particular account is also *de minimis*. At the same time, the very large number of accounts in the pool means that aggregate performance data can effectively smooth out the effects of any idiosyncratic performance aspects of particular accounts in the pool. That the pool as a whole has a specified payment rate, yield, or charge-off rate has real significance, because those aggregate statistics are generated using millions of data points, none of which is individually important to the overall picture they, in the aggregate, present.

In addition, credit card issuers typically provide Exchange Act reports for the full term of the securitization obligations, providing current and prospective investors with extensive monthly data about the pool of assets. Investors typically have access to many years of this performance data, as well as the static pool data mandated in existing Regulation AB that breaks down performance by year of origination of the account, from which they can determine overall trends in the portfolio, tracking those trends to macroeconomic events and comparing them across the industry.

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46 Indeed, the Commission has acknowledged that the seasoning of assets can be a significant indicator of credit quality, asking whether it should be one of the new criteria to determine shelf eligibility. Proposing Release at 23348.

47 Proposing Release at 23360.

Transaction structures in credit card securitizations, and in particular the role of the "excess spread" calculation, provide early warning of problems in pool performance and trigger early repayment of securities. Credit card securitization structures determine the financial health of the overall structure by comparing the yield on the receivables to the costs of the securitization. The typical calculation, which determines an amount referred to as "excess spread," takes yield (which includes finance charge collections, fees, recoveries and interchange, and may include the net effect of an interest rate swap or discount receivables) and subtracts from it the interest rate on the securities, the servicing fee, charge-offs and any credit enhancement fees. The excess spread calculation presumes that there will be losses on the receivables pool, and the historical aggregate pool performance data show the range of such losses in previous periods.

The excess spread calculation can be done on a security-by-security basis, using the portion of these amounts allocated to a particular security, or it can be done based on the entire amount of securities issued by the structure, or both. The seller's interest is typically not included in the calculation. If excess spread falls below zero, typically on a three-month rolling average basis, principal collections would be used to repay investors rather than being reinvested in new receivables. However, new receivables would continue to flow automatically into the securitization trust.

The excess spread is (1) the most significant indicator of the financial soundness of the securitization vehicle at any point in time, (2) the most significant, though not obvious, form of credit enhancement in the vehicle, as the excess spread interest absorbs first losses, (3) an important driver of profits in the business of the credit card originator, which strongly aligns the originator's interest with the investors' interests, and (4) the most significant trigger of reserve account funding, early amortization events and early redemption events. Early amortization events and early redemption events cause the securitization to stop reinvesting in new receivables and unwind by applying all principal collections to repayment of investors, in turn minimizing the period during which investors are exposed to losses and rapidly shifting portfolio exposure back to the originator. We are unaware of a concept correlative to excess spread that has been used in any amortizing trust structure.

b. *To our knowledge, grouped asset data has never been used to evaluate credit card pools, and as proposed does not appear to have significant utility.*

Because there are no existing models for using grouped asset data to evaluate credit cards, its value is, at best, speculative, while the costs of producing it are substantial, even without considering the competitive issues described in Part II.A.4 above. We do not believe this form of presentation is being used by credit card originators to value their own portfolios. We understand that at least one investor specifically requested a similar report in its response to the FDIC's advanced notice of proposed rulemaking, which the Commission acknowledges as being the basis of its proposed groupings.[48] We also understand that "rep lines" or

48 Proposing Release at 23373 n.297.

"representative lines" have often been used to evaluate RMBS and other asset classes. But every asset class has unique attributes, and the attributes of credit card receivables—including the fact that they are revolving and actively managed—make them singularly unsuitable for this type of presentation.

We understand that credit card securitization issuers and investors have reached agreement as to a basic reporting package that would include limited grouped asset data. To assist the Commission in evaluating that package compared to the Commission's proposal, we want to point out a number of specific aspects of the Commission's proposal that we believe are either problematic or do not convey relevant information in the context of credit card receivables portfolios:

- Column (a)(1) of Schedule CC establishes lines based on different buckets for credit scores, and the instructions in proposed Item 1111B of Regulation AB are to state the score range for each bucket "if the credit score is FICO." There is no discussion of what to do if the credit score is not FICO.[49] The buckets, which appear to be derived from the investor comments to the FDIC, do not match the buckets that credit card securitization issuers use to report their account characteristics. Indeed, the buckets do not reflect the crucial divider at 660, which bank regulatory agencies generally treat as the cutoff between prime and subprime. Also, there is no indication of whether the credit score is intended to reflect the score at origination, which may become stale, or a refreshed score, which may or may not be refreshed frequently. We understand that a number of issuers buy FICO scores for a representative sample of the portfolio only—or not at all—and may not refresh them regularly. All of these may limit the ability to produce rep lines that depend on credit scores, or require the ability to present rep lines that extrapolate such scores based on a representative sample.

- Column (a)(2) of Schedule CC establishes lines based on different delinquency statuses, but many of the lines would be meaningless for accounts that are more than 60 days delinquent. For instance, the credit score in all likelihood has dropped dramatically and the available credit line is likely to be zero for all such accounts. Similarly, the state of residence and age of account will no longer be relevant, and the APR is of less significance given that payments are not being made. Indeed, we believe that the only relevant information for accounts more than 60 days delinquent, for predictive purposes, is the amount outstanding and the number of accounts, both of which are already included in the aggregate delinquency data for the pool.

- We appreciate that it makes sense to disclose in aggregate pool characteristics the states in which the largest portion of the pool is concentrated, as this information indicates whether the pool may be particularly vulnerable to economic downturns

[49] We note that this same dilemma exists in other portions of Schedule L that require the disclosure of FICO scores. *See, e.g.*, Item 2(c)(3), relating to residential mortgage loans.

in one or more regions. But we believe geographic location generally has little correlation to credit card performance beyond those aggregate concentration aspects, especially because—unlike RMBS—credit card receivables are unsecured, and thus not closely correlated to property values in a particular region.

- Column (a)(5) of Schedule CC establishes lines based on interest rate basis, divided among "fixed," "prime" and "other." We believe there are challenges in grouping accounts in this way. Individual receivables within an account may have different interest rates than other receivables in the same account, as a result of, among other factors, promotional rates, balance transfer rates, cash advance rates, regulatory limits on changing rates for outstanding balances, and penalty pricing following delinquencies. Guidance should be provided as to how to determine the appropriate grouping of the account where multiple rates apply. Moreover, the disclosure of the interest rates associated with accounts may be misleading in certain circumstances. For example, for cardholders who are "convenience users" the rates disclosed are those that would apply if the cardholder did not pay the card balance in full every month—but because the cardholder pays the card balance in full each month, the relevant receivables do not in fact accrue finance charges.

- For the same reasons we have indicated with respect to column (a)(5), column (b)(4) of Schedule CC, requiring the Weighted Average APR for the group of accounts, also would potentially provide misleading information. We also understand that APR is the most competitively sensitive disclosure item for credit card issuers and any requirement to disclose it could act as a significant deterrent to issuance.

- Column (b)(5) of Schedule CC, requiring the Weighted Average Net APR (defined as the weighted average APR net of servicing fees associated with the account), would provide identical data to that provided in column (b)(4), which would require the Weighted Average APR. Although we appreciate that, for residential mortgage loans, a servicing fee may be directly associated with an account, to our knowledge this is universally not the case for credit card receivables.

c. *An alternative that may be helpful to investors without imposing undue burden on issuers would be to expand the categories of aggregate data presented for the portfolio.*

We believe that providing additional tables of aggregate data may be an effective way to capture incremental additional portfolio detail without creating the difficulties presented by extensive grouped asset data. We understand that the reporting package being contemplated by issuers and investors would include additional and more layered presentations of aggregate pool data, and would also provide more granular information about charged-off accounts. We believe this is an appropriate approach.

d. *New "soft data" disclosures should not be required for credit card securitizations.*

The Commission asked whether it should require additional information about cardholders, such as home ownership status, mortgage or rental information, income, debt-to-income ratio, educational level and occupation. Very little, if any, of this information is obtained in the initial credit card application, the information that is obtained is often difficult or prohibitively expensive to verify and the type of information collected varies by card issuer. Further, as noted above, as accounts become more seasoned, information obtained at account origination becomes stale, may not be refreshed, and has the issues associated with self-reported data that we mention in Part II.A.1 of this letter. Even if it were feasible to do so, we do not believe it would be appropriate to require credit card originators to collect and verify data that they do not consider as part of their credit-granting procedures.

5. *Student loans*

a. *"Pool stratifications" or "pool strats" are more appropriate than asset-level disclosure for ABS backed by student loans.*

Student loan securitizations are subject to many of the issues we have discussed with respect to other asset classes. We have significant concerns about privacy issues and reverse engineering of proprietary underwriting standards. As in the case of other ABS asset classes in which each securitization involves large numbers of assets with small individual principal balances, we believe loan-level data may be too expensive to produce and audit, and requiring issuers to provide this data will create significant disincentives to securitize assets, even where securitization has been an important funding source. Accordingly, we believe pool stratifications provide better disclosure than loan-level data.

6. *Equipment loans and leases*

The equipment finance sector provides a significant source of funding for small businesses and a valuable alternative source of funding for large businesses in the United States. Many of the issuers in the equipment finance sector are small- to mid-size companies whose access to the securitization markets, we believe, are likely to be adversely affected by the increased costs associated with many of the Commission's proposed revisions to Regulation AB. Similarly, many of the obligors of equipment leases and loans are small- and mid-sized Main Street businesses who rely on equipment finance as an important part of their business models. The lessees and borrowers in the equipment finance sector are overwhelmingly commercial enterprises and not consumers.

Most equipment-backed ABS transactions contain a pool of equipment finance contracts backed by widely diversified equipment types, obligors, industries and geographic locations, such that no one equipment finance contract is material to an investor in the security. In our experience, aircraft have been the only individual pieces of equipment about which disclosure is considered important to investors, while individual leases and loans have only been considered important in equipment ABS transactions involving aircraft, railcar and certain other transportation assets with high obligor concentrations. We believe it is significant that asset-level information traditionally has been provided only in securitizations of such transportation equipment, indicating that investors and issuers in this sector have been able to agree on the circumstances in which such asset-level information is material to an investment decision and those in which it is not material.

a. *Businesses that rely on equipment finance may be easily identified from loan-level data, revealing competitively sensitive proprietary information.*

As we have noted in connection with other asset classes, asset-level data relating to equipment loans and leases can be used by competitors of an issuer to derive proprietary pricing and underwriting data for individual assets, as well as the issuer's confidential business strategy and information about their individual customers. For instance, because of the limited number of businesses within a particular zip code, by combining the zip code of a customer and the customer's business type, competitors could derive the identity of the customer and then use the remainder of the asset-level data to obtain confidential information and equipment usage information about the customer as well as proprietary pricing information and underwriting data.

b. *Disclosure of obligor ability to pay is not a meaningful data point for equipment finance.*

The Commission has asked whether it should require data points on the obligor's ability to pay an equipment lease or loan.[50] We do not believe this would be relevant disclosure. Equipment financing companies develop their own underwriting process that may consider the importance of the equipment to the customer's business, the ease of remarketing the equipment to other end users at the end of a lease term, the ease of repossession, and whether alternative equipment is available. We understand that the equipment finance sector rarely collects information such as FICO scores, though Dun & Bradstreet ratings, Dynamar ratings or other rating services may be used in addition to proprietary internal credit scores. We do not believe credit analyses will be comparable across issuers, and there is a significant risk that they would reveal proprietary underwriting criteria.

c. *Disclosure of historical realization rates on residual equipment values and pool stratifications of aggregate residual values is more appropriate than asset level disclosures of residual values.*

We understand that most equipment lessors and lenders develop residual values using proprietary techniques. Disclosing such amounts on an individual basis could significantly harm the sponsor's competitive position by revealing to its competitors how the sponsor values specific equipment classes. Furthermore, we understand that asset-level residual values are generally not treated as a valuable component of the collateral when structuring equipment ABS, and in most situations investors are not relying on any specific asset-level residual value to support the equipment ABS. Instead, investors evaluate historical realization of equipment

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[50] Proposing Release at 23357-58.

residual values to determine the capability of a servicer to successfully manage residual values and, in transactions in which residual value is important, may require on-going reporting on the actual realization of residual values as well as amortization events or similar trigger events to collect additional cashflow if the actual realization of equipment residual values varies significantly from historical realization rates.

We suggest that, instead of requiring asset-level residual value information, the Commission require disclosure of historical realization rates on residual equipment values on a portfolio-wide basis or within specific category bands, plus periodic reporting of actual realization rates on a portfolio-wide basis. We believe that residual values should only be required to be disclosed when they are a material element of the overall credit enhancement for the equipment ABS and such disclosure should be on an aggregate basis for the entire asset pool, rather than an asset-by-asset disclosure for each item of equipment. If the Commission determines that asset-level residual values are important, we suggest that the Commission only require such asset-level disclosure where the equipment had an original value of $500,000 or more or where there is an industry-wide source for residual values (such as the Kelley Blue Book for automobiles).

d. *Disclosure of originator information in equipment finance sector securitizations is not relevant because assets are reunderwritten by the sponsor, but may disclose proprietary origination channels.*

Generally, for equipment ABS the assets not originated by the sponsor are reunderwritten by the sponsor prior to the offering in order for the sponsor to be able to make new eligibility representations for each receivable added to the asset pool. Investors rely on these sponsor representations and the accompanying repurchase obligations, rather than on the representations by the underlying originator. Accordingly, the identities of the underlying originators are typically of little value to investors. Moreover, requiring disclosure of the identities of originators may put the sponsor at a competitive disadvantage by revealing its broker channels to its competitors. We suggest that, where the sponsor has reunderwritten the asset, originator information may be omitted.

e. *Presentation of delinquency information should be by aging buckets, not specific number of days past due.*

For equipment finance transactions, delinquency is normally tracked and reported by aging buckets, rather than by the specific number of days a payment is past due. We believe that all Items of Schedule L, such as Item 1(b)(5), that appear to contemplate an actual day count, should be modified to require disclosure only by delinquency buckets with ranges in 30-day increments.[51] In addition, in certain sectors of the equipment finance industry, "past due" status is typically tracked based on whether the obligor has made at least 90% of the schedule payment. For equipment ABS, we believe reporting should be permitted based on this standard rather than on payment of the "full scheduled payment."

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[51] We believe this is an issue for other asset classes as well. We are not aware of any asset class for which it is common for delinquencies to be tracked by days, rather than by buckets or payment cycles.

f. *Presentation of payments, collections and outstanding balances for equipment finance securitizations should be based on "regularly scheduled payments" rather than interest and principal payments.*

In the equipment finance industry, payments are normally tracked based on a "regularly scheduled payment" concept that does not distinguish between principal and interest components, because although a lease payment implicitly contains "principal" and "interest" components, these are not separately tracked. We recommend that for equipment ABS, the items for interest and principal payments be combined into a "regularly schedule payment." Equipment leases are also generally tracked based on an "implicit principal balance" rather than on "current asset balance" and "current scheduled asset balance". We recommend that for equipment ABS, items that refer to these terms be modified to reflect current industry practices.

In addition, we believe that disclosure items that require information on "actual other amounts paid" should be clarified to refer only to such amounts that constitute collateral for the transaction. For instance, late fees, documentation fees and similar charges that are payable to the sponsor or servicer, sales and property taxes payable to governmental authorities and pass-through items billed on behalf of a third party (such as a monthly service or repair charges or insurance) do not flow through to investors, and so detailed reporting of such information would not be relevant to investors.

g. *Servicing fees for equipment finance transactions are not tracked on an asset-by-asset basis.*

In the equipment finance industry, securitization servicing fees are generally based on the total securitization pool and are not tracked on an asset-by-asset basis. Reporting a servicing fee on an asset-by-asset basis is therefore not meaningful.

h. *Asset types and obligor industries should be expanded.*

For descriptions of types of equipment in Items 6(b)(1) and 7(b)(1) of Schedule L, we believe "food service" and "retail" should be added. For obligor industry in Items 6(c)(1) and 7(c)(1), we suggest adding codes for railroad, maritime, interstate highway, aircraft and aircraft engines.

i. *Issuers should not be required to distinguish "true leases" from "finance leases," which we believe would be based on a reasoned analysis rather than a bright-line test.*

We believe the characterization of a lease as a "true lease" or a "finance lease" is sufficiently complicated that it cannot be determined with certainty, and therefore it would not be a meaningful disclosure for investors. Generally, this is a legal determination that may be tied to the amount of any residual payment due at the end of the lease and other lease terms. The determination may be different for different purposes, such as accounting, tax, perfection of security interests and insolvency. Many leases may have aspects of both true and finance leases that prevent definitive characterization absent a court's determination. Accordingly, we suggest that Item 7(a)(1) be deleted.

7. *Floorplan receivables*

The common issues affecting multiple asset classes described above regarding the proposed expansion of the data requirements apply equally to the asset class of floorplan receivables. In addition to these general concerns, there are also a number of specific issues that apply to floorplan receivables.

a. *In addition to the privacy issues described above that affect multiple asset classes, asset-level data requirements raise particular confidentiality issues for floorplan asset-backed securities.*

For many floorplan issuers, loan-level data requirements would allow easy identification of dealers. For example, for many issuers, it is rare for more than one dealer to be located in the same zip code, and often there are only a small number of dealers in particular states. Even where there are several dealers in a zip code, loan-level data would allow easy identification of the largest dealers, who would be well known to competing dealers and competing floorplan lenders. Because floorplan relationships with dealers tend to be exclusive, other competing dealers could determine, based on the loan-level data, such things as the amount of vehicles purchased by the borrowing dealership, the models purchased, the models sold, the speed at which particular models are sold, and the pricing and terms of the dealer's floorplan line of credit. As a result, it will be a competitive disadvantage if a floorplan lender securitizes its floorplan loans because dealerships are likely to avoid using such floorplan lenders.

In addition, the relative ease in identifying the dealership borrowers, particularly the large ones, makes it easier for competing floorplan lenders to determine the business terms of a dealership's floorplan loans and to offer more attractive proposals to those dealers. Many floorplan issuers would likely exit the market rather than risk having the identity of their borrowers and the terms of their loans publicly available.

b. *A number of the proposed asset-level data requirements are not applicable, relevant or verifiable for floorplan asset-backed securities and would not provide valuable information to investors*

In examining the specific data fields required for floorplan asset-backed securities, we believe many of the asset-level data points are not applicable and therefore should not be required. For example, since the vast majority of floorplan receivables arise under a "pay-as-sold program" whereby a dealer is obligated to pay interest monthly but principal repayment on any particular item of inventory is due and payable only at the time of sale of that item by the dealer, asset-level data points such as original asset term, asset maturity term, original amortization date, original interest only term, and remaining term to maturity would not apply. For other data points, it is unclear whether they are applicable or not, such as first payment date, current scheduled asset balance, current scheduled payment amount, current scheduled principal amount, current scheduled interest amount, pay history and next due date. In addition, certain concepts appear especially mortgage or consumer finance orientated and do not apply to floorplan issuers such as credit score, credit score type, current interest rate, servicing advance methodology, next interest rate, repurchase notice and pledged prepayment penalty.

We also note that the amount of loan-level data for floorplan issuers is likely to be burdensome, and in fact may be more extensive than the amount of data required by the Commission for mortgage loans because of the large number of floorplan receivables in a floorplan master trust at any time, the fact that each receivable is related to a specific vehicle or product, the short term nature of the receivables and the revolving nature of the trust.

Under any circumstances, if the final rules require asset-level data, it would be better for the unit of measurement to be the dealer's loan rather than each individual invoice financed. A dealer typically has many invoices outstanding at one time, and it is unlikely that providing data at the invoice level would be more helpful to investors than data at the dealer level.

c. *There are important differences between floorplan securitizations and securitizations of other asset classes that make the provision of grouped asset data disclosure meaningful and asset-level data irrelevant*

Floorplan receivables are revolving, not amortizing, assets. Even for those floorplan securitization programs where the list of dealer accounts that have been dedicated to a securitization trust may change infrequently, the balances of those accounts, and the relative proportion of the receivables in each account to the total pool, change daily. All receivables, and all payments on receivables, related to those dedicated accounts automatically flow into the securitization trust. In addition, floorplan receivables are in many cases short-term assets, with large numbers of receivables repaid shortly after being sold to the securitization trust. In general, inventory gets sold almost immediately after purchase by the dealers, and typically within 90 days after purchase. As a result, the receivables supporting floorplan securitizations are generally repaid at rates much faster than those necessary to repay the securities they support. Unlike in amortizing structures, however, these payments do not create prepayment risk for investors that may affect their yield expectations; instead, the cash proceeds are "reinvested" in new receivables until needed for a scheduled repayment. This means that the maturities of the securities issued by floorplan securitization programs can be easily structured to meet investor needs and market demand.

Floorplan securitization portfolios are typically far more "seasoned" than the financial assets securitized in other asset classes. For instance, it is typical for many sponsors that the dealer relationships with the sponsor originated well over five years before the transaction, and in some cases the floorplan dealer/sponsor relationship has continued for more than twenty years. Older accounts are far less likely to suffer performance problems that have derived from issues at origination. Information provided by the dealer at origination becomes increasingly stale and irrelevant, and the very fact of continuing performance by the account increasingly signifies the credit quality of that account. In floorplan lending, credit underwriting and monitoring happen periodically, but not at the time each receivable is originated. Credit lines and pricing may be reduced or increased based on the dealer's behavior, macro-economic trends and changing credit standards for the aggregate portfolio. As a result, in a well-managed portfolio, the originator and servicer would be expected to take action to mitigate developing risks with respect to pool accounts and such accounts should not affect the long-term performance of the investment.

d. *Grouped asset data disclosure would be more appropriate for floorplan asset-backed securities*

We believe that grouped asset data disclosure for floorplan asset-backed securities is more appropriate than asset-level data disclosure and will provide investors with the meaningful information they need to make investment decisions. The use of grouped asset data will avoid both the general concerns with the data requirements as described above and the problems an asset-level approach will raise with respect to floorplan receivables specifically as described below.

If the Commission agrees that grouped data would be more appropriate than asset-level data, the Commission should be careful to assure that the groupings are always large enough so that individual dealers and their loan terms would not inadvertently be required to be disclosed.

e. *Static pool data would be particularly cumbersome for floorplan receivables.*

Because floorplan issuers tend to have virtually all of their floorplan receivables in their master trust, it would be difficult to provide static pool data on a series by series basis. Static pool data on a vintage basis would also make little sense as series issued by a master note trust are not backed by any particular vintage. Most of the dealer relationships for typical floorplan issuers are more than five years old. The fact that losses do not often occur and that the concept of a "delinquency" does not typically exist for floorplan loans again makes static pool disclosure particularly inappropriate for this asset class. We are not aware of any floorplan issuer that has provided the full static pool data required by Regulation AB.

8. *Resecuritizations*

a. *Resecuritizations of RMBS, which are typically used to manage risk by splitting an existing RMBS into a senior tranche and a subordinated tranche, should be allowed to continue for RMBS issued prior to the implementation date of the new rules even though the more comprehensive disclosure and reporting package required under the new rules will not be available for the underlying RMBS.*

Although the Proposing Release defines "resecuritization" in terms of "asset-backed securities,"[52] thereby potentially including not only the classic RMBS "re-REMIC" transactions

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52 Proposing Release at 23367 ("In a resecuritization ABS, the asset pool is comprised of one or more asset-backed securities.").

most often associated with the term "resecuritization," but also CDOs of asset-backed securities (and certain ABCP transactions), for purposes of this section we have focused solely on re-REMIC transactions.[53] Unlike CDOs of RMBS, which are frequently actively managed, re-REMICs have a fixed pool of assets. Also, although resecuritizations are sometimes registered under the Securities Act when the underlying securities have also been so registered, we believe the vast majority of resecuritizations are conducted in the private markets.

Resecuritizations may be undertaken for a number of reasons and may include underlying securities that were either acquired for the express purpose of resecuritization or retained by the original issuer (or affiliates of the issuer) of the primary securitization to which they relate. However, the bulk of resecuritizations that have been completed, at least over the last two years, have been sponsored by investors holding RMBS that, when resecuritized, either were rated AAA or had previously been downgraded from an original rating of AAA.[54] We believe the investor-driven aspect of this market should be an important consideration for the Commission in its approach to resecuritizations in its final amendments to Regulation AB. In a typical resecuritization of this kind, an RMBS can be individually restructured, generally into one senior tranche and one subordinate tranche. When multiple RMBS are resecuritized for this purpose, a separate "group" is typically created within the resecuritization for each such RMBS, with each such group supporting one senior and one subordinate tranche. By effectively splitting the RMBS into two tranches, these "restructuring" resecuritizations enable the investor to segregate risk in a senior RMBS it owns, obtaining liquidity by selling the senior tranche and keeping the subordinate tranche, thereby retaining most of the investor's initial investment risk. Alternatively, the investor can retain the senior tranche and sell the subordinate tranche to an investor in a better position to manage its risk. In the latter case, the resecuritization may be undertaken by a regulated financial institution to achieve the more favorable capital treatment associated with holding higher-rated securities.

The underlying RMBS may have been offered publicly or privately at the time of issuance. Generally, however, securities issued in resecuritization transactions are offered privately, in Rule 144A-eligible transactions. Under existing Commission rules, the underlying security must be freely tradable (or be registered as part of the resecuritization transaction); and any applicable disclosures related to the underlying security would also have to be made under Regulation AB's "significant obligor" requirements, the satisfaction of which can be complicated by the automatic suspension of Exchange Act reporting for the underlying ABS. These rules, which are designed in part to ensure that resecuritization is not a means to avoid the Securities Act's registration requirements for the underlying security[55] and in part to ensure that investors receive a consistent level of information in connection with a public offering of securities

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[53] We note that this term would include resecuritizations of both RMBS and CMBS, and although our focus has been on RMBS, most of our analysis would apply equally to re-REMICs of CMBS.

[54] According to news articles that referred to a June 2009 report by Bank of America Corp., RMBS re-REMIC volume was approximately $27 billion up to that point in 2009, up from $17 billion for all of 2008. "Morgan Stanley Plans to Turn Downgraded Loan CDO Into AAA Bonds," Bloomberg, July 8, 2009.

[55] Asset-Backed Securities, 70 Fed. Reg. 1506, 1528-29 (Jan. 7, 2005).

without regard to the reporting status of the underlying securities,[56] have in many instances made the private markets the only feasible venue for these transactions. The Commission's new proposals would make public resecuritizations of ABS issued before the effective date of the new rules all but impossible. We therefore ask that the Commission consider grandfathering the resecuritization of RMBS, CMBS and other ABS issued pursuant to a registration statement before the implementation date for the new rules or provide an extended period, after the implementation date, during which those rules do not apply to resecuritizations of ABS originated prior to the implementation date of the new rules.

9. *Stranded cost securitizations*

a. *We agree with the approach outlined by the Commission with regard to stranded cost securitizations, and suggest that the Commission consider including other types of "utility tariff securitizations" within these rules.*

In the Proposing Release, the Commission proposes to exclude ABS backed by "stranded costs" from the asset-level disclosure and waterfall computer program requirements the Commission would apply to other asset classes. We agree with this approach. We note as well that the same methodology has been used to securitize a variety of similar utility-related assets that do not fall under the label "stranded costs." These "utility tariff" transactions include, for example, storm recovery/hurricane reconstruction ABS and mandated pollution control ABS. In addition, the State of Louisiana has recently adopted Act 988, the "Louisiana Electric Utility Investment Recovery Securitization Act," that would apply utility tariff securitization methodology to certain qualifying investment recovery costs, including cancelled construction of electric generating or transmission facilities, certain long-term fuel supplies and other capital investments that are determined by the Louisiana Public Service Commission to be suitable for utility tariff securitization. We believe the term "utility tariff securitization" may better characterize the securities that should be the subject of the proposed exclusion. In any event, we would ask the Commission to consider clarifying in its final rules that the exclusion for stranded costs would apply equally to these very similar types of ABS.

C. <u>Other disclosure matters</u>

1. *We generally support standardized presentation of pool-level data, but caution that it may not wholly achieve the results intended by the Commission.*

We believe that applying standardized ranges for pool-level data may be a relatively easy way for issuers to provide investors with data they can better use for comparisons across issuers, and we generally support requirements to standardize the presentation of data. Standardization is not, however, a perfect solution. Data that appear to be comparable may have subtle differences. For instance, there are a number of different providers of FICO scores that use somewhat different methodologies to compute those scores, preventing those scores, even when based on

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[56] *Id.* at 1573.

Fair Isaac's methodology, from being directly comparable.[57] Other disclosures may vary based on the servicer's methodology and systems, or based on the specific attributes of the assets that are included in the pool. We do not believe this lack of comparability can be cured by requiring standardized definitions or methodologies. The costs of moving to a standardized approach for definitions and methodologies would be borne disproportionately by some issuers than by others, even if all such issuers used equally valid approaches, and in some cases might be great enough to deprive issuers of market access. We believe that issuers should define the terms they use in preparing pool-level data tables to allow investors to better understand some of the differences in preparation.

We also believe that sponsors should be permitted to determine which pool-level tables are included in the offering materials and prospectus where there is no standard set of such tables that would be material for all pools of assets in a particular category. Even within the class of RMBS, for instance, there will be differences depending on the nature of the mortgage loans involved, and we believe investors will receive better disclosure if pool-level tables are crafted to reflect the key attributes of the pool. We would therefore prefer to see ranges established as guidelines rather than mandates. For tables for which the Commission has prescribed standardized ranges of data, we believe issuers should be able to subdivide those ranges, presenting additional data, where material information would be conveyed by narrower ranges in a particular band. Finally, if the Commission decides to encourage or require standardized ranges for pool-level data, we ask that the applicable ranges be proposed for public comment before they are adopted.

2. *It is important that the requirements as to the disclosure of data based on measurement dates and cut-off dates be consistent with current industry practices regarding the collection of such data for various asset classes.*

A number of the proposals would require disclosures as of a particular "measurement date" or "cut-off date." In addition, the Commission has asked about reporting frequency for updated data. We believe it is important to ensure that final requirements are consistent with the limits on the frequency with which issuers can generate pool data, and we note that those limits are likely to be more severe given the increased scope of the proposed disclosures.

Reporting requirements for ABS during the term of a transaction are generally organized around the concept of a collection period and a related distribution date on which collections received during the prior collection period are distributed to investors. For master trust structures, prospectus disclosures would reflect the same reporting cycles as those used for outstanding securities issued by the master trust. For amortizing assets, as the Commission has noted, there is also a "cut-off date," which is generally used to determine the precise composition of the pool and which collections are treated as belonging to the securitization. Following the cut-off date and before the closing of the transaction, the pool assets will continue to perform (or

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[57] We do not believe the Commission should mandate that issuers purchase one version of the score rather than others, thus providing monopoly power to a single provider.

fail to perform), principal and interest payments may be received, current accounts may become delinquent, or delinquent accounts may become current.

For many issuers, it may be impossible to provide meaningful updates on an intra-month basis, and for all issuers it would likely be quite burdensome. One reason for this is that the underlying obligations have their own monthly cycles with specific payment dates. For example, if a servicer only invoices mortgages on the 5th of each month, with payments due on the 25th, the significance of information collected on the 24th will be very different from that of information collected on the 26th. Data will likely only be comparable if consistently collected at the same point in time. We would be very concerned about any proposal that required data to be updated on a more frequent schedule. Issuers may also have systems limitations that would prevent them being able to compile data more frequently than monthly.

In most cases for RMBS, the measurement date used for the 424(h) preliminary prospectus will be the same date as the cut-off date used for the 424(b) final prospectus. However, there may be cases where an earlier date will be used for the preliminary prospectus and that decision should be left to the issuer and market convention. Most of the data points other than principal balance will not be affected by measuring the data at different points in time. While delinquency status would be a relevant data point that could change from one month to the next, any delinquent loans during the offering period would presumably be removed from the pool prior to closing.

For CDOs, there is a further complication in determining relevant dates for reporting purposes if assets have been purchased or sold. Some transactions tie their reporting to the trade date, without regard to the settlement date, and others report only when the trade has been settled. In our view, so long as the applicable convention used for the transaction is clear and consistently applied, reported information should be considered accurate regardless of the convention used.

3. *The final rules should reflect a recognition that some information may not be available to the sponsor and, thus, cannot be disclosed by it.*

The Commission refers in several places in the Proposing Release to Rule 409 under the Securities Act, which allows a registrant to omit information that is not known or reasonably available to it without undue effort or expense. The Commission has also commented that "not applicable," "unknown" or "other" would not be acceptable responses for a large number of loan-level data points.[58] Many originators, particularly those not originating residential mortgage loans, routinely obtain a smaller subset of data than the Commission references, reflecting business judgments about the cost of collection versus the utility of such information. We believe that any information not used in the origination and servicing of the assets cannot, by definition, be material to an evaluation of the assets, and the Commission's loan-level disclosure provisions should clearly indicate that the Commission does not intend to compel the collection of such information. In addition, some information, such as FICO scores, may only be available

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58 Proposing Release at 23357.

at a cost, and we do not believe issuers should be forced to buy information that they would not otherwise use in their business. Further, if the Commission does intend to force issuers to gather data they would not otherwise obtain, we believe that the lack of such additional data for loans originated prior to the implementation date of the final amendment, even if not provided for a large number of loan-level data points, should not be viewed as a failure to satisfy the disclosure requirements of the form.

4. *We do not believe that detailed information about the financial condition of originators, servicers and sponsors should be required.*

Current industry standards and disclosure practices already incorporate the use of risk factors, where appropriate, to highlight the risk that an obligated party's financial or business condition may have a material impact on such party's ability to comply with its repurchase obligations. To the extent the Commission intends to codify such practices, we support the proposed requirement. It is not clear, however, how much disclosure would be required. The proposed rule does not reference audited financial statements or compliance with Regulation S-X, and we do not believe that providing detailed financial information would be more helpful than the narrative discussion that is included in risk factors. With respect to servicers, we believe that any formal financial statement disclosures would be overwhelming in transactions with multiple servicers. We request that the Commission specify that narrative disclosures of particular risks would satisfy the proposed requirement.

5. *Consolidated presentation of the contractual waterfall and related defined terms may make it easier for investors to locate the disclosure, but will not resolve issues of inconsistencies between the contractual waterfall and the plain English disclosures.*

As the Commission notes in the Proposing Release, under the Commission's plain English rules[59] information in a prospectus must be presented in a clear, concise and understandable manner. The Commission further admonishes against copying legal language verbatim into the prospectus.[60] For all but the most simple flow of funds structure, issuers, underwriters and their counsel currently must translate the legal language of the cash flow structure—which legal language itself may be a translation of a more mathematical construct—into a plain English, narrative discussion in the prospectus.[61]

We appreciate that the plain English description of the waterfall, when done properly, can be a significant aid to understanding the waterfall. In our experience, however, many issuers and

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59 Securities Act Rule 421, 17 C.F.R. § 230.421.

60 Proposing Release at 23352.

61 We understand, from what we have heard anecdotally, that in many RMBS prospectuses, the waterfall is described in precise, legal terms in the prospectus and then copied verbatim into the transaction documents. Indeed, some issuers' counsel have been reluctant to make changes to the waterfall as it appears in the transaction documents, even where the change would make the rule more precise, so as to avoid the trustee or bond administrator's need to subsequently construe how the rule should work, because it then might be considered to be inconsistent with the prospectus.

their counsel have struggled with the plain English description. This sets up a conundrum for transaction parties—draft the disclosure in plain English, which increases the possibility of inconsistencies between the waterfall in the prospectus and the waterfall as included in legal language in the transaction documents—or draft the disclosure in the legal terms that otherwise would be reserved for the transaction documents, which reduces the possibility of inconsistencies or errors between the disclosure and the contractual terms but violates the Commission's plain English rules and makes a critical piece of the disclosure more opaque. As we discuss in Part III, in our view, the addition of the proposed requirement to provide a computer program in complex programming language, and to ensure that both this computer program and the plain English translation of the waterfall are consistent with the legal description of the waterfall in the transaction documents, is a standard that is nearly impossible to achieve.

D. Ongoing reporting requirements

Subject to our comments in Parts II.A and II.B above and several specific concerns we discuss below, we generally support the Commission's proposed changes to the Exchange Act reporting requirements. Moreover, we are appreciative of the Dodd-Frank Act's mandate to the Commission that it adopt regulations relating to application of that Act's amendment of Section 15(d) of the Exchange Act to eliminate (subject to exemptive regulations to be issued by the Commission) its applicability to ABS. We look forward to analyzing the Commission's proposed rules in that regard. We comment below on several specific Exchange Act reporting proposals included in the Proposing Release.

1. *It may not be possible for annual reports on Form 10-K to identify whether a material instance of noncompliance identified in a servicer's Item 1122 assessment and attestation is applicable to that transaction.*

The Commission proposes to require that if a servicer's Item 1122 assessment and attestation identifies any material instance of non-compliance ("MINC"), the body of any annual report on Form 10-K to which the assessment and attestation are attached also identifies whether the MINC applies to the transaction to which the annual report relates.[62] We do not believe that this proposed change is appropriate. As the Commission intended with the adoption of these requirements in Regulation AB, assessments and attestations are done on a platform level for each asset class with which the servicer (including trustees, custodians or other participants subject to Item 1122's requirements) is involved. We understand from conversations with independent accountants familiar with 1122 assessments and attestations that testing for 1122 compliance is done by sampling transactions included in the servicer's defined platform for the asset class and is not, nor is it intended to be, a review of every transaction in that platform. Although the sample testing will identify the specific transaction or transactions in which the MINC occurred, without a further testing of all of the remaining transactions in the platform, which we believe would be both unduly expensive and time-consuming, it will not be possible to identify all of the transactions in an asset class to which the MINC relates. In addition, we note that, at least for primary servicers, the non-compliance would be reported in the servicer's Item

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62 Proposing Release at 23391.

1123 statement of compliance for that transaction. We agree, however, that if the MINC is identified as relating to a particular transaction (*e.g.*, it is one of the transactions in the sample found to be involved in the MINC), then the fact that it relates to the transaction should be reported in that transaction's annual report on Form 10-K. Anecdotally, we believe that such information is in fact being reported in annual reports on Form 10-K. Accordingly, we would support clarification of Item 1122 to require the disclosure of the MINC in the annual report on Form 10-K in any transaction identified in the servicer's assessment and attestation as being the subject of the MINC, so long as it was clear that the lack of such disclosure could not be interpreted as confirmation that the transaction had not been affected.

For privately issued ABS and, assuming that the Commission will issue regulations providing for some asset classes or types of offerings of ABS to suspend reporting under Section 15(d) pursuant to the Dodd-Frank Act, the Item 1122 assessments and attestations and Item 1123 statement of compliance will not be publicly available. We understand, however, the importance of such information to investors even if the transaction was never or is no longer reporting, and we are aware that many registered RMBS transactions provide that assessments, attestations and statements of compliance will be made available to investors even after suspension of the Exchange Act reporting for that transaction. In our experience, however, there may be some reluctance to provide Item 1122 assessments and attestations in connection with privately issued ABS transactions, particularly where the servicer (or other servicing function participant) does not include privately issued ABS in its servicing platforms.

2. *The Commission should clarify that reports relating to any material change in the sponsor's retained interest in an ABS transaction, to the extent risk-retention is addressed in the final amendments to Regulation AB, do not apply to reductions in the principal balances (if any) of any retained classes as a result of waterfall payments or application of realized losses.*

In connection with the Commission's proposed risk-retention requirements for shelf-registered securities, the Commission proposes to require filing a current report on Form 8-K to report any material change in the sponsor's retained interest in any ABS issued in the transaction, including the amount of the change in that interest and a description of the resulting interest after such change.[63] Although elsewhere in this letter we ask the Commission to defer including any risk-retention requirements in Regulation AB pending the joint agency rulemaking mandated by the Dodd-Frank Act, we nonetheless have one observation on the proposed Form 8-K reporting requirement. The proposed reporting item would seem to require the reporting of changes in the principal balances of any retained securities as a result of payments made under the waterfall and/or allocation of realized losses to the class or classes of securities retained by the sponsor. The beginning and ending security balances, amount of principal (if any) payable on each class and realized losses for each class customarily are included in the periodic payment or distribution reports provided or made available to investors pursuant to Exchange Act reports on Form 10-D. We believe that the Commission should clarify that no report on Form 8-K is required in respect

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[63] Proposing Release at 23393.

of any such reductions, and that any such report is intended to cover changes resulting only from the purchase, sale or other acquisition or disposition of the securities by the sponsor.

3. *Proposed Item 1121(c), requiring disclosures related to repurchase demands, would need to be clarified in order to be workable for transaction parties.*

The Commission proposes to add a new requirement to Item 1121 of Regulation AB to require the reporting of repurchase demands made to and fulfilled by the party obligated in respect of breaches of asset representations and warranties.[64] We recognize that one of the issues identified in the recent financial crisis was the lack of strong enforcement mechanisms in pooling and servicing agreements for breaches of loan representations and warranties on the mortgage loans included in RMBS transactions, and we believe that this type of additional reporting would be a helpful tool in ameliorating this problem. However, from our experience, this issue is peculiarly applicable to RMBS transactions and we are not aware of any similar complaints of issuer or originator "stonewalling" in CMBS or with other asset classes. Accordingly, we believe that this requirement could be limited to RMBS transactions without harm to investors in other asset classes.[65]

In addition, we have several concerns with the proposed language of Item 1121(c). As written, proposed Item 1121(c) would require the reporting of repurchase demands made and fulfilled during the reporting period covered by the report. On the most fundamental level, the proposed language highlights the difficulty of the reporting party (and transaction parties) to determine what constitutes a valid "demand" for repurchase. Over the past several years, as delinquencies have increased dramatically, trustees have been pressured to make demands that the obligated party cure or repurchase the delinquent loans on the basis that *some* loan representation and warranty undoubtedly had been breached at the time of closing, without any real, tangible evidence that such breaches had in fact occurred (over and above the fact that pool delinquencies were beyond the level expected by investors). Thus, we recognize that the industry would need to come to some consensus about what constitutes a credible allegation of a breach that should be examined and a valid and legitimate demand be made by the trustee, or other transaction party charged with enforcement, against the obligated party. As we discuss elsewhere in this letter, progress was made on this front in the recent Sequoia Mortgage Loan Trust 2010-H1 transaction, which included in the transaction documents more granular and

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64 Proposing Release at 23390-91.

65 Unlike RMBS transactions, remedies for breaches of representations and warranties in CMBS transactions typically are not limited to repurchase, but instead permit the party obligated on the representations and warranties to make a "loss-in-value contribution" (calculated in accordance with the transaction documents) in lieu of repurchase. Accordingly, if retained for CMBS, the obligation to report repurchase activity in Form 10-D for CMBS transactions with respect to breaches of loan representations and warranties should include the ability to report that the obligations with respect to such breaches (whatever they may be) have been satisfied by such loss-in-value contributions rather than being limited to the obligation to repurchase. More fundamentally, many CMB transactions include a special servicer, which generally has broad authority with respect to exercise of remedies for repurchase, and which typically is subject to removal by the first-loss investor if it fails to exercise such authority, thereby minimizing the concern about failure to exercise remedies for such breaches that has arisen in the context of RMBS transactions.

robust enforcement mechanics. We expect that the RMBS industry will continue to make refinements and enhancements to these mechanisms.

We note, as well, as discussed above in connection with CMBS transactions, RMBS transactions also give the obligated party a period of time either to cure the loan representation and warranty that has been breached, if a cure can be achieved or, subject to customary time limits, to substitute a new mortgage loan having the same key characteristics of the defective mortgage loan (e.g., the same maturity date, the same interest type, the same or substantially the same interest rate, the same lien position, etc.). In other instances, an alternative remedy for breach can be indemnification of the securitization trust for resulting losses. As proposed, Item 1121(c) would not address demands that are handled through the cure, substitution or indemnification process rather than repurchase of the affected mortgage loan.

Finally, in RMBS transactions, the party obligated to make repurchases typically has a period of time (typically 60 to 90 days) in which either to effect a cure of the breach or repurchase the affected mortgage loan. Requiring monthly reporting of repurchase activity would not seem to provide for a "matching" of each particular repurchase demand and the related repurchase activity. We suggest that the Commission consider requiring, instead, that repurchase activity be reported on a quarterly basis (or as the parties otherwise require in the transaction documents) or at least clarify that the repurchases that are reported may not necessarily relate to the repurchase demands made in the same reporting period. In addition, we note that there is some ambiguity in the language of Item 1121(c) as proposed, because it seems to apply, on the one hand, to assets in the transaction, but, on the other hand, there is a reference to "publicly securitized assets originated or sold by the obligor." The latter language calls into question whether the Commission intended disclosure of repurchase activity for the obligor's platform, which would be very difficult, if not impossible, for the reporting party to ascertain. Accordingly, we recommend that the phrase "publicly securitized assets originated or sold by the obligor" be deleted in the final rule.

III. WATERFALL COMPUTER PROGRAM FILING REQUIREMENT

In a securitization, the contractual waterfall—also known as the cash flows, the flow of funds or the priority of payments—is a core aspect of the transaction.[66] It provides the instructions to the parties, including the trustee and master servicer, as to how cash received by a securitization vehicle should be allocated among the different holders of interests in that vehicle. Those interest holders may include, in addition to investors with varying degrees of seniority, the trustee, servicers, swap counterparties, credit enhancement providers, taxing authorities, and administrative agents. There may be senior and subordinate tranches, sequential pay tranches, interest-only or principal-only strips, principal-protected tranches, tranches that benefit from

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66 As we discuss later in this Part III, we believe that the contractual waterfall is significantly different from the "waterfall computer program" proposed by the Commission. We have found in preparing these comments that using the term "waterfall" in both these contexts has created some degree of confusion. Accordingly, where possible, we have referred to the Commission's proposal as the "computer program" rather than the "waterfall computer program" and have reserved the term "waterfall" for the contractual waterfall that governs the flow of funds.

interest-rate or other swaps, and tranches that receive credit enhancement that does not apply to the transaction as a whole. The contractual waterfall may also contemplate deposits to, or withdrawals from, various reserve or cash collateral accounts, which may be fully or partially funded, or entirely unfunded, at the time of the transaction. There may be provisions that change the allocations upon the occurrence of certain events. In master trust structures, new interest holders are added from time to time, and each new issuance must interlock with the existing cash flow structure.

Each step in the contractual waterfall generally provides instructions to take an amount of cash and apply it to a specific obligation[67] until the obligation has been paid or the available cash supply has been exhausted. If the cash runs out before the obligation is paid, a subsequent waterfall step may determine whether there are other sources of cash to cover that obligation. If the obligation is fully satisfied and there is cash remaining, the waterfall provisions would then determine the next obligation to which such cash should be applied. For some transactions, the waterfall provisions may also allocate losses to various classes of investors as an initial matter and reallocate losses to subordinate classes if permitted by the securitization's subordination provisions. The contractual waterfall may change to an alternate set of steps, however, if certain adverse events occur.

We appreciate that analyzing the securitization waterfall can be a daunting task for investors, and we understand the Commission's reasons for proposing a requirement to file a computer program that would reflect the contractual waterfall and the efforts the Commission has made to design a technical solution it believes would be of real use to investors. We appreciate, also, the complexity of securitization structures; the concern that, in the past, investors may not have had the knowledge or resources to evaluate those structures adequately; and the desire to provide investors with the tools they need to create models independent of those published by the rating agencies. We believe that both issuers and investors will benefit by working together to develop industry standards for modeling programs to the extent such programs do not already exist—although we note that there are sophisticated third-party suppliers of such models that already plan a significant role in these markets—and that the Commission's proposals for uniform presentation of securitization data may facilitate the creation and use of such standards and programs. We believe the Commission could consider implementing a voluntary pilot program to investigate the potential to provide investors with enhanced technical tools. We note, as well, however, that some of the issues in the securitization industry can be attributed to reliance by sponsors, rating agencies and investors, among others, on flawed models of the type the Commission has proposed requiring. Ultimately, as we discuss in detail below, we have concluded that the proposed requirement that issuers create and file a computer program to assist with investor analysis, while innovative and intriguing, and perhaps worthy of further exploration on a voluntary basis, is not as proposed an appropriate way to achieve the Commission's goals.

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[67] The "obligation" may in fact be a payment obligation, or it may be a requirement to fund a reserve account, make a deposit or reimburse a loss.

A. The waterfall computer program requirement will require issuers to create new programs they do not currently have or use, in a language generally unfamiliar to their personnel.

In our experience, the extent to which securitization issuers maintain computer programs to facilitate waterfall allocations can vary significantly. From what we have heard, anecdotally, we understand that many issuers use nothing more than a Microsoft Excel spreadsheet to determine the monthly distributions; and, on occasion, we have even seen issuers compute the required distributions *manually*. By contrast, for master trust issuers, the computer programming is often extremely complex because of the need to integrate the waterfalls of multiple series and classes of securities that are issued with different terms and, in many instances, by distinct but interrelated trusts and that generally have cash-flow-sharing provisions that operate differently under different conditions and among different types of securities. The programs for these structures have frequently been created on a customized basis by external vendors because of the programming complexity. They have been refined and expanded over many years and undergo extensive testing at each change in structure or new issuance.

We believe that even where the waterfall currently runs through a customized computer program, rather than through a spreadsheet (or a notepad), most industry participants are not using Python for these programs. We realize that the Commission selected Python because it is open-source and interpretive.[68] Anecdotally, however, we are hearing that there is little familiarity with the Python programming language among many of those involved in securitization, including issuers and vendors of third-party securitization analytics. Indeed, following the Commission meeting approving issuance of the Proposing Release, one of the questions we heard most frequently was, "What *is* Python?" For simpler structures, developing a distribution program in Python may be relatively straightforward—if, that is, the issuer has personnel who have programming skills and are capable of learning how to program in this language. By contrast, we understand, again anecdotally, that translating existing master trust waterfall programs from their current formats into Python is beyond the technical skills of many significant issuers, would have to be outsourced, would have to be maintained and updated with little or no internal technical support because Python is not in common use in the enterprise, may be a years'-long endeavor, may create obstacles to providing structural enhancements that would benefit investors, and may potentially create significant risks of error.

In addition, the computer program requirement would effectively transform the ABS issuer into a software distributor, a role that is likely to be outside its core business and for which it is likely to be wholly unsuited. Issuers will not have experience writing software instruction manuals, providing customer service, updating the program as technology changes, issuing security patches if security issues develop, or conducting any of the myriad other activities that are part of running a software business.[69] We do not believe they should be put in a position

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68 Proposing Release at 23328.

69 We believe that an issuer should not be put in the position where it *must* provide customer service or publish software manuals, all of which have their own liability risks. However, their absence may limit the usefulness of the program.

where they would have to do so. We are also concerned that the Commission has underestimated the significance of the intellectual property issues associated with satisfying the computer program requirement. For instance, even if the program is created using an open-source language, that does not mean that the program is not subject to intellectual property protections that may prevent subsequent issuers from using a similar program or that the issuer is not potentially subject to claims that the program infringes a third-party's intellectual property rights.

B. Determining the priority of payments in a waterfall requires a distribution algorithm, not a predictive model, yet the Commission's proposal would require issuers and underwriters to develop the latter.

The Commission's proposed Item 1113(h)(1) of Regulation AB describes the waterfall computer model as follows:

> (1) For purposes of this paragraph, a Waterfall Computer Program shall mean a computer program that:
>
> (i) Gives effect to the provisions in the transaction agreements that set forth the rules by which the funds available for payments or distributions to the holders of each class of securities, and each other person or account entitled to payments or distributions, from the pool assets, pool cash flows, credit enhancement or other support, and the timing and amount of such payments or distributions, are determined;
>
> (ii) Provides a user with the ability to programmatically input:
>
> (A) The user's own assumptions regarding the future performance and cash flows coming from the pool assets underlying the asset-backed security, including but not limited to assumptions about future interest rates, default rates, prepayment speeds, loss-given-default rates, and any other assumptions required to be described pursuant to Section 229.1113; and
>
> (B) The current state and performance of the pool assets underlying the asset-backed security by uploading directly into the computer program the initial XML-based Asset Data File (as defined in §232.11 of this chapter) and any subsequent monthly updates to that file; and
>
> (iii) Produces a programmatic output, in machine-readable form, of all resulting cash flows associated with the asset-backed security, including the amount and timing of principal and interest payments payable or distributable to a holder of each class of securities, and each other person or account entitled to payments or distributions in connection with the

> securities, until the final legal maturity date as a function of the inputs described in paragraph (h)(1)(ii) of this section.[70]

Only clause (a) of this proposed language would mandate a computer program that matches the contractual waterfall as described in the prospectus and the transaction documents. A program that provided the functionality described in clauses (b) and (c) would *not* be the programmatic equivalent of the contractual waterfall. Rather, it would establish a predictive model that includes a waterfall component. We believe this to be a critical distinction.

One of the statements the Commission makes in the Proposing Release, without citing any reference, is, "The ABS issuer or the underwriter generally will have a computer model of the waterfall."[71] As we discuss above, we do not believe this statement is correct in general, even with respect to the contractual waterfall, and it is even less correct with respect to the enhanced functionality described in clauses (ii) and (iii) of proposed Item 1113(h). We have been told, in fact, that a true predictive model of a credit card master trust waterfall does not exist and that efforts to design such a model in the past have failed. Moreover, we believe that the *underwriter's* having a computer model of the contractual waterfall is not the same, for disclosure purposes, as the *issuer's* having such a model.

Whether the contractual waterfall consists of nine steps or ninety steps, it never does more than provide instructions on how to allocate cash and losses among various competing interests. It gives effect to the actual performance of the assets from the previous collection period and the balance of the securities at the beginning of that collection period. Moreover, the contractual waterfall is used to process aggregate, rather than loan-level, data and, even if converted to a computer program, may not be adaptable to work with the proposed asset data files. We are uncertain, for example, how the information from the asset data files would be expected to be usable in the computer program. How does the geographic distribution of the assets, for instance, correlate to what will be available for distribution in the waterfall? Would the issuer be expected to design a program that would allow investors to make different assumptions about performance based on that geographic distribution? Would the program design have to support layered assumptions, for instance based on geographic distribution, credit score and interest rate? It seems to us that the Commission's proposal could lead to a requirement for an exceedingly complex modeling system.

Existing computer programs that issuers use to implement contractual waterfall provisions are typically designed to allocate distributions on a monthly basis, not to generate projections on a multi-year basis. Any adjustments made in the prior month—for instance, reflecting the reduction of principal balances of beneficial interests—are known, not hypothetical, and may be hard-coded inputs in those programs. Although there are certainly models and projections that are run for some securitizations or some aspects of securitizations, they are generally separate from the computer program implementing the contractual waterfall provisions and should not be confused with it.

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[70] Proposing Release at 23429.

[71] *Id.* at 23378.

In order for many existing computer programs that implement the contractual waterfall provisions to have predictive capability, they would need to be converted from running a distribution algorithm that makes determinations on a monthly basis to a model that could layer the effects of future distributions and allocations in each month over the life of the transaction. In addition, they would have to be modified to include as inputs predictions or assumptions as to the future availability of collections and other cash inflows, in addition to cash already collected and accounted for. By proposing to require this additional module, the Commission is expecting issuers to create and disclose computer programs they may be unqualified or unprepared to implement.

C. The creation of yet a third iteration of a securitization transaction's waterfall will not eliminate the issue of inconsistencies between the description of the waterfall in the disclosure document and the waterfall contained in the transaction documents, but rather may well exacerbate the problem.

As we discuss above, waterfalls described in the disclosure documents have occasionally differed from, and conflicted with, the waterfalls set forth in the contractual documents. Instead of resolving any such conflicts, the computer program will only magnify them. Not only will there now be two different versions of the waterfall in the disclosure—the textual description and the computer program—but the computer program will be written in a different language and have different functionality, as well.

More importantly, as noted above, the computer program as proposed would not be simply the programmatic equivalent of the contractual waterfall's cash flow provisions. It would instead be an entirely new program, based on the contractual waterfall and with a significantly broader range of functions that would add significant possibility of error. In addition, the verification that would be uniformly undertaken in conventional disclosure documents would be much more difficult to undertake in the context of the computer program. In our experience, for instance, disclosure documents are generally reviewed by a variety of persons involved in the offering process, including lawyers, accountants, issuer personnel, underwriter personnel, trustees and their counsel, and third-party auditors. The officers of the depositor who sign the registration statement would likewise be expected, or at least be able, to review and verify all relevant disclosures. We believe that because the parties and their representatives would likely not be able to review and verify the operation of the computer program proposed by the Commission in a meaningful way, there would be a serious gap in the verification process. Among other things, flaws in the program may not be noticed until some time after the offering is complete, based on market conditions existing at that time. By virtue of the liabilities associated with securities offerings under Sections 11 and 12 of the Securities Act, it is possible that underwriters, and possibly issuers, will be hesitant to proceed with an offering as to which there may be a risk of substantial liability. Even though underwriters may have a due diligence defense under Section 11, the Commission's proposal calls into question how underwriters would be expected to discharge their due diligence obligations in the context of the Commission's computer program proposal.

If the computer program is viewed as a purely analytic tool to help investors make an investment decision, and not as disclosure in the legal sense (as we discuss below), then at least we can conclude that the inconsistencies and errors to be guarded against are limited to the narrative disclosure in the prospectus and the more precise waterfall rules in the transaction documents. We believe it would be a serious mistake to allow the computer program to create yet a third possible candidate for the "definitive" waterfall for the transaction.

D. The proposed waterfall computer program does not fit within the disclosure and liability provisions of the federal securities laws.

We could find no support in the federal securities laws for the Commission's proposed mandate that issuers supply investors with analytic tools in addition to required disclosure. The Commission's waterfall computer program proposal represents the first time the Commission has suggested requiring tools of this kind to be included in a registration statement and prospectus.[72] As such, there is no precedent for understanding how the computer program would be treated under the framework of the Securities Act.

We have attempted to determine whether a computer program developed by an issuer and filed by it with the Commission would constitute information supplied by, or statements of fact made by, the issuer.[73] Merriam-Webster's online dictionary includes several definitions of "statement," from the conventional ("a single declaration or remark" or "a report of facts or opinions") to the modern ("an instruction in a computer program"). The latter meaning, however, could not have existed in 1933 when the Securities Act liability standards were adopted. In addition, the word "statement" as an element of computer code does not have the correlative concepts of "misstatement" or "statement of a material fact." An incorrect line of computer code may fail to advance the program, but it does not fail to state a fact (much less a *material* fact).

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72 We do not view the Commission's XBRL requirements to be a precedent, because XBRL requires only data-tagging that uses, for most purposes, a standardized taxonomy.

73 The Securities Act establishes the framework for disclosure obligations with respect to securities offerings and the potential liability of market participants relating to that disclosure. Section 7 of the Securities Act, together with the related Schedule A, sets forth the basic information required to be included in the registration statement, but it also authorizes the Commission to exclude information or to require that the "registration statement shall contain such other information, and be accompanied by such other documents, as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors." Section 11(a) of the Securities Act provides for the imposition of civil liabilities where "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." Section 11(b) allows certain offering participants to avoid liability, including by establishing a due diligence defense, but does not allow such a defense to be established by the security's issuer. For the issuer, Section 11(a) is a strict liability standard, applied irrespective of the issuer's knowledge of the accuracy of the facts in question. Section 12(a)(2), though using similar language, adds a knowledge standard, subjecting to civil liability a person who offers or sells a security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."

Nor can the term "statements of fact" reasonably be considered applicable to a computer program's outputs. The computer program, as described in proposed Item 1113(h)(1), would enable the user of the program to "programmatically input the user's own assumptions regarding the future performance and cash flows coming from the pool assets underlying the asset-backed security." The issuer of the securities would therefore not know either (a) what assumptions the user made in using the program or (b) what information the computer program generated in response to those assumptions; and, because they are based on assumptions, the outputs are, at best, predictions rather than statements.

Whether a computer program constitutes a "statement" (or consists of "statements") is not merely a matter of semantics. As noted above, the liability system created by the federal securities laws is based on statements made by the issuer and the underwriters about a particular security. It is not based on "functionality." With that precept in mind, we have considered, among others, the following liability issues:

- What would be the basis, if any, for liability under the federal securities laws if, on a one-month basis, the computer program accurately reproduced the results of applying the contractual waterfall to the distribution of the issuer's available funds but did not provide the range of functionality required under the Commission's proposed requirement?

- If an issuer discovered a latent error in the predictive component of the computer program and corrected that error, would the issuer nonetheless be liable if an investor had made an investment decision on the basis of modeling that gave effect to the error?

- If a logic error in the computer program caused the program to generate faulty outputs with respect to highly unlikely input scenarios, and an investor, having purchased the related security on the strength of the outputs, discovered thereafter that the outputs were faulty, would the issuer have liability even if the unlikely input scenarios never came to pass and the program worked correctly for all actual distributions?

- Would the issuer be liable if the computer program caused damage to an investor's computer, made it vulnerable to viruses, or simply failed to run on an investor's system though it worked properly on other computers?

- Would the issuer be liable for a material omission if the investor could not figure out how to use the computer program?

- Under what circumstances would the outputs of the waterfall computer program constitute forward-looking statements that would be eligible for the protection of the safe harbor articulated in Section 27A of the Securities Act? Would issuers be able to include appropriate cautionary statements without knowing what assumptions were made by the investor?

We do not understand the role of the proposed sample inputs and outputs and how these would factor into liability. The Proposing Release states that if the investor matches the sample expected outputs by running the program with the sample inputs, "the investor will be able to confirm that the program is working correctly."[74] We request that the Commission confirm whether this is intended only to be a test that the investor has properly downloaded the program, or whether it is intended to imply that the program will function to some prescribed level of accuracy. We believe it would be impossible to construct a set of inputs and outputs that constitutes a valid check of all facets of the program. We note as well that the Proposing Release states that the sample inputs and outputs are not to serve as representations as to the related transaction's expected performance. We are concerned, however, that investors' expectations might nevertheless become biased toward, or "anchored" on, the performance that was "forecast" by the sample outputs.[75]

If the Commission adopts the computer program requirement and the final rules treat either the design features or the output of the computer program as issuer "statements"—none of which we believe would be appropriate—we would urge the Commission to apply, at most, a Rule 10b-5 liability standard, rather than a strict liability standard, for any alleged securities law violations relating to the program. We believe that in connection with the program, there is a reasonable basis for imposing liability only for knowingly false material textual statements, or textual omissions of material facts relating to the program, or for the reckless disregard of such matters. At a minimum, the Commission's proposed rules should emphasize that securities law liability, if any, for errors in, or omissions from, computer programs must be assessed by considering the materiality of any such errors or omissions not in isolation on a standalone basis but in conjunction with, in the context of, and qualified by reference to, the other parts of the related offering document, all parts of the offering document being considered together as an integrated whole. We also believe that an issuer should be able to limit its liability with respect to a computer program with a general cautionary statement regarding its accuracy (or lack thereof) as a predictive tool. Issuers should not be required to devote extensive effort to preparing an exegesis of all the assumptions and qualifications associated with the program.

The Commission's proposal to require issuers to develop computer programs and codes as components of their offering documents substantially increases the risk that issuers acting in good faith and with reasonable diligence will make mistakes. If the final rules require issuers to educate their employees in a new programming language; convert their distribution waterfall into a program in that new language; and expand the functionality of that program so that it includes predictive modeling and the ability to accommodate user-defined assumptions and somehow incorporates loan-level data with dozens of variables; and if the Commission applies to that program a strict liability regime with respect to outputs generated not by the issuer but by investors, we believe it likely that issuers will be induced to consider alternatives, such as statutory private placements, by which they may offer their securities without subjecting

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74 Proposing Release at 23379.

75 For a discussion of the anchoring phenomenon, *see, e.g.*, Amos Tversky and Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," 185 SCIENCE 1124, 1128, Sept. 27, 1974.

themselves to these requirements, and that lawyers may find few arguments to dissuade them from doing so.

As we discuss above, we do not believe issuers generally have computer programs with the functionality the Commission proposes to require for the proposed waterfall computer program, and we do not believe they generally have appropriate personnel who know how to program in Python. If ABS issuers cannot create the waterfall computer program internally and outsource it to a third-party service provider, which we believe is a likely outcome, a core element of their disclosure will be based on external work. We simply do not see how underwriters, senior officers and directors of the issuer will become comfortable with the computer program, how they will be able to analyze its code from a due diligence perspective, or how they will get the level of comfort from third-party providers that will provide appropriate protections from securities law liabilities. How would issuers be able to give required certifications in these circumstances? How would officers and directors be able to sign registration statements and Exchange Act reports?

Third-party providers of analytics currently work with investors to provide many of the modeling functions the Commission proposes, but they are not subject to securities law liability for doing so. We believe these third parties are in a much better position to continue to fulfill this role. Certainly the Commission's approach would shift the cost of developing a program to an issuer, and make it potentially liable for the program's design and operation, but that approach is unlikely to result in a *better* model.

E. <u>The requirement to provide a computer program is inconsistent with the cautious approach the Commission has previously taken with respect to new technology, and we believe the Commission should take a more cautious approach.</u>

The Commission at one time was highly concerned about permitting electronic distribution of prospectuses, requiring that investors specifically consent to electronic distribution and explicitly prohibiting electronic distribution in conjunction with proxy solicitations related to business combination transactions.[76] Part of the rationale for the Commission's safeguards was the feeling that investors should not be limited in their receipt of disclosure by their available technology. The Commission has become increasingly comfortable with electronic delivery of disclosure materials as the percentage of US households with internet access increases, but has continued to mandate that a paper option be made available to investors.[77] And the Commission has continued to approach expansion of electronic delivery of disclosures cautiously. In the case of electronic delivery of proxy materials, the Commission took incremental steps, first permitting electronic distribution of proxy materials to shareholders upon the shareholder's election,[78] then mandating electronic distribution as an investor choice

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[76] Use of Electronic Media for Delivery Purposes, 60 Fed. Reg. 53458, 53461 n.29 and accompanying text (Oct. 13, 1995); *see also* Internet Availability of Proxy Materials, Exchange Act Release No. 34-55146, at 1 (Jan. 22, 2007).

[77] Exchange Act Release No. 34-55146, at 8-11.

[78] *Id.* at 1 and 9.

only for the largest public companies,[79] and over time phasing in the requirement for smaller companies. Most of the Commission's technology-related rule changes in recent years have demonstrated a similarly cautious and careful acceptance of electronic innovations. With respect to the adoption of XBRL interactive data requirements, the Commission began a voluntary pilot program in 2005 but did not adopt rules mandating XBRL disclosures until four years later, in 2009.[80] For smaller companies, phase in will not be required until late 2011.

Given the significant technical and legal issues associated with the Commission's proposed computer program, we believe the Commission should continue to take a cautious approach to the introduction of new technology, with extensive assessment of investor and issuer capabilities and existing third-party resources. Moreover, if the Commission does proceed with some version of the computer program requirement, we believe there should be also be a meaningful hardship exemption, for instance allowing the computer program to be supplied in the form of a Microsoft Excel spreadsheet, so that technical difficulties do not deprive issuers of critical market access.

F. The requirement to provide computer programs creates very real cost, timing and testing issues for issuers.

The Proposing Release estimates that, for each securitization transaction for which an issuer is required to file a waterfall computer program with the Commission, the issuer will incur (in addition to the one-time setup cost) a time burden of approximately two person-hours to verify that the program's mechanisms work properly and that the program meets the requirements of the proposed rules set forth in the Proposing Release.[81] However, because ABS transactions frequently are structured during the marketing process to respond to feedback from investors as to their specific needs for a security with a particular feature, each new issuance is likely to have unique considerations that will require additional design, programming and maintenance costs associated with software development, as well as a unique asset data file that will have to interface with the program. Issuers will incur additional costs subjecting developed software to quality assurance testing, both to ensure the software is functioning properly and to ensure the results are accurate and reproducible. Finally, the program's ultimate cost will be increased by updates to the program to correct errors or to deal with issues unforeseen on or before the closing date of the sale of the related securities. We believe the initial design and development of the program, where it can be done at all, will be extremely expensive and time-consuming. We further believe that the Commission's estimate that only two hours will be required in order to update the program in connection with a new issuance grossly underestimates the transaction-specific costs. Not only will the computer program requirement add significant expense to the offering process; it will also create the very real risk that issuers will lose market opportunities because their technology personnel are working in a back room testing and debugging a computer program that is not ready for distribution.

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79 Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 34-56135, at 5-6 (July 26, 2007). *See also* Interactive Data To Improve Financial Reporting, 74 Fed. Reg. 6776, 6776, 6784-88 (Feb. 10, 2009).

80 74 Fed. Reg. at 6776-77.

81 Proposing Release at 23405.

G. By encouraging overreliance on models, the computer program may recreate the problems that preceded the crisis.

Finally, we question whether the focus on analytical tools is appropriate to this market and whether the efforts of the Commission to make such tools available within such carefully defined parameters will serve the goal of better investor understanding of structured finance securities. We have already seen that the rating agencies' sophisticated models failed, either because the models' assumptions proved incorrect or because the rating agencies failed to understand significant features of the transactions. If sponsors provide investors with the waterfall computer program, those investors may feel that understanding the waterfall as described in the contractual documents and the prospectus is unnecessary. We believe that such an understanding is an important part of evaluating a structured finance security, and we are reluctant to see the Commission take an approach that may again encourage investors to acquire securities they have not independently analyzed.

One rationale set forth for the waterfall computer program requirement in the Proposing Release is that:

> [F]or smaller institutional investors, . . . it may not be feasible to acquire the financial and technological expertise necessary to develop a computer program of the waterfall. Thus, investment decisions with respect to ABS may be made without the benefit of the investor performing its own quantitative valuation analysis. This may encourage undue reliance on the determinations of credit rating agencies.[82]

We believe this argument is flawed in several respects: First, third-party modeling solutions were available for most classes of assets for those investors that wished to use them. Second, the acknowledged difficulty of acquiring the "financial and technological expertise necessary to develop a computer program of the waterfall" highlights the extent of the burden the requirement may place on securitization sponsors, for which compliance with the requirement may be no more feasible than independently developing a program would be for investors. Third, there is little reason to believe that investment losses resulted from investment decisions that were "made without the benefit of the investor performing its own quantitative valuation analysis," given the significant investment losses suffered by sophisticated market participants who were often actively involved in structuring the transaction. On the contrary, we believe that the assumptions on which those valuation analyses were based—as to quality of assets, recovery rates, reliance on historical housing values and delinquencies and the strength of the economy as a whole—were flawed, even when made by highly sophisticated investors with comprehensive models. Requiring issuers to provide an analytical model will not improve the accuracy of the assumptions made by the model's users.

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[82] *Id.* at 23378-79.

Senator Chuck Schumer has noted:[83]

> "[C]omputerized models were supposed to determine which mortgage investments were safe and which were not. Automated underwriting systems were supposed to prevent borrowers who could not afford loans from getting them. The reliance on technology became a substitute for good judgment and proactive regulation, allowing companies and regulators to go forward without asking the important questions. . . . The new regulatory structure must have . . . , most importantly, the resources and technical capability to oversee and question the assumptions and decisions that financial institutions make when it comes to technology and strategy that are overly reliant on computer modeling. . . . Computer-based models are no substitute for good judgment and experience."

H. The computer program would be impossible for certain asset classes, such as dealer floorplan loans.

In floorplan lending, outstanding credit lines and pricing are reduced or increased from time to time based on the dealer's behavior, macro-economic trends, composition and seasonality of product lines and changing credit standards for the aggregate portfolio. For all of the reasons set forth above regarding the difficulties of preparing asset-level data for floorplan receivables, it is impossible to prepare a predictive model that works based on asset-level data. Further, like credit cards, it would be extremely difficult to prepare models of the master trust allocations that would take into account the uncertainties of the revolving floorplan receivables as well as the possible effects of various events on other series of the master trust, or even if there will be additional future series of the master trust. We note that we are not aware of any existing predictive models for floorplan ABS.

IV. SHELF ELIGIBILITY FOR DELAYED OFFERINGS

Shelf registration has become an essential aspect of public market access for ABS issuers, and we strongly believe that any changes to the eligibility criteria for shelf registration should preserve the opportunity for ABS issuers to use this powerful tool. Moreover, we believe that notwithstanding the events of the last several years, the Commission's policy reasons for extending shelf registration to ABS remain sound.

The Commission has recognized that restoring smooth functioning and investor confidence to the securitization market is important to the U.S. economy as a whole.[84] In a well-

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[83] Senator Charles E. Schumer, Keynote Address at the Securities Industry and Financial Markets Association Summit on the Troubled Asset Relief Program (TARP) (Nov. 10, 2008).

[84] Proposing Release at 23329-33; David Adler, "A Flat Dow for 10 Years? Why it Could Happen," *Barrons* (Dec. 28, 2009) (noting that new securitization issuances, except for those sponsored by the government, have largely come to a halt).

functioning economy and market, ABS offerings are numerous and frequent and enable investors to choose from a variety of instruments that match their investment objectives in terms of (among other criteria) maturity, liquidity, credit or market risk and yield. We believe that shelf registration is vital to the restoration of a robust market that offers these investment opportunities. Further, we believe the continued availability of shelf registration for offerings of ABS is consistent with the critical goal of investor protection. Accordingly, we discuss the Commission's proposed changes to the eligibility criteria from the perspective that the goal of the revised criteria should be to facilitate shelf registration's continued availability.

A. The original policy reasons for shelf registration support continued ABS access to shelf registration.

The Commission's primary mandates include promoting capital formation and ensuring the efficient functioning of the capital markets.[85] When it first permitted shelf registration beyond the narrow circumstances permitted by Guide 4,[86] as well as when it extended shelf eligibility to non-mortgage-backed ABS in 1992,[87] the Commission acknowledged the value of shelf registration in this regard, noting that it would "reduc[e] burdens and costs to registrants"[88] and enhance issuers' ability to issue on an expedited basis so as to "take advantage of favorable conditions in a changing market."[89] In establishing and expanding shelf registration, the Commission has always been careful to require that investors continue to receive the full disclosure contemplated by the Securities Act and the benefit of the Securities Act's liability scheme.

We believe availability of shelf registration for ABS continues to be appropriate as a means to enhance both efficiency and flexibility of market access. As we discuss in Part V.A, of this letter, we acknowledge that speed of market access must be balanced against the need to give investors adequate time to consider and review the disclosures they receive, and we support limited "speed bumps" for some securitization offerings. Even though such speed bumps will slow market access, their duration is fixed—issuers will know precisely the minimum amount of time they will have to wait after the filing of a Rule 424(h) prospectus before a transaction may

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85 *See* Section 2(b) of the Securities Act:

> Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

15 U.S.C. § 77b(b).

86 Securities Act Release No. 33-4363, 33 Fed. Reg. 18617 (Dec. 9, 1968). Among the circumstances permitted by Guide 4 were when the registrant proposed to engage in a continuing acquisition program or in the case of securities underlying exercisable options, warrants or rights. After reexamining Guide 4's provisions, the Commission decided its policy was too restrictive and expanded it beyond the Guide's narrow confines along with formalizing it in official rule form. Securities Act Release No. 33-6276, 46 Fed. Reg. 78 (Jan. 2, 1981).

87 Securities Act Release No. 33-6964, 57 Fed. Reg. 32461 (Oct. 22, 1992).

88 *Id.*

89 Securities Act Release No. 33-6334, 46 Fed. Reg. 42001 (Aug. 6, 1981).

be priced. That certainty would be lost if ABS issuers had to file a registration statement on proposed Form SF-1, or new Form S-1, for each new offering and wait for Staff response and perhaps full review.

The Commission and others often refer to shelf registration as "short-form registration."[90] However, for shelf-registered ABS, the disclosure requirements have never differed materially from those mandated in connection with offerings registered using the current form of registration statement on Form S-1, either under Regulation AB or under Staff guidance prior to the adoption of Regulation AB.[91] In practice, ABS registration statements and prospectuses traditionally have been anything but "short," as the Commission discusses in connection with its proposed revision of Rule 430D.[92] ABS shelves are not short-form and generally do not rely on making available to investors the information disclosed in the issuer's periodic Exchange Act reports.[93] Accordingly, for most ABS issuers, shelf eligibility will not affect the aggregate amount of disclosure included directly in the registration statement.

B. <u>The eligibility criteria proposed by the Commission to replace investment grade credit ratings will not provide a workable alternative to the current use of ratings.</u>

An important theme in the governmental response to the economic and market crises of the last few years has been concern whether references to credit ratings by "nationally recognized statistical rating organizations" ("NRSROs") in the Commission's and other agencies' regulations fostered undue investor reliance on those ratings.[94] We believe, however, that the causal chain ran in the other direction, i.e., that market acceptance of, and reliance on, credit ratings as a proxy for more detailed financial and statistical information preceded and resulted in the Commission's use of ratings as a criterion for shelf eligibility and elsewhere in its regulations.[95] When the Commission first proposed an investment-grade rating as a shelf eligibility criterion for high quality, non-convertible corporate debt securities, the stated rationale was that "such securities are generally purchased on the basis of interest rates and security

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90 *See* Proposing Release at 23341.

91 *See, e.g.*, Securities Act Release No. 33-6964, 57 Fed. Reg. 48970, 48973 (Oct. 29, 1992): "By making Form S-3 and shelf registration available for asset-backed securities offerings, the Commission does not intend to change the character or quality of the disclosure that is customary in these offerings."

92 *See* Proposing Release at 23336-37.

93 One exception is credit card ABS, where the pool of assets and the issuing entities generally remain the same for each issuance and the issuers continue to provide Exchange Act reporting for the full term of each transaction, providing investors with years of historical information about pool attributes and performance.

94 *See, e.g.*, Release No. 34-61050, Amendments to Rules for Nationally Recognized Statistical Rating Organizations, *available at* http://www.sec.gov/rules/final/2009/34-61050.pdf, pp. 4–10; *see also* Proposing Release at 23334.

95 *See, e.g.*, Release No. 33-6383; 47 Fed. Reg. 11380, 11391 (Mar. 16, 1982) (stating that the Commission "recognized the importance of security ratings to investors and the marketplace").

ratings."[96] The investment-grade criterion then seems to have been carried over by analogy when first RMBS and later ABS were granted access to shelf registration.

References to credit ratings are embedded in many investors' investment policies, and we suspect that eradicating them from agency rules will not change their significance in the financial landscape, notwithstanding the problems that have been uncovered in recent years regarding rating agency processes. The market has not yet found a substitute for credit ratings as an independent marker of the credit quality of an investment; and in the absence of a market-accepted solution, we have significant concerns that the Commission's efforts to dictate a replacement standard by changing shelf eligibility criteria will limit shelf access without providing meaningful new indicia of credit quality. At the same time, given the Dodd-Frank Act's elimination of Rule 436(g) and the unwillingness of credit rating agencies to consent to being named as experts in registration statements, the need to move away from credit ratings in registered securitization transactions has taken on a new urgency. We appreciate this as a central problem, not only for the Commission in its rulemaking but also for the market as a whole, and in discussing the Commission's proposals, we have attempted—although not wholly successfully—to develop alternative standards that would better suit these goals.[97]

We have evaluated the four conditions that the Commission has proposed as possible replacements for the minimum credit ratings, and we support the Commission's decision to move away from the investor-type restrictions that were originally proposed as replacements for the rating criteria. As we have previously stated, we were reluctant to see the Commission replace ratings requirements with investor qualifications and other similar restrictions.[98]

We support the Commission's proposal to require an undertaking to continue periodic Exchange Act reporting, notwithstanding the automatic suspension of the reporting duty under Section 15(d) of the Exchange Act, as a new condition for offering ABS under a shelf registration statement. We are uncertain, however, as to whether the modification of Section 15(d) of the Exchange Act effected by Section 942 of the Dodd-Frank Act[99] effectively moots this point. Given the passage of this legislation, we would expect to see ongoing reporting for all registered, publicly offered ABS regardless of the form on which such ABS would be registered, subject to any limited exceptions the Commission determines appropriate, and we believe that to be an appropriate result.

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[96] Release No. 33-6331; 46 Fed. Reg. 41902, 41910 (Aug. 18, 1981).

[97] We appreciate that Section 939A of the Dodd-Frank Act requires all federal agencies to review their use of ratings in regulations and modify those regulations "to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." Dodd-Frank Act, Section 939A(b).

[98] ABA Section of Business Law September 12, 2008, letter to SEC, *available at* http://www.sec.gov/comments/s7-18-08/s71808-31.pdf.

[99] Dodd-Frank Act, Section 942. We understand that some in the industry have suggested that Section 942 applies to all ABS transactions, even those that had delisted pursuant to Section 15(d) prior to the enactment of the Dodd-Frank Act. We do not believe that it was Congress's intent to subject such transactions to renewed Exchange Act reporting requirements, and we would support clarification of this point by the Commission.

The passage of the Dodd-Frank Act has complicated the analysis of the proposed risk-retention requirement as a condition for shelf registration but has not, we believe, fully mooted it. In the following subsections, we discuss the Commission's proposals concerning risk retention, third-party review of repurchase obligations and CEO certification.

1. *Because the Dodd-Frank Act mandates development of risk-retention regulations on an interagency basis through a joint rulemaking process and exempts certain types of asset-backed securities from the risk-retention requirements, we do not believe risk retention should be required as a condition for shelf eligibility.*

Since the start of the ongoing financial crisis, some commentators have attributed the cause of the crisis in part to the so-called "originate-to-distribute" model of securitization engaged in by many sponsors and originators.[100] Given the strong call for risk-retention requirements for ABS, we appreciate the Commission's decision to use the tools it had available, in particular the availability of shelf registration, in an effort to encourage market participants to retain risk on securitized assets.[101] The Commission's proposal would require the sponsor or its affiliates to retain a net economic interest in each securitization in one of the two following ways:[102]

- such person(s) would retain a minimum of five percent of the nominal amount of each of the tranches of securities sold or transferred to investors, net of hedge positions that are directly related to the securities; or

- in the case of revolving asset master trusts, such person(s) would retain a minimum of five percent of the nominal amount of the securitized exposures net of hedge positions that are directly related to the securities or exposures taken by the sponsor or affiliate, provided that the originator's interest and securities held by investors are collectively backed by the same pool of receivables.

In other words, a sponsor would be required to retain a claim on the cash flows of securitized assets equivalent to at least five percent of those payable to investors.

The sponsor's retention of five percent of each tranche available to investors was meant to create a "vertical slice" instead of one or more "horizontal" interests, such as the residual equity tranche that some sponsors have held in the past. The Commission has noted that investors in a particular tranche can have incentives that differ from those of the ABS sponsor, requiring a piece of each tranche aligns the sponsor's incentives with those of all the investors,

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100 *See, e.g.*, CFA Institute Centre for Financial Market Integrity and Council of Institutional Investors, "U.S. Financial Regulatory Reform: The Investor's Perspective," July 2009; John C. Dugan, Comptroller of the Currency, Remarks before the American Securitization Forum: Securitization, "'Skin-in-the-Game' Proposals, and Minimum Mortgage Underwriting Standards," (Feb. 2, 2010).

101 We note that the FDIC has taken a similar approach, proposing risk retention as a condition to its regulatory safe harbor for asset sales by insured depository institutions.

102 Proposing Release at 23339.

the goal being to provide that the originator/sponsor has a shared interest with all of the third-party investors in the performance of the underlying assets.[103] The net economic interest would be measured at issuance and maintained on an ongoing basis.[104]

The Dodd-Frank Act, which was signed into law after the publication of the Proposing Release, mandates that the Commission and certain of the federal bank regulators jointly promulgate rules on risk retention for the securitization market as a whole.[105] Nothing in this legislation suggests to us that the risk-retention requirement is to be determined on the basis of the form of the offering, and we therefore do not believe that establishing different rules for shelf-registered offerings versus non-shelf offerings would be appropriate. Moreover, we believe doing so would add significant complexity to the rules and would not conform to Congressional intent. For instance, would securitizations of qualified residential mortgages, which Congress has exempted from the risk-retention requirements, nonetheless be required to comply with the risk-retention eligibility condition if the related RMBS were offered using shelf registration? We believe that eliminating the risk-retention requirement from the proposed Regulation AB rules, and addressing risk retention instead in a joint rulemaking process, is the appropriate response to the new legislation. For purposes of the Regulation AB amendment process, we would instead suggest that mandating disclosure of the amount and type of risk retained by the various parties (originators, sponsors and aggregators) would be a better alternative to ensure that investors are fully aware of the alignment of interests in each offering.

In addition, we feel that a decision to defer to the joint rulemaking process with respect to the adoption of risk-retention requirements is counseled by Section 941(c) of the Dodd-Frank Act, which directs the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairperson of the FDIC and the Commission to study the impact of the new credit risk-retention requirement and Statements of Financial Accounting Standards Nos. 166 and 167 on each individual class of ABS.[106] The Chairman of the Financial Services Oversight Council has also been directed to conduct a study on the macroeconomic effects of the risk-retention requirements with an emphasis on potential beneficial effects on stabilizing the real estate market.[107] Throughout the financial reform process, we have been concerned that legislative and regulatory responses to the crisis have preceded, rather than followed, an analysis of the causes of the crisis and of the effect of such responses. With respect to risk retention, we believe that the Commission (and the other agencies working with the Commission to establish final rules) should take account of the results of the fact-finding and economic studies mandated by the Dodd-Frank Act in crafting their regulations, rather than allow such regulations to be established without the benefit of those studies. Those studies might analyze the effects of alternative forms of risk retention, such as retention of lower priority tranches where the sponsor cannot market them for a reasonable price

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[103] *Id.* at 23331.

[104] *Id.* at 23338.

[105] Dodd-Frank Act, Section 941.

[106] Dodd-Frank Act, Section 941(c).

[107] Dodd-Frank Act, Section 946(a).

or because of contractual requirements. Other examples of what the studies should cover include giving substantive representations and warranties, collateralizing such representations and warranties and obtaining incentive-based servicing fees.

Recent economic analysis of tranche retention shows that different retention mechanisms can have different impacts on the incentives of the originator or sponsor to screen borrowers and that there is no appropriate "one size fits all" approach.[108] Other recent research, such as that by Stephen Ryan,[109] shows that the ultimate amount of risk transfer achieved through securitization depends on the specific structure of the transaction. The International Monetary Fund ("IMF") finds that the optimal retention scheme, defined in terms of which tranches are retained and their magnitude, depends critically on reasonable assumptions about the quality of the loan pool and the economic conditions expected during the life of the securitization.[110]

The risk-retention requirements mandated by the Dodd-Frank Act, if implemented without appropriate care, could raise the costs of providing securitized products, to the detriment of consumers and businesses. The IMF stresses these issues and argues,

> While many incentive problems in securitization remain to be resolved, without the replacement of maturing securitized products, banks face a contraction of their funding sources, which may exacerbate already tight credit conditions. At the same time, as banks continue to repair their balance sheets in the current environment, the absence of a risk transfer mechanism is likely to perpetuate deleveraging pressures rather than alleviate them.[111]

We believe that in order to be consistent with the various statutory exemptions[112] and guiding principles for developing risk-retention rules provided in the Dodd-Frank Act, the risk-

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108 Ingo Fender and Janet Mitchell, "Incentives and Tranche Retention in Securitization: A Screening Model" (Sept. 2009) *available at* http://ssrn.com/abstract=1481663 ("Fender and Mitchell 2009") (stating that a "one size fits all" approach "could end up being ineffective or raising costs in ways detrimental to the goal of a sustained market revival."); Ingo Fender, "The Future of Securitization: How to Align Incentives?" (Sept. 2009). *See also* Peter M. DeMarzo, "The Pooling and Tranching of Securities: A Model of Informed Intermediation" (Oct. 2003); Janet Mitchell, "Financial Intermediation Theory and Implications for the Sources of Value in Structured Finance Models" (July 2005) (suggesting that sophisticated investors are the ones more likely to buy the riskier and more information sensitive tranches, as they are more capable of analyzing the various risks involved).

109 Stephen G. Ryan, *Financial Instruments and Institutions: Accounting and Disclosure Rules*, Hoboken: John Wiley & Sons, 2007.

110 John Kiff, Andy Jobst, Jodi Scarlata, and Michael Kisser, "Restarting Securitization Markets: Policy Proposals and Pitfalls," Global Financial Stability Report (2009), at 25, *available at* http://works.bepress.com/cgi/viewcontent.cgi?article=1015&context=john_kiff.

111 *Id.* at 3.

112 Section 941(b) of the Dodd-Frank Act amends the Exchange Act to allow for exceptions and exemptions relating to risk retention and hedging, so long as the adaptations "help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization" and "encourage appropriate risk management practices by the securitizers and originators of assets, improve the

retention requirements proposed by the Commission should not be a "one size fits all" mandate but rather should take into account economic and structural factors. The interagency studies mandated by the Dodd-Frank Act may provide guidance on:

- whether some classes should be subject to lower risk retention or be exempted entirely if underwriting standards with respect to the assets underlying a given issue of ABS, or the due diligence procedures performed in structuring such ABS, are adequate to ensure reliable performance;

- whether a "horizontal" retained interest is sufficient where it provides meaningful alignment of interest;

- the appropriate degree of permitted hedging to avoid negating the alignment of risk without depriving sponsors of necessary risk-management tools[113];

- whether allowing an ABS sponsor or appropriate affiliate to retain a representative sample of assets with characteristics materially similar to those in a given securitized pool, rather than a vertical interest or seller's interest, would achieve the same goals;[114] and

- the appropriate duration of any mandatory risk retention.

We do not believe this sort of nuanced evaluation should be made by the Commission unilaterally in the context of the shelf registration criteria.

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access of consumers and businesses to credit on reasonable terms, or otherwise [are] in the public interest and for the protection of investors," and to exempt certain federal programs and types of securities, such as "qualified residential mortgages."

113 With respect to hedging, we believe that it is crucial for risk-retention mandates to permit appropriate interest-rate and currency-risk hedging and that investor demand for stable and predictable cash flows on issued ABS cannot effectively be met otherwise, given the ubiquitous market need to tailor the characteristics of underlying assets to investor objectives in ABS. Further, we support the Commission's proposal to allow hedging by the using broad-based indices that would track market movements but not address the specific risk of the retained pool. We feel this proposal is an appropriate way to restrict the hedging of credit risk while still protecting the entities that hold such retained interests against market movements that are outside their control.

114 In this connection, the FDIC has proposed that a securitizer be allowed to hold a representative sample of financial assets outside of the pool as part of the transaction. 75 Fed. Reg. 27471, 27479–80 (May 17, 2010). This approach may, for some issuers, mitigate adverse effects on the securitizer's accounting treatment, and may be a more economically attractive alternative to retaining a 5% vertical slice of each securities tranche. We believe that a coordinated interagency approach to these issues that takes into account the potential accounting impact of market developments such as collateralized warranties, retention of a portion of subordinated or mezzanine tranches (in addition to mandated retention requirements), incentive-based servicing fees and the like will be important to developing risk-retention requirements that are economically feasible.

2. *Although we acknowledge that RMBS investors have had difficulty enforcing remedies, we do not believe the proposed third-party review of repurchase obligations will have a meaningful effect on repurchases, and we do not believe such review should be a condition to shelf eligibility.*

We are aware that some investors in RMBS issued prior to the financial crisis have questioned the efficacy of traditional contractual remedies requiring the repurchase of loans that had been the subject of breached representations and warranties, asserting that these procedures did not include clear enough procedures and standards for review.[115] However, market pressures have already created significant incentives for market participants to address this issue in the most recent transactions. For instance, as a result of such investor concerns, repurchase provisions that were formerly "market standard" were substantially reworked in Sequoia Mortgage Trust 2010-H1, the first post-crisis public RMBS transaction backed by new mortgage loan originations.[116] The market is clearly focused on the issue, and the give-and-take of negotiations between interested parties will facilitate fine-tuning of repurchase provisions and other remedies, guided by feedback from experience under transactions including the new provisions, whereas an inflexible mandate may produce undesired results. Because we have significant concerns that the Commission's proposal to require third-party opinions is not feasible, we feel that market solutions are more likely to address these concerns successfully.

We do not believe that lawyers would be willing to issue opinions on fulfillment of repurchase obligations, and we agree with the Commission that it is unlikely that accountants would be willing to do so. We are aware of companies that provide due diligence and credit risk management reviews of assets on both pre-closing and post-closing bases, but those companies do not issue "opinions" within the customary usage of opinions in the context of securities transactions. Rather, such companies simply set forth the facts and their view of whether the loans satisfy the criteria specified by the party requesting such review. In addition, an "opinion," unless the transaction documents make it binding on the parties, would not ultimately be considered a "final" determination of whether a breach of a loan representation and warranty had occurred. Third-party review would undoubtedly add to deal expense and could create frequent and inefficient conflicts among the parties without providing commensurate gain or certainty to investors.

One additional factor bears mentioning in the context of RMBS backed by longer maturity mortgage loans. We question the benefit of mandating a review of assets for possible breaches of loan representations and warranties in circumstances where the loan has been performing for three, five or even more years following the closing of the transaction. The longer a residential mortgage loan has been performing in accordance with its terms, the less likely it is that fraud was perpetrated at the time of the closing of the transaction. Accordingly, we believe that careful consideration should be given to allowing the transaction parties to

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115 We believe this issue has largely been confined to RMBS transactions.

116 Prospectus Supplement dated April 23, 2010 for Sequoia Mortgage Trust 2010-H1, *available at* http://www.sec.gov/Archives/edgar/data/1176320/000114420410022414/v182145_424b5.htm.

determine not only the specific enforcement mechanism in the transaction, but also the duration of the mechanism.

Trustees in securitizations of asset classes other than RMBS have noted there are not typically issues with repurchases to necessitate third-party review. We also note that such an obligation could potentially have a disparate impact on non-RMBS securitizations, such as auto loans, with a greater number of receivables in the pool, and, as is expected and planned for in such cases, a larger number of repurchase obligations triggered. Even if the Commission remains reluctant to rely on the marketplace with regard to review of repurchase obligations and decides to adopt the third-party review requirement, we urge it to consider whether any material purpose is served by applying this requirement to any asset class other than RMBS.

3. *We do not believe the CEO certification requirement could or should be given in its proposed form, and we have tried to define a risk-of-loss analysis relating to the assets and structure that might be an appropriate alternative.*

The text of the CEO certification as proposed by the Commission is the following:

> To my knowledge, the securitized assets backing the issue have characteristics that provide a reasonable basis to believe that they will produce, taking into account internal credit enhancements, cash flows at times and in amounts necessary to service any payments of the securities as described in the prospectus.[117]

In our view, the proposed certification is qualitatively different from any officer certification the Commission currently requires in periodic Exchange Act reports, in that it appears to require the signing officer to make predictions that are based on assumptions regarding the future and are not qualified by any of the risk factors and other disclosures that would insulate the registrant from liability if the securities failed to perform. We assume that the knowledge qualifier is intended to prevent the certification from becoming an unconditional personal guarantee of payment, but it does not overcome what we believe to be fundamental flaws in the form of the proposed certification. Knowledge will be tested in hindsight (and in litigation), with debate over not only what was known but what should have been known. Investors in the junior-most tranche in a registered public offering would have the same ability to make claims against the CEO as investors in the senior-most tranche, even though they had been told that they were investing in subordinated securities and were receiving a higher rate of return for taking on the risk of the junior tranche. In addition, investors are being provided extensive information so that they can make their own assessments of the cash flows the assets are likely to support. The Commission should not be requiring the CEO of the depositor to do more in this regard than what is already required of the CEO under Section 11 of the Securities Act—i.e., to evaluate whether there are material facts about the assets that have not been disclosed. We do not believe it should be a condition to the depositor's access to shelf registration that its CEO

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117 Proposing Release at 23420.

assume responsibility for the performance of the assets in addition to his or her current responsibility for ensuring adequacy of the disclosure.

To the extent the Commission is effectively asking registrants to make statements that the securities are investment grade (admittedly, without using that term), the Commission should make that request of the registrant, not an individual officer. Will CEOs be compelled to sacrifice market access for their companies in order to avoid an unreasonable assumption of personal liability? What purpose is served by requiring CEOs to take on this additional personal risk in this context? Although, on the basis of the Sarbanes-Oxley Act mandates, the Commission currently requires officer certifications, such certifications are intended to limit senior executives' ability to disclaim knowledge regarding the contents of the Exchange Act report or certain information about their businesses. The certification requirement of the Sarbanes-Oxley Act sets forth the basis on which the signing officer takes responsibility for disclosure, but the certification is limited to disclosure and matters integral to disclosure and does not involve anything approximating guarantees of future performance.

We believe the proposed CEO certification has a wholly different purpose. The certification requires an evaluation not of the disclosure, but of the underlying assets and the security itself; and it requires forward-looking statements without the benefit of the Commission's forward-looking-statements safe harbor.

We see no reason that the burden of replacing the investment-grade-rating criterion should fall on an officer of the registrant. In our view, the Commission's mandate under the Dodd-Frank Act to replace credit ratings criteria throughout its rules—and the replacement of credit ratings criteria will affect not just ABS or shelf eligibility—will require an approach that places the burden of assessing the quality of the offering on the registrant, not its officers. Moreover, whatever new approach is ultimately taken should not result in an effective guarantee of the performance of those securities, which of course investment-grade ratings have never done. With these concerns in mind, we suggest that the Commission consider requiring in the prospectus, subject to safe harbors for forward-looking statements, disclosures, perhaps under the heading "Risk of Loss," along the following lines:

- The depositor or sponsor has made certain assumptions regarding payment rate, losses, recoveries, yield and other matters, as relevant, all of which are disclosed in the prospectus.

- The assumptions were based on specified historical data and/or projections and applied stated levels of stress to that data or those projections (for example, by doubling historical default rates or reducing yield by half).

- The assumptions, if any, used by the depositor or sponsor in the prospectus are no less severe than the assumptions used by the depositor or sponsor in assessing its own risk management procedures and contingency planning.

- To structure the ABS, the depositor or sponsor used risk modeling with stated attributes and limitations. (An explanation of the risk-modeling process would make it more transparent, facilitate movement away from exclusive investor reliance on credit ratings, and assist investors in forming an independent assessment of whether the modeling used would be a good predictor of the timeliness of payments and risk of default on the securities.)

- The ABS includes interests junior to those offered to the public, including subordinate classes of securities, third-party credit enhancement, reserve accounts or excess spread, all of which are described in the prospectus.

- The depositor or sponsor's risk modeling indicates that, on the basis of the stated assumptions, all losses on the assets would be expected to be absorbed by the junior interests.

- All assumptions and modeling are subject to the risk factors identified in the disclosure and to any limitations or qualifications stated in the prospectus.

However, if after taking account of the comments to the proposed rules and the policies and mandates of the Dodd-Frank Act, the Commission continues to believe that an officer's certification attesting to the quality of a given ABS transaction is appropriate, we would propose an alternative. The certification should be principles-based, along the lines of the proposed disclosures described above, rather than a short, mandatory text suggestive of a personal guaranty of payment, which we believe would be of limited usefulness to investors and which, for the reasons stated above, we would generally have difficulty advising a client to execute. Non-exhaustive examples of some of the due diligence items to which the officer could certify include the following:

- If applicable, that the underwriters of the ABS have stated to the officer that in connection with modeling the transaction and assessing the adequacy of the internal credit enhancement, they have utilized a specified range of prepayment, default and loss-given-default assumptions for the underlying assets; or

- That the officer conducted or supervised specified due diligence procedures relating to the selection of the pool assets and/or the disclosure of various pool or asset characteristics.

We note that if the Commission retains the standard proposed for this certification in any form, at a minimum the standard should take into account interest-rate and currency derivatives to which the issuing entity is a party and which are typically provided by counterparts outside the certifying officer's control. Interest-rate derivatives are commonly used to enable issuers to react to investor preferences by issuing floating-rate ABS backed by fixed-rate receivables (or vice versa), and currency derivatives are essential to enable foreign originators of non-U.S. dollar assets to access the U.S. dollar ABS markets. When used, these derivatives are important to transaction cash flows, as demonstrated by the Regulation AB line items addressing them. The Commission may have intended such derivatives to be included in the reference to "the assets backing the issue"; but the point should be clarified, especially as we understand that a derivative may at any given point in time be recorded as an asset or a liability, depending on whether the issuing entity's interest in the derivative is currently in or out of the money.

C. Eligibility to use shelf registration should be evaluated annually, not quarterly.

We recognize that because ABS issuers do not file audited financial statements, a disclosure disparity exists between ABS issuers and other securities issuers. We believe it is appropriate for the Commission to eliminate that disparity by requiring an *annual* evaluation of compliance by ABS registrants (and affiliated issuers, as identified in the Commission's current and proposed rules) with the shelf eligibility requirements (which we are proposing should be limited to compliance with periodic reporting requirements). In other words, we support the Commission's proposal to require an annual evaluation of whether affiliated issuers that were required to report in the previous twelve months have done so on a timely basis.

We do not support the Commission's proposal to also require quarterly evaluations of shelf eligibility, which goes beyond advancing parity with non-ABS issuers and instead imposes a higher burden on ABS. We recall the Commission's dissatisfaction with periodic reporting compliance by ABS issuers in the past, but we believe the market has substantially improved its performance on this score. The Commission's additional step is neither necessary nor appropriate.

Finally, we note that proposed Rule 401(g)(4)(ii) would establish a separate test, compliance with which would be assessed as of 90 days after the end of an issuer's most recent fiscal year and pursuant to which "all material required to be filed" would have to have been filed during the relevant period and in a timely manner. Given the severe penalty that applies if this test cannot be satisfied, we believe that the Commission should adopt a safe harbor that addresses the following:

- *Filing incorrect or delinquent asset level data required by Schedule L.* For example, a loan foreclosure in June that is not reported until the filing of the Form 10-D in July should not result in a loss of shelf eligibility. Given the large volume of data points that will have to be reported, we believe the risk of occasional errors or oversights is fairly high. We note in this regard that the instructions to proposed Form SF-3 already include a safe harbor for a number of Form 8-K items.

- *Failing to include, when due, any required reporting items from third parties as a result of their default in delivering the reporting items to the issuer.* An issuer may be unable to include servicer and vendor Item 1122 assessments and attestations and Item 1122 statements of compliance required by Regulation AB to be included in the issuer's annual report on Form 10-K, as these are often received too late by the preparer to be included in the initial filing thus necessitating the filing of an amendment to the annual report. In addition, over the past several years, a number of servicers have ceased operations or have filed for bankruptcy protection and are unable or unwilling to provide such reporting items or only do so after a lengthy delay and much effort by the issuer. We do not believe that the inability of the issuer of obtain all assessments, attestations or compliance statements, despite diligent efforts do so, or the late filing of an amendment with such items, even when the amended annual report falls outside of the Rule 12b-25(b) existing safe harbor, should affect the ability of the issuer to utilize shelf registration.

V. PROPOSED TIMING REQUIREMENTS WITH RESPECT TO RULE 424(B) FILING

We support the Commission's efforts to provide a minimum waiting period for registered offerings by asset-backed issuers, so that investors have adequate time to analyze the securities. We suggest, however, that the Commission consider a more tailored approach. In particular, as we discuss below, we have several key recommendations: first, that the proposed five-business-day period be shortened, as it is too long for all ABS offerings; second, that any new waiting period imposed as a result of changes to material disclosures be tailored to the nature of the changed disclosures and the amount of time investors would reasonably need to absorb them; and third, that the Commission should acknowledge that investors will need less time to analyze new offerings by programmatic issuers, perhaps creating a special category for such issuers similar to its well-known seasoned issuer ("WKSI") designation.

In the Proposing Release, the Commission indicates that although it previously believed that investors could insist on adequate time to understand and analyze securities, it now believes that investors may be unable to do so in an active market.[118] We appreciate that investors that do not feel they have adequate time must choose between investing in securities they have not fully analyzed and allowing a potentially desirable investment opportunity to pass. At the same time, we believe that many issuers and underwriters in the ABS markets have been sensitive to the circumstances under which investors may need more time, and have attempted to adjust the time frames of their offerings to allow the market to absorb unusual features or divergences from prior issuances.[119]

A. <u>An appropriate set of criteria, comparable to "well-known seasoned issuer" status under the Commission's securities offering reform rules, should determine the applicable minimum waiting period for shelf-eligible asset-backed securities offerings.</u>

By recognizing differences among the types of asset-backed securities and how those differences impact the necessary time period needed for investors to understand and analyze such securities, the Commission's rules would be able to attain the objective of providing an

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118 Proposing Release at 23330.

119 The Commission has raised, by way of example, the advance-notice requirements in the context of providing information to the Federal Reserve Bank of New York in connection with a TALF-eligible transaction, or when information is provided to rating agencies in advance of a transaction, but we do not believe that these are analogous situations. With respect to TALF-eligible offerings, the very fact of TALF eligibility established baseline pricing that to some degree obviated the need to find the best market window. Communications with ratings agencies involve an iterative process that takes place over the course of the transaction, instead of providing fixed or near final terms at the commencement of the offering process.

appropriate level of investor protection, without risking the possibility of causing a material disruption to the asset-backed securities offering process. In this regard, we think that the best model for developing this differentiated approach is the Commission's set of special offering rules applicable to "well-known seasoned issuers," which are subject to fewer restrictions in the securities offering process by virtue of their extensive market following, which ensures investor familiarity with the issuer, its securities and its disclosures.

We believe that an approach where the more widely followed, well-known issuers of asset-backed securities could be subject to a shorter, standardized, minimum waiting period between the time of the Rule 424(h) preliminary prospectus filing and the sale of the securities is appropriate, because the amount of time necessary to assimilate and analyze the information about such an offering would be substantially less than what is required for less familiar transactions. For these purposes, we believe that a one-business-day waiting period is appropriate for widely followed, well-known issuers of asset-backed securities, while a two-business-day waiting period would provide sufficient time for analysis of all other transactions that qualify for shelf registration on proposed Form SF-3.

We believe that an analogous WKSI concept could apply in differentiating among issuers, sponsors, asset-classes and structures for purposes of determining if the one-business-day waiting period should apply. There are sponsors that have issued tens or even hundreds of billions of dollars of ABS over decades, using securitization programs that have consistent documentation from deal to deal. These programmatic issuers are well known to their investor base, who need far less time to absorb transaction details than they would for a new, unique transaction. Credit card and auto transaction sponsors are among the particularly prominent programmatic issuers, with strong reputational ties to their programs, and credit card issuers who have master trust structures generally use the same issuing vehicle and the same asset pool to support all their securities.

We believe that a category of "well-known seasoned asset-backed sponsors" that was designed to encompass programmatic issuers should include any sponsor that meets any of the following criteria:

- Issuer Classification – seasoned depositors and sponsors with established securitization programs, as determined by reference to prior analogous transactions in an aggregate specified amount and/or over a specified period of time.

- Asset Class Classification – master trust issuances (including issuances from a linked note issuance trust) where the asset pool does not change materially from transaction to transaction and a specified number or dollar amount of transactions have been issued supported by the pool.

- Transaction Structure – transactions by the same depositor or sponsor, where issuances involve waterfall structures that do not change materially from transaction to transaction.

We believe that in those offerings where the transactions are very similar over time, the market's familiarity with the offerings, the sponsor, the issuer, the structure and the assets should be sufficient to outweigh any investor protection concerns associated with a short minimum waiting period, such as one business day. In these well-known seasoned issuances, the amount of analytical time will be minimized by the presence in the market of pre-existing analytic models and a familiarity with structures, assets and terms.[120]

B. For other shelf-eligible asset-backed securities, we believe two business days would be a more appropriate waiting period than the five business days proposed by the Commission.

We believe that a two-business-day waiting period, as opposed to the proposed five-business-day waiting period, offers an appropriate amount of time for an investor to assimilate the information available with respect to the proposed offering and to analyze that information in time to make an informed investment decision. We have heard that most investors consider that a shorter period of time, such as two business days, would give them sufficient time to review the preliminary prospectus. In addition, a longer waiting period exposes the issuer to changes in the market and may increase the cost of originating the asset (which may be passed along to the obligor on the asset) as the originator must take into consideration the length of time needed to complete a securitization that includes the asset.

C. The Commission should more specifically prescribe the filing obligations with respect to the proposed Rule 424(h) filing.

While we support the Commission's proposed new Rule 430D, we suggest that the Commission expand the proposed Rule to specifically address several concerns with how the preliminary prospectus filing requirement will operate.

With respect to the content included in the Rule 424(h) filing, the Commission should specifically define what is contemplated by the phrase "information dependent on pricing," given that such information would not be required in a Rule 424(h) filing.[121] In this regard, it is important to know whether this information specifically contemplates only quantitative pricing terms, or whether it could also include other additional information that is typically determined at pricing, such as the selection of a swap counterparty, weighted average life calculations, or for credit card master trusts, transaction size and minimum principal receivables balance requirements.

Moreover, we believe it would be beneficial in facilitating an orderly offering process if the Commission more clearly defines the types of information that would, if omitted or changed, trigger the requirements to file a revised Rule 424(h) filing and to recommence any applicable waiting period. For instance, changes in pool composition as a result of ordinary events such as

120 In our experience, these programmatic issuers also tend to slow down their offerings voluntarily if there are any significant changes to their structure or assets so that their investors have time to absorb the changes.

121 Proposing Release at 23336.

payments of interest or principal, should not in our view require additional disclosure or a renewed waiting period unless such payments reflected another material change. Similarly, we do not believe *de minimis* substitutions where a small percentage of the assets have prepaid, become delinquent or defaulted and have been replaced by assets with similar characteristics should require recommencement of a waiting period.

In addition, a five-business-day waiting period, as proposed, would create significant transaction execution risks for issuers without providing a significant benefit to investors. For material changes requiring the filing of a revised Rule 424(h) prospectus, we believe that a relatively short period—not more than one or two business days—should be required to permit investors to absorb new information. We suggest that such changes be disclosed in a supplement to the preliminary prospectus to facilitate easy identification of such changes. A supplement would serve to better focus prospective investors on the changed information without burdening them with a completely revised preliminary prospectus. This focus on the changed information also would support a shorter waiting period, as the amount of time necessary to review and analyze a supplement specifically identifying the changed information would be substantially reduced given the more focused presentation.

VI. PRIVATE MARKET OFFERING PROPOSALS

The Commission has proposed significant amendments to Rule 144A and Rule 506, as well as revisions to Rule 144 and adoption of a new Rule 192, to address concerns about the lack of information available to investors with respect to ABS offered in exempt offerings. The proposed rules would amend the safe harbors provided in Rules 144, 144A, and 506 to, among other things, require that issuers of structured finance products (i) covenant to provide initial investors and transferees, as applicable, with the right to request the same information—both on an initial basis and, under Rules 144 and 144A, on a periodic basis—that would be required if the offer or resale were registered and (ii) file with the Commission public notices of initial placements of structured finance products. Moreover, the Commission proposes to apply these changes to any offering or resale of a security that constitutes a "structured finance product" and is conducted in reliance on these safe harbors. The term "structured finance product" is broadly defined by the Commission and may create uncertainty in a wide range of private markets that may not have been intended to fall within the scope of the Commission's proposals.

We have significant concerns regarding the scope and burdens associated with the proposals, their lack of clarity as they relate to securities for which the Commission has not adopted line-item disclosure requirements, the potential inclusion of a very broad range of securities and the risk that they will wholly eliminate transactions in classes of securities for which compliance is not feasible. If adopted as proposed, the amendments could have a substantial adverse impact on the market for structured finance products—including securities that have not been specifically targeted by the Commission—creating obstacles to capital formation and decreasing liquidity. As a result, we strongly oppose the proposed amendments.

We appreciate, however, the concerns the Commission has expressed with respect to private market securitization transactions and the importance of fostering appropriate disclosure practices within those markets. Although we fundamentally believe that private market investors can and will demand any enhanced disclosures they need to make an informed investment decision, and that the market solutions that will result from such demands will represent the most appropriate and sustainable changes in private market disclosure standards, we realize that the Commission may choose to intervene rather than allowing the market to self-correct. If it does so, we believe the Commission has tools at its disposal to influence market disclosure without impairing critical safe harbors. In Part VI.J of this letter we discuss several initiatives the Commission could consider as alternatives to the safe harbor changes it proposes, including establishing a pilot program for CDO disclosures, using proposed Form 144A-SF to obtain and assess private market disclosures and requiring a legend in the offering materials for private market transactions indicating that the disclosure does not satisfy the requirements of Regulation AB.[122]

A. The Commission should not use its authority to adopt safe harbors, which are intended to provide certainty with respect to the circumstances under which a statutory exemption is satisfied, to instead require issuers of structured finance products to make disclosures equivalent to those for a registered offering.

Since its adoption in 1933, the Securities Act has exempted from its registration requirements transactions by any person other than an issuer, underwriter or dealer[123] and transactions by an issuer not involving a public offering.[124] In order to provide clarity as to which transactions were exempt from registration under the Securities Act, the Commission adopted rules that provide "safe harbors" to issuers and others. Compliance with these safe harbors has provided offering participants assurance that the transactions in which they are engaged will not be subject to later claims that the transactions ran afoul of the Securities Act's registration requirements, possibly subjecting the issuers to civil and perhaps criminal liabilities and penalties. Although we acknowledge that the Commission has the authority to condition or even eliminate the regulatory safe harbors, we believe that the proposed amendments are inconsistent with the long-standing treatment of the private markets by the Commission and would be unnecessarily burdensome to issuers.

In adopting the Securities Act, Congress made clear that its purpose was to impose the Securities Act's disclosure provisions only on public offerings by issuers and not on secondary transactions. As noted in a 1933 report of the House of Representatives on the adoption of the Securities Act, Section 4(1) "broadly draws the line between distribution of securities and trading in securities, indicating that the [A]ct is, in the main, concerned with the problem of distribution as distinguished from trading."[125]

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122 A more stringent version of the legend requirement that the Commission could also consider would be to require that issuers include a table at the front of the offering document that lists those disclosure items that would have been required under Regulation AB but are not included in the offering document.

123 15 U.S.C. § 77d(1).

124 15 U.S.C. § 77d(2).

125 H.R. REP. NO. 73-85, at 15 (1933).

Rule 144 was adopted in 1972 to provide objective parameters for determining whether transactions in restricted securities of reporting companies constitute prohibited distributions under Section 4(1).[126] If the parameters of the Rule 144 safe harbor are established, as of a particular transaction date, market participants have assurance of a valid exemption from registration.

In 1988, Rule 144A was proposed to support a substantial and rapidly growing secondary trading market for privately placed securities.[127] In its release proposing Rule 144A, the Commission stated that:

> Proposed Rule 144A could have a significant impact on both the primary and secondary domestic markets for unregistered securities of reporting as well as nonreporting issuers. Removing uncertainties as to the legitimacy of resales to institutional buyers by providing a safe harbor from registration could permit some transactions to take place that otherwise might not occur. Such transactions might include resales by persons that purchased securities privately with a view to their immediate resale to a number of institutions. Providing a framework in which institutional resales could be made freely may increase the efficiency of the private placement market. Liquidity in the market may increase, not only as the result of increased efficiency, but also as a consequence of the resale provisions of proposed Regulation S. The potential increase in efficiency and liquidity could significantly lower the discount commonly associated with private placements, which in turn may attract an increasing number of issuers to the private placement market.[128]

The Commission also noted that "[t]he Congress and the Commission historically have recognized the ability of professional institutional investors to make investment decisions without the protections mandated by the registration requirement of the Securities Act."[129]

As finally adopted in 1990, Rule 144A[130] provides a safe harbor from the Securities Act registration requirements for resales of restricted securities to qualified institutional buyers ("QIBs"). The primary purpose of the safe harbor was to clarify the circumstances under which resales could be made without having the resales treated as distributions, facilitating more active

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126 *See* Securities Act Release No. 5223, 37 Fed. Reg. 591, 591-92 (Jan. 14, 1972).

127 *See* Securities Act Release No. 6806, 53 Fed. Reg. 44016, 44021 (Nov. 1, 1988) ("A secondary market for privately placed securities has become an established feature of American corporate finance.").

128 *Id.* at 44022 (citations omitted).

129 *Id.*

130 55 Fed. Reg. 17933 (Apr. 30, 1990).

private market trading among investors that did not need the protections of Securities Act registration because of their financial sophistication.[131]

In addition to the Section 4(1) exemption, Congress expressly provided that the registration requirements of the Securities Act did not apply to transactions not involving a public offering.[132] As the Supreme Court stated in *SEC v. Ralston Purina*, "[s]ince exempt transactions are those as to which 'there is no practical need for * * * [the bill's] application,' the applicability of § [4(2)] should turn on whether the particular class of persons affected need the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'"[133]

Rule 506 of Regulation D[134] was adopted by the Commission in 1982 to provide a safe harbor to permit an issuer to determine, with clarity, which transactions will be deemed not to involve a public offering within the meaning of Section 4(2). Regulation D has facilitated private offerings, in particular enabling counsel to deliver legal opinions that provide comfort to issuers and placement agents as to compliance with the federal securities laws.

In our view, a regulatory safe harbor should identify those situations that are so clearly within the scope of a statutory provision that the persons or entities subject to the provision can, by complying with the safe harbor's conditions, have confidence that they are not violating the statutory provision. In the case of Rule 144, Rule 144A and Rule 506, the intent of each safe harbor is to allow rule-compliant transactions to be deemed transactions that are not distributions of securities to the public. Sections 4(1) and 4(2) of the Securities Act, as discussed above, are transactional exemptions that focus on the nature of the transferor, the nature of the transferee and the means by which the offering or resale takes place.

The Commission has acknowledged in the Proposing Release that it does not have the statutory authority to impose Regulation AB disclosure requirements on transactions that fall within the scope of the Section 4(1) and 4(2) exemptions but outside the existing safe harbors,[135]

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[131] Rule 144A also addresses the broad and uncertain scope of the definition of underwriter in Section 2(a)(11) of the Securities Act.

[132] Section 4(2) of the Securities Act. Additionally, in discussing the legislative history of Section 4(2), former SEC Commissioner Owens stated that "Congress recognized that, under certain carefully limited circumstances, it might be unnecessary for an issuer to make available through the registration process all the information material to an intelligent evaluation of securities because certain persons in certain circumstances already have access to such information through other channels." Hugh F. Owens, Commissioner, SEC, Address at the Annual Meeting of District No. 4, NASD (May 16, 1972), *transcript available at* http://www.sec.gov/news/speech/1972/051672owens.pdf.

[133] 346 U.S. 119, 125 (1953) (ellipsis and brackets in the original).

[134] 17 C.F.R. §§ 230.501-230.508.

[135] As the Commission notes in the Proposing Release, "We acknowledge that the steps we are proposing to take in the private placement market are significant. We recognize that structured finance product issuers may conduct offerings in reliance on a statutory exemption under the Securities Act without seeking the safe harbor provided by Rule 506 of Regulation D or without representing that the securities are eligible for resale under Rule 144A. As a result, our proposed amendments to the safe harbors would not apply to these offerings, and

and is using its ability to create safe harbors in an effort to achieve indirectly what it does not have the authority to do directly.

Significantly, although the Dodd-Frank Act includes new restrictions on issuances of structured finance products, including many that are consistent with the Commission's proposals, it does not remove or modify the Section 4(1) and Section 4(2) exemptions.[136] Nor does the Dodd-Frank Act identify any abuses in disclosure practices in the private offering process and require the Commission to restructure the Rule 144, Rule 144A and Rule 506 safe harbors in order to address disclosure issues relating to private offerings.[137] Congress has given the Commission specific direction to expand disclosure requirements for *public offerings* of structured finance securities but has not provided similar instructions with respect to the private markets. Even in dealing with the same concerns and considerations as those raised by the Commission—and acting after the Commission's proposals were published for public comment—Congress did not give the Commission express authority to regulate disclosures in the private markets on the basis of the nature of the offered security. We do not believe the Commission should now use its regulatory authority to go beyond its Congressional mandate.

B. <u>The changes the Commission is proposing are overly broad and will deprive issuers of reasonable access to the private markets in circumstances in which they have legitimate business reasons for not providing Regulation AB-equivalent disclosures but would nonetheless meet the standard set forth in Rule 10b-5.</u>

In proposing these changes to its regulatory safe harbors, the Commission cites problems in the CDO market as contributing to the loss of liquidity during the financial crisis. Most of these problems, however, related to CDOs of MBS, which were often transactions that pooled residential mortgage-backed securities into leveraged structures that magnified risk. As discussed elsewhere in this letter, we believe asset-backed securities in most asset classes that were not directly (or, as in the case of some CDOs, indirectly) linked to residential mortgage loans have performed as expected and did not cause or influence the financial crisis. Instead, they were *harmed* by the financial crisis, as lack of confidence in credit ratings for structured products rippled through the entire structured finance market and caused a lack of liquidity for other asset classes. Many other sectors of the financial markets unrelated to ABS, however, experienced a lack of liquidity as well. We believe the Commission's broad-based treatment of all structured finance products in the proposed amendments is neither supported by empirical evidence, nor reflective of the level of risk associated with such securities.[138]

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as such, may not fully address the concerns we seek to address in all securitization transactions." Proposing Release at 23394.

136 The Dodd-Frank Act does, however, direct the Commission to increase the necessary qualifications for "accredited investor" status.

137 Although the Dodd-Frank Act changes the standard for accredited investors, we do not believe that change is relevant to this point.

138 In the Proposing Release, the Commission cites the role of CDOs in the financial crisis, and the issues created by assertions of the lack of information regarding CDOs. *See*, *e.g.*, Proposing Release at 23330 (footnotes 30 and 38 and the accompanying text).

Further, although pools of mortgage-backed securities continue to be created as part of the government's Public-Private Investment Program initiative, FDIC resolution strategies and other workouts of distressed portfolios, we do not believe that CDOs of MBS continue to be issued. Moreover, we do not anticipate a revival in CDOs of MBS, nor do we believe investors, sponsors, rating agencies or other market participants would bring the same overly sanguine approach to new CDOs of MBS that they brought to them in the overheated market that preceded the crisis. Accordingly, imposing changes to the private markets will have little, if any, effect on CDOs of MBS, but has the potential to seriously disrupt the private ABS markets in general.

We also question whether mandating the type of disclosures to be made to sophisticated investors will improve the ability of such investors to assess risk. Many of the market participants that suffered the greatest losses from structured finance products over the past several years were involved in structuring those very securities and had access to all material information. The financial crisis did not so much expose deficiencies in the availability of information regarding privately issued structured finance products as it exposed the inability of various sophisticated investors to make accurate judgments regarding the basic assumptions underlying their analysis and the risk profiles of products with which they may have been intimately involved. The Commission's proposals will not resolve the inability of various sophisticated investors to make accurate judgments. Nor will the proposals necessarily have any significant effect on disclosure practices in the private markets, especially to the extent the Commission's proposed disclosure requirements cannot be satisfied for particular securities. In those circumstances, they may merely curtail the market, causing issuers to issue securities that are not eligible for resale under Rule 144A (or to avoid issuing securities entirely), reducing liquidity for investors and complicating transfer arrangements. We do not believe these outcomes would be in the best interest of investors or issuers.

Finally, we believe the information provided to investors in the Rule 144A markets is quite robust and does not support the view that private markets need policing. Issuers may choose to distribute their securities pursuant to offerings that rely on an initial purchaser's ability to resell in accordance with Rule 144A, rather than through a registered public offering, for many reasons, including timing considerations, a need to satisfy the requirements for an exemption from the Investment Company Act of 1940 (the "Investment Company Act"), or the inability to satisfy a technical requirement of the Securities Act and the regulations thereunder. Rule 144A transactions must still meet the Rule 10b-5 standard, however, and in our experience issuers in these transactions generally provide a complete offering document in substance and scope very similar to what is currently provided in public transactions.[139] Counsel also universally deliver 10b-5 negative assurance letters for these deals.

We are concerned that the Commission's proposal to expand Regulation AB to the private markets—which would encompass not only CDOs and RMBS, but also privately placed CMBS, credit card, auto and other common classes that have performed well through the crisis—

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139 In some deals with actively managed portfolios, detailed criteria for asset purchases and sales and guidelines for portfolio composition may be specified in place of direct details of the assets. For asset classes, such as credit cards and auto loans, where similar securities are frequently issued publicly, aggregate pool data similar to what is required under Regulation AB is typically provided.

would force issuers to comply with the Commission's Regulation AB proposals by preventing them from utilizing the private markets for legitimate business reasons. As we discuss elsewhere in this letter, issuers may determine that compliance with the updated requirements of Regulation AB as proposed by the Commission would be too expensive or too difficult in the context of a registered public offering, or they may determine that compliance would disclose competitively sensitive information that would jeopardize their businesses. For smaller issuers in particular, the cost of compliance may be an insurmountable barrier to entry. In transactions involving a concentration of assets, such as many CMBS transactions (most notably large loan transactions or credit tenant lease transactions with a significant concentration of borrowers or tenants), borrower or tenant financial information may be unavailable in full, or appropriate comfort may not be available. Required information being provided by third parties may be subject to confidentiality restrictions and may therefore be unavailable absent execution of confidentiality agreements. Accordingly, in some cases requirements of registered public offerings become impossible or impose so great a burden on issuers that they must forgo the benefits of registration rather than comply. We believe that importing the Securities Act's public disclosure requirements to the private markets will exacerbate these issues, depriving issuers of reasonable access to the securities markets as a viable alternative avenue for capital formation.

In the Proposing Release, the Commission expresses concern that even sophisticated investors require significantly greater information regarding structured finance products than they currently receive. In our view, however, the market has been self-correcting with respect to private market disclosures and does not need Commission intervention. QIBs have the ability to choose not to buy securities for which they receive what they deem to be inadequate disclosures. They also have the requisite sophistication to determine which disclosures they need in order to conduct an appropriate risk analysis. These are fundamental precepts of our private securities markets, and we believe they continue to be sound. During the financial crisis, investors in registered, publicly offered securities that were issued in compliance with the Commission's current disclosure rules suffered significant losses. There is little reason to believe that applying those disclosure requirements to privately offered securities would have limited losses incurred in respect of those securities. Indeed, the significant proposed changes to Regulation AB reflect the Commission's rethinking of its disclosure standards in light of the events of the last three years. Investors have watched those same developments with keen interest and have adjusted their investment criteria and risk models accordingly. Accordingly, we believe that even if the proposed disclosure rules are not applied to private transactions, the private market will self-correct on these issues and it should be allowed to do so without help or interference from the Commission. To the extent the market does not fully self-correct, we believe the Commission should first attempt to use more tailored interventions to address these issues, rather than imposing such a significant change on much of the ABS market as well as structured finance products that have not previously been subject to Securities Act disclosure rules.

C. The adoption of the proposed amendments would lead to a number of adverse consequences.

We believe the Commission should consider that its proposal to mandate private market disclosures will impose real burdens on market participants.

First, every issuer of structured finance products that seeks to rely on the Rule 506 safe harbor or that seeks to permit investors to rely on the Rule 144A safe harbor will be required to incur the costs and time delays associated with preparation of a full registration statement and will thereafter be required to devote resources to providing the same information that would be required to be made available were it a reporting company.[140] These costs and burdens are considerable. Not only would preparation of the information prevent an issuer from accessing the markets quickly and efficiently, but investors would likely bear costs associated with these information requirements, even if no investor thought it necessary to request this information.

Second, although no issuer is required to rely (or, in the case of Rule 144 and Rule 144A, to enable its investors to rely) on the safe harbors, an issuer seeking to access the markets without the ability to rely on the safe harbors may find a significant decrease in the demand for its structured finance products. QIBs that would otherwise expect to resell in accordance with Rule 144A would be required to accept that their securities are restricted securities as to which the conditions set forth in Rule 144 or the mechanics of what is often referred to as "Section 4(1-1/2)" must be satisfied in order for the securities to be transferred. Without the ability to rely on the safe harbors, investment bankers and counsel may have considerably more difficulty completing the diligence necessary to confirm the availability of Securities Act exemptions. Unless the structured finance product or the offering falls within the scope of exemption from state "blue sky" laws, issuers may be required to register (or seek exemption from registration) in each jurisdiction where the securities will be sold.

Third, as indicated above, the proposed amendments would apply to all asset classes of structured finance products, without any differentiation made on the basis of risks posed, the availability of information generally regarding the asset class, the historical performance of securitizations of such asset class, or other factors that would be expected to factor into an investor's evaluation of the security. While we do not believe that the availability of offering exemptions should be tied to the nature of the offered security, if the Commission determines to proceed with such an approach, the exemptions should be narrowly focused to avoid imposing these conditions on such a broad scope of products.

Fourth, as we discuss in the context of specific disclosure proposals, we are concerned that transaction sponsors may be unable to make the disclosures required as a condition to availing themselves of the safe harbors, because certain information may not be available to them at issuance or on an ongoing basis.[141] This inability to satisfy the safe harbors' conditions could therefore have the effect of denying such sponsors access to the capital markets—including, for instance, sponsors of established programs supported by non-mortgage loan assets and commercial mortgage loan assets that, in each case, have continued to pay their investors in

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[140] Although the proposal is cast in the form of requiring a covenant to provide the disclosure upon request, we do not believe compliance with such a covenant could be achieved unless the full disclosures were prepared from the transaction's commencement.

[141] As we note elsewhere, issuers may also be unable to create waterfall computer programs with the functionality the Commission is requiring.

full and on time throughout the recent crisis.[142] The Commission has recognized in other contexts that issuers often avail themselves of alternative offering methodologies, such as exempt offerings, because the compliance costs associated with shelf registration may be too great.

Fifth, the Commission's proposals may well hinder innovation because determining which information would be required to be included in a registered offering of a novel and unique product may be difficult. To the extent that an issuer is uncertain what information would be required if the issuer registered a new and innovative product under the Securities Act, it takes the risk that, even if it seeks to comply with the safe harbor provisions, the safe harbor may later be determined to have been unavailable because the issuer failed to covenant to provide certain information. In that case, the issuer's exemption from the registration provisions of the Securities Act may therefore depend on the statutory exemptions alone. Moreover, the loss of the Rule 506 safe harbor exemption could give rise to claims that the security was not a covered security under the National Securities Markets Improvement Act and was therefore not entitled to exemption from state blue sky registration. The consequence of the foregoing is that issuers may, in the future, be more reluctant to issue innovative securities, notwithstanding that such securities may respond to market needs.

Finally, the increased regulation of structured finance products by the Commission may result in a greater effort by issuers and resellers to offer such products offshore.[143] In our view, the U.S. capital markets are not well served if U.S. institutional investors do not have access to a broad range of financial products. The failure of certain institutional investors to fully have evaluated their risk with respect to certain classes of highly volatile structured finance products, or to request additional information that is considered relevant only with the benefit of hindsight, does not provide an appropriate basis for denying the entire institutional market the opportunity to invest efficiently in the full spectrum of structured finance products.

D. The Commission's definition of structured finance products is overly broad and may include common financial instruments—including structured notes, covered bonds, hybrid capital securities and pooled investment vehicles—that the Commission does not appear to intend to be covered by the ABS rules.

In its discussion of the proposed modifications to the Rule 144A and Rule 506 safe harbors, the Commission states that securitization in the private, unregistered market played "a

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[142] A 2009 study conducted by NERA Economic Consulting, titled *An Update on the Credit Crisis Litigation: A Turn Towards Structured Products and Asset Management Firms*, found that as the credit crisis grew more severe, an increasing number of securities lawsuits involved complex financial instruments such as CDOs and CDS. The finding suggests that the problems fueling the crisis were much narrower than the structured finance products markets as a whole. NERA Econ. Consulting (June 15, 2009), *available at* http://www.nera.com/extImage/PUB_Litigation_Update_VI_0609.pdf.

[143] The Commission's proposals related to private market offerings would not apply to the Regulation S safe harbor for offshore sales, although the Commission requests comments on whether they should. *See* Proposing Release at 23398. We do not believe that it would be prudent for the Commission to expand the proposals to offerings conducted in reliance on Regulation S given the serious concern we have about the effect of the changes, as proposed, to the private markets.

significant role" in the financial crisis.[144] However, as the basis for this conclusion, the Commission cites only CDOs that were issued in private placements and it does not describe other private offerings that have led it to its determination to cast a broad net for all "structured finance products." We are concerned that the proposed definition is overly broad and will damage sectors of the securities markets that are outside the Commission's area of concern. We believe the uncertainty surrounding the proposed definition of "structured finance product" may result in issuers' placing greater reliance on the traditional statutory private placement and resale exemptions for U.S. offerings and resales, whose parameters are less clear than those set by regulation and incorporated in Rule 144A and Regulation D. Avoidance of the regulatory safe harbors may lead to less market liquidity, harming issuers and investors without achieving the Commission's goals.

The proposed safe harbor modifications would apply to "structured finance products," the definition of which is broader than the proposed revised definition of "asset-backed security" in Item 1101(c) of Regulation AB. The Commission notes that it used this broader term "in order to reflect the wide range of securitization products that are sold in the private markets."[145] Unfortunately, however, the broad, general language of the proposed definition of "structured finance product" may capture securities that contain structured finance elements (such as the use of a special purpose vehicle) but would not traditionally be thought of, or categorized, as structured finance products.

The proposed rules would define a "structured finance product" to mean: [146]

(a) a synthetic asset-backed security; or

(b) a fixed-income or other security collateralized by any pool of self liquidating financial assets, such as loans, leases, mortgages, and secured or unsecured receivables, which entitles the security holders to receive payments that depend on the cash flow from the assets, including —

  (i) an asset-backed security as used in Item 1101(c) of Regulation AB,

  (ii) a collateralized mortgage obligation,

  (iii) a collateralized debt obligation,

  (iv) a collateralized bond obligation,

  (v) a collateralized debt obligation of asset-backed securities,

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144 Proposing Release at 23393.

145 Proposing Release at 23395.

146 While not expressly included in the proposed definition, the Commission states in the Proposing Release that both asset-backed commercial paper and any residual tranche of a structured finance product would qualify as structured finance products. *See* Proposing Release at 23395 n.467.

(vi) a collateralized debt obligation of collateralized debt obligations, or

(vii) a security that at the time of the offering is commonly known as an asset-backed security or a structured finance product.

We believe this language presents a number of interpretive issues. For instance, the term "synthetic asset-backed security" in clause (a) above is not defined and is particularly unclear in that it seems to relate to the category of securities currently defined by Item 1101(c) of Regulation AB. Clause (b)(vii) appears to leave a regulatory concept to be defined by common sentiment. Is the "structured finance product" definition intended to cover the broad category of structured products issued by investment banks? Covered bonds? We discuss below a number of types of securities that may be caught within this definition and subject to uncertainty or transfer restrictions as a result.

Structured notes. We do not believe that traditional structured notes issued by an investment bank or a corporate affiliate, which are typically unsecured obligations of the issuing entity, should constitute structured finance products.[147] These securities would not satisfy the collateralized pool element of clause (b) of the proposed definition.[148] However, we are concerned that a structured note could be construed to be a synthetic asset-backed security under clause (a) of the proposed definition. Unlike clause (b), which has qualifying language before the list of specific types of products, clause (a) is simple and express: a synthetic asset-backed security would be a structured finance product. Arguably, to the extent that a traditional structured note is linked to one or more reference assets that could otherwise be included in the pool of financial assets in an asset-backed security (*e.g.*, bonds or loans or bond/loan indices), a broad interpretation of the term "synthetic asset-backed security" could apply to that structured note, and the obligation of the issuer to make payments based on the performance of those reference assets could be said to represent a synthetic investment in them. Although we do not consider structured notes to be synthetic asset-backed securities, we believe the Commission should adopt a definition of "synthetic asset-backed securities" that clearly excludes them.

Covered bonds. Covered bonds are recourse corporate debt instruments as to which a bank sets aside high quality assets in a collateral pool—either pursuant to ring-fencing laws in the bank's jurisdiction or structurally through use of a special purpose entity—to support the ultimate repayment of the bonds. The collateral pool, in a sense, "covers" the bank's obligation, and, therefore, the noteholders have only a contingent interest in the assets. Covered bonds have been widely touted as the future of bank finance, with the belief that these obligations will essentially replace asset-backed securities as a key funding source. Indeed, legislation to support the development of a covered bond market in the United States was very nearly included in the

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[147] Traditional structured notes are issued "on the balance sheet" of the corporate issuer and combine a debt instrument with one or more derivatives. A noteholder's return at maturity may be linked to the return of one or more underlying reference assets, rates, currencies, or indices.

[148] The absence of the collateralized pool element is also important because it would preclude application of the catch-all language in clause (b)(vii) of the proposed definition to such securities. Structured notes are often referred to as structured products, which could be confused with the term "structured *finance* product."

final version of the Dodd-Frank Act that emerged from conference committee, and a separate bill relating to covered bonds has recently been approved by the House Financial Services Committee.[149] We are very reluctant to see this type of security encumbered by issues from the securitization industry before a United States market even has a chance to develop. A broad reading of the "cash flow" element of the Commission's proposed "structured finance product" definition could, however, include payments—including liquidation proceeds—received from the covered bonds' collateral pool after a default or issuer insolvency under the covered bonds. Although we do not believe payments on covered bonds "depend on the cash flow from the assets" in the collateral pool, we believe covered bonds should be explicitly excluded from the "structured finance product" definition.

Hybrid capital securities. We are concerned that common forms of hybrid capital may be picked up by the definition of "structured finance product." For example, trust preferred securities are primarily supported by junior subordinated debentures issued by a bank or an insurance company and sold to, and held by, the trust that issues the trust preferred securities. Another form of hybrid capital involves a standby capital facility where the issuing trust invests the issuance proceeds in high grade assets, such as U.S. Treasuries, and agrees to purchase junior subordinated debentures (or other securities) from an entity in exchange for a commitment fee. Although these are effectively corporate obligations, to the extent that hybrid capital securities are issued out of a special purpose vehicle where the cash flow from a pool of self-liquidating financial assets supports payments on those securities, they in all likelihood would constitute structured finance products under the proposed definition. We do not believe these securities are intended to be covered by the proposed rules, and we recommend that the Commission revise its proposal to exclude them.

Pooled investment vehicles. Unlike an asset-backed security, which is a security that is *primarily* serviced by the cash flows of a discrete pool of receivables or other financial assets that by their terms convert into cash within a finite time period, a structured finance product need only be a security that is collateralized by any pool of self-liquidating financial assets and the payments on which *depend* on the cash flow from those financial assets. The broad language of the proposed definition of structured finance product could possibly apply to money market funds, fixed income funds, certain hedge funds, and other pooled investment vehicles that hold a broad array of financial and other assets. Again, we believe the Commission should revise the proposed rule to clearly exclude these securities.

As we discuss above, we do not believe the expansion to private placements of the disclosure requirements for offerings registered under the Securities Act is appropriate. If the Commission were nonetheless to proceed on this path, we would respectfully suggest that it consider a narrower definition of "structured finance product."

First, we suggest that the Commission consider excluding from the definition all securities that fall within the definition of "asset-backed security" as currently set forth in Item 1101(c). As we noted, issuers of securities offered in Rule 144A transactions tend to follow the

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149 The United States Covered Bond Act of 2010 (H.R. 5823).

Commission's disclosure requirements where the Commission has established line-item requirements for a particular class of security. Although issuers do not have to comply with every aspect of those requirements, there is a recognizable standard for disclosure that establishes the baseline. We are not aware of any qualitative difference between asset-backed securities and other types of securities that are sometimes publicly offered and sometimes privately placed that would suggest that there is likely to be greater deviation from Commission standards for privately placed ABS than for such other types of privately placed securities.

Second, we believe the term "synthetic asset-backed security" should be replaced with something that more closely relates to CDO structures. For instance, the proposed definition might apply to "a collateralized mortgage obligation, collateralized debt obligation, collateralized bond obligation, collateralized debt obligation of asset-backed securities, collateralized debt obligation of collateralized debt obligations, or a security collateralized primarily by a swap that synthetically replicates the payment streams associated with any of these securities."

Third, we suggest explicit exclusions for structured notes, covered bonds, hybrid capital securities, and interests in pooled investment vehicles, as well as any other security that is a general obligation (whether secured, or unsecured), or directly issued or benefiting from a guarantee, of an operating company or other Securities Act registrant that also has a class of its securities registered under Section 12 of the Exchange Act.[150]

E. <u>If public offering-type discussion is required for private market transactions, the disclosure requirements for certain types of securities that traditionally have not been publicly offered need to be clarified.</u>

Regulation AB currently provides specific line-item disclosure requirements for a variety of asset-backed securities commonly offered pursuant to a registration statement. Those requirements in general have been tailored to the applicable asset class, and the Proposing Release preserves that approach. There are no correlative requirements, however, for types of securities that are generally not publicly issued. Moreover, to the extent those securities would not constitute "asset-backed securities" as defined in Item 1101(c) of Regulation AB, it is not clear to us that the specific line-item disclosure requirements for asset-backed securities would apply, as opposed to the more generalized disclosure requirements—such as audited financial statements and management's discussion and analysis—that would apply to securities registered on Form S-1. For example, we do not believe there are clear standards in the Proposed Release regarding the information requirements for a registration statement for CDOs, CLOs, asset-

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150 By taking out of the scope of the defined term "structured finance product" those securities that are general obligations of issuers with a class of securities registered under Section 12 of the Exchange Act, structured notes, hybrid securities and covered bonds will be excluded. From a principles-based approach, investors will have information readily available about these issuers and in respect of securities that are their general obligations, will be looking to the issuers (not to particular assets) for repayment. The availability of such information addresses the concerns expressed by the Commission in the Proposing Release that investors in disclosures relating to structured finance securities were inadequate because the disclosures provided insufficient explanation regarding the financial assets, the parties involved in the securitization process, and similar matters. *See* Proposing Release at 23332-33. The same concerns are not present where investors are looking principally to the obligor, and not to specific assets.

backed commercial paper or synthetic asset-backed securities. In addition, where securities that we would not consider to be ABS, such as trust preferred securities, arguably fall within the definition of structured finance product, we do not believe their issuers should have to provide the disclosures required under Regulation AB if operating company disclosures are more appropriate. We believe that much more substantial guidance would be required to confirm compliance with the proposed regulatory safe harbor.[151]

F. Issuers of asset-backed commercial paper may be unable to comply with the proposed disclosure requirements.

Asset-backed commercial paper ("ABCP") programs have traditionally relied on the private placement exemptions of Rules 144, 144A and Regulation D, and have a number of characteristics that would make compliance with the Commission's proposed rules at best extremely difficult, time-consuming and expensive, and, at worst, could have a substantial chilling effect on the ABCP industry. ABCP programs include a variety of different assets within a single program; they have a revolving pool of assets that changes constantly, both as a result of changes in the assets transferred by the customers of the ABCP issuer and as a result of changes in the identity of those customers obtaining funding through the program; and they acquire their assets through individually negotiated agreements with the originators of those assets that reflect both particular needs of those originators and the results of substantial asset-level due diligence by the sponsor.

While the proposed rules provide specific disclosure requirements tailored for many asset classes commonly funded by both term ABS and ABCP,[152] they do not take into consideration the broader range of financial assets that are, or potentially could be, funded through ABCP. In particular, the proposed rules fail to provide guidance as to what disclosure would be required for ABCP backed by trade receivables, health care receivables, tax liens, lottery receivables, intellectual property and structured settlements.[153] Trade receivables, which comprise a substantial portion of the assets funded by ABCP programs, are accounts receivable that operating companies generate by selling their goods or services to their customers. They are generally short-term obligations, due 30 to 60 days after issuance of an invoice, and the list of obligors for those receivables is typically the proprietary and competitively sensitive customer list of the originator. The originators of assets for trade receivables securitizations are among the least sophisticated participants in the securitization market, and they use their trade receivables facilities as a lower-cost alternative to obtaining a secured corporate loan. We believe many of these operating companies would be completely overwhelmed, for instance, by the waterfall computer program requirement and by any expansion in their reporting obligations, which are typically handled by a small accounting or treasury staff.

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151 See also our discussion of these points at Parts II.A.8, IV.C and VI.A in this letter.

152 The asset classes include auto or equipment loans or leases, commercial or residential mortgages and credit card receivables.

153 We note that this is not an exhaustive list of all asset classes that are, or potentially could be, funded by ABCP.

A significant percentage of ABCP-funded transactions (probably a strong majority) are backed by revolving asset pools, but the proposed rules clearly target fixed amortizing pools more likely to be found in term ABS transactions.[154] The proposed rules provide no guidance as to what static pool disclosure (if any) would be required for ABCP programs or their underlying transactions. Moreover, the proposed rules do not contemplate structures that include a broad array of disparate assets. We believe ABCP issuers and sponsors would have little clarity regarding what disclosure they would be required to provide.

ABCP issuers generally have little or no ability to obtain asset-level or pool-level information except from customers of theirs that originate and service the related assets. We believe that even if the proposed rules provided sufficient guidance regarding the information required to be disclosed, many customers of ABCP issuers would be unwilling (because of confidentiality concerns) or unable (because of systems or other operational limitations) to provide ABCP issuers with such information or to permit such information to be disclosed to ABCP investors.[155] As a further complication, some of these customers may have entered into multi-year commitments, with no opportunity for the ABCP issuer to renegotiate reporting obligations prior to the end of the facility term. Further, the proposed rules raise many questions regarding liability for errors and omissions in reported information. Because ABCP issuers and their sponsors lack direct access to underlying asset-level and pool-level data and must instead obtain such data from originators and servicers, the prospect of unlimited liability for third-party data may cause many (perhaps all) sponsors to terminate their ABCP programs if they cannot rely on exemptions other than the regulatory safe harbors.

Although ABCP issuers may theoretically be capable of complying with the Commission's proposed requirement that issuers provide computer programs for each transaction, the sheer number of transactions funded by any particular ABCP issuer would pose substantially greater administrative burdens and risk of liability for mistakes than those facing issuers of term ABS.[156] We do not believe that sponsors as a practical matter would be able to comply with disclosure requirements relating to the computer program.

Finally, we note that ABCP is, by definition, a short-term obligation with a maturity measured by days, not years. We suspect that investors would have to devote far greater resources to analyzing the multiple layers of waterfall computer programs and the disparate asset classes for an ABCP program than for even the most complex term ABS transaction. Such analysis will have limited utility because of the continual changes in the asset pool—not only

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[154] We recognize that the proposed rules provide specific guidance with respect to credit card master trusts and resecuritizations, but those guidelines omit the bulk of asset classes commonly funded in revolving ABCP transactions.

[155] Many customers of ABCP programs that originate consumer assets are companies that have not yet developed the systems or market presence to participate in the term ABS market. For such companies, ABCP transactions function as stepping stones to developing the systems, expertise and credit history necessary to access the broader capital markets (including the term ABS market). Many such companies may be unable to comply with the rigorous disclosure requirements established by the proposed rules; and, therefore, the proposed rules may effectively exclude such companies from the capital markets.

[156] ABCP issuers are often parties to more than 100 individual ABCP-funded transactions.

because many originators transfer revolving assets, but because the ABCP issuer's customer list also changes frequently over time. We believe it is far more likely that investors that are moving away from reliance on credit ratings with respect to their short-term investments will develop simpler ways to ensure themselves of the overall soundness of these ABCP programs, for instance by obtaining additional information from the sponsor about the diligence process it applies in adding its customers' assets to the pool.

There is a long history of exempting commercial paper from the provisions of the Securities Act and the Exchange Act, including by reliance on Section 3(a)(3) of the Securities Act, and we recommend that the Commission exempt ABCP from any provisions limiting the availability of the Rule 144A and Rule 506 safe harbors for structured finance products. In our view, even if the Commission were to adopt the changes it proposes to the Rule 144A and Rule 506 safe harbors, limiting the ability of issuers of term ABS to rely on those safe harbors, we believe such changes are inappropriate for the ABCP market. In particular, compliance with disclosure requirements along the lines the Commission has proposed for other asset classes would be so difficult for ABCP issuers that we do not believe there is any realistic possibility that the proposed rules will result in increased transparency of this market. Instead, we believe the loss of the regulatory safe harbors will achieve nothing beyond significantly curtailing the ABCP market, with resulting declines in liquidity and funding options for the customers this market has traditionally served.

G. <u>Resecuritizations also may be unable to comply with the proposed disclosure requirements.</u>

Resecuritizations, which we also discuss in Part II.B.8 above, are often structured as exempt offerings or exempt resales because they cannot easily comply with existing Commission disclosure rules applicable to registered offerings. The proposed disclosure rules applicable to registered offerings are significantly more burdensome, and extending them to the private markets would have the effect of making resecuritizations altogether impracticable. We believe all or nearly all resecuritizations of RMBS and CMBS issued before the implementation date of the new rules would have to be done without reliance on the Commission's exempt-offering and exempt-resale safe harbors, because the disclosure for the underlying securities will not be brought into compliance retroactively following the adoption of the new requirements,[157] and we believe the resulting limits on liquidity will deter the vast majority of these transactions. We appreciate the Commission's reluctance to allow new public offerings of securities that will not meet its new loan-level data and computer program requirements, but we fail to see how the same policy concerns would justify imposing the new requirements on private-market resecuritizations of securities that were issued before those rules were adopted. The Commission is not proposing that outstanding RMBS and CMBS would be unable to continue to trade in reliance on Rule 144A (or that RMBS and CMBS issued pursuant to an effective registration statement would lose their status as freely tradable securities) because the Commission is changing its disclosure requirements. We therefore see no appropriate basis for the Commission

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157 Resecuritizations after the implementation date of the proposed rules would be subject to the new requirements, regardless of whether the issuance of the underlying RMBS or CMBS predated the implementation date. Proposing Release at 23400 n.497.

to impose conditions on the use of its Rule 144A and Rule 506 safe harbors that may effectively eliminate resecuritizations of these legacy securities.

Compliance with the proposed disclosure requirements for resecuritization of RMBS and CMBS issued on or after the implementation date of the new rules would also present challenges, which would increase in proportion to the number of RMBS being resecuritized. The loan-level data and computer program requirements, which will be onerous for direct issuances of RMBS and CMBS, will be even more onerous for securitizations comprising multiple classes of underlying securities and will require the resecuritization issuer to take responsibility for disclosures it cannot audit or otherwise verify.

Although our strong recommendation, as indicated earlier, is that the Commission should add no condition to its exempt-offering and exempt-resale safe harbors that would require issuers of privately placed structured finance products to provide disclosures equivalent to those for registered public offerings, we believe that if the Commission nonetheless adopts any such condition, it should in any event acknowledge the difficulties the condition would pose in the context of resecuritizations. One practical solution would be to require that, for resecuritizations, the issuer covenant to forward to an investor, on request, all asset data files, periodic reports, computer programs or other information received by the resecuritization issuer with respect to the structure, assets and performance of the underlying securities, with no obligation on the part of the resecuritization issuer to produce or verify such information independently.

H. Just as a "one size fits all" regulatory approach does not work for ABS in general, it also does not work for the broad range of structures and vehicles that fall under the term "collateralized debt obligation."

As the Commission has indicated, problems in the CDO markets have been a key basis for the Commission's decision to propose changes to the Rule 144A and Rule 506 safe harbors for exempt offerings. However, as we have noted elsewhere, the term "CDO" or "collateralized debt obligation" encompasses a wide array of transaction structures and asset types, many of which were not implicated in the crisis and provide important support for corporate financing throughout the United States. Because we believe compliance with the Commission's proposed rules for transactions that rely on the private offering exemptions would be particularly problematic for CDOs, we are addressing these structures separately here.

1. *CDO structures refer more to a process of securitization than to a type of asset, and encompass disparate vehicles with very different risk profiles.*

CDOs are investment structures that pool a variety of financial assets and instruments, and finance the investment in that pool by issuing securities that are of varied seniority and take specified levels of pool risk. "Balance sheet" CDOs, which we believe present fewer issues in terms of Regulation AB compliance, generally involve the securitization by a bank or other financial institution of a pool of loans originated or held by that institution; and in this regard, they resemble many other types of bank-sponsored securitizations, such as auto-loan-backed ABS. Balance sheet CDOs frequently involve a static pool of assets, interests in which are sold to obtain liquidity for new lending and to manage the risk of certain credit exposures.

"Arbitrage" CDOs generally securitize a pool of assets acquired in secondary market trades specifically for the securitization and in many ways are more similar to hedge funds or other pooled investment vehicles than to typical ABS. "Synthetic" CDOs use credit derivatives to replicate the performance of a pool of assets and can be used either for balance sheet structures—especially where transfer restrictions may make a transfer of the pool assets unwieldy—or for arbitrage structures. The term "cash CDO" is often used to distinguish CDOs with a real pool of assets from those with a synthetic pool.

The earliest CDOs were structured in the late 1980s and early 1990s. These CDOs generally fell into one of two categories: CLOs, which were collateralized with interests in syndicated bank loans, and CBOs, which were collateralized with corporate bonds. Over time the CDO market has come to include a broader range of collateral, including emerging market bonds, subordinated ABS, MBS and other "multi-sector" collateral, REIT debt, project finance debt, distressed debt, trust preferred securities and, most recently, private equity and hedge funds, commodities and municipal finance.[158] However, despite the proliferation of other types of collateral, more traditional CLOs that invest almost entirely in senior secured corporate loans are a large sector of the CDO market and an important component of the corporate loan market as a whole. According to the Loan Syndications and Trading Association (the "LSTA"), from 2004 through the first half of 2007, CLOs purchased more than 60% of new institutional loans.[159]

CDO structures, like many other forms of securitization, are based on the premise that pools of financial assets perform in a predictable manner and that default rates, loss severity, recovery amounts and recovery periods can be reliably forecast. These forecasts consider historical data that indicate how categories of assets have performed over time and through various economic cycles, and they use that data to develop a capital structure with appropriate levels of credit enhancement to support the risk that investors are willing to assume.[160] The credit rating agencies that typically rate these transactions have developed various criteria and statistical methodologies and analyses to "stress" a pool of assets to determine the level of credit enhancement required for their respective credit ratings and have continued to modify those criteria to reflect market developments and current financial performance of the underlying assets, including in the most recent credit crisis. Where loss and recovery data is not available or

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158 The ability of CDOs, CLOs and other structured finance products to accommodate an assortment of financial assets and structures has made them an important source of liquidity for the financial markets.

159 See the LSTA presentation on "CLO's: Challenges … and Opportunities" (2010) (hereinafter, the "LSTA Presentation"), *available at* www.lsta.org/WorkArea/downloadasset.aspx?id=10522. Throughout this letter, except where the context indicates otherwise, we have used the term CDO to include CLOs.

160 It may be argued that in addition to the concentration of credit risk within subprime RMBS, the sizes of the tranches of a CDO's capital structure were erroneously calculated. *See* "Subprime and Synthetic CDOs: Structure, Risk, and Valuation," Dr. Elaine Buckberg, Dr. Frederick C. Dunbar, Max Egan, Dr. Thomas Schopflocher, Dr. Arun Sen, and Carl Vogel, NERA Econ. Consulting (June 3, 2010), *available at* http://www.nera.com/nera-files/PUB_CDOs_Structure_Risk_Valuation_0610.pdf. *See also* "DvD Insights – The Links Between CDS Spread and Default Probabilities," Donald R. van Deventer, *available at* http://www.riskcenter.com/story.php?alter=print&id=20234 (observing that the method by which default probabilities are calculated affects the assessment of CDS spreads and, therefore, risk).

reliable, credit enhancement is more difficult to assess and, as a result, there may be more risk to an investor.

CDOs are typically structured in a way that leverages the risks and returns of the related portfolio. A typical CDO would have a triple-A rated tranche, one or more additional investment-grade tranches, one or more non-investment-grade tranches and an “equity” interest (which might be in the form of subordinated debt) that would receive the residual cash flows from the structure and absorb first losses. Subordinate tranches provide credit enhancement for senior tranches.

For most cash CDOs, the collateral pool is actively managed by a collateral manager that selects the initial portfolio and makes trading decisions over the term of the transaction. The collateral manager, which may be an independent asset management firm or an asset management affiliate of a commercial or investment bank, a hedge fund or a private equity fund, provides the related investment advisory services to the CDO issuer. Accordingly, the collateral manager will be either a registered investment adviser or exempt from registration under the Investment Advisers Act of 1940. With the passage of the Dodd-Frank Act, we believe virtually all collateral managers for CDOs will be required to be registered with the Commission. Investors typically evaluate the collateral manager as the initial step in an investment decision.

Investors and credit rating agencies generally tend to evaluate the risk of arbitrage CDO structures on the basis of their investment parameters rather than their actual investments, which may not be known at the time of issuance and, at least in the case of managed CDOs, may change over time. The investment parameters are a set of requirements that the collateral must generally meet in order for the collateral manager to complete a trade, and they include the type of asset, diversity, weighted average rating, weighted average maturity, and weighted average spread/coupon, all of which are intended to ensure that the risk attributes of the portfolio are consistent with the loss and recovery assumptions on which the structure is based. CDOs often will allow principal proceeds to be reinvested in additional eligible assets during a specified reinvestment period and may continue to allow limited trading and reinvestment of sale proceeds after the reinvestment period. Most CDOs also close without having the portfolio fully “ramped”—meaning the collateral manager is still identifying and acquiring the initial pool of assets—and contemplate a post-closing “ramp up” period in which the balance of the portfolio assets will be acquired. In such a case, asset level data is less important than the guidelines for future investments and trading of such assets.

In addition to the active trading aspect of CDOs, a number of other aspects both of the structure and the process around these transactions make them very different from traditional ABS. First, as with other types of private fund structures, alignment of the interests of the collateral manager with the interests of the investors is a key component of the structure. Typically, the collateral management fee would be structured with senior and subordinate components (the subordinate fee being payable only if current debt service is met), as well as an incentive fee that is based on the lifetime performance of the transaction. Investors also often require the collateral manager to hold some portion of the equity tranche, with less-established collateral managers generally required to hold a larger portion for a longer period of time.

Second, in managed CDOs, the portfolio is typically acquired, for tax reasons, through secondary market trades, with little or no origination of assets by any party to the transaction. The transaction sponsor, typically an investment bank, will generally have exposure to the assets in advance of the securitization only by funding the warehousing of assets selected by the collateral manager in contemplation of the securitization, and will not be in the chain of title for the assets. The ultimate CDO issuer, typically an offshore "orphan" special purpose entity that is unaffiliated with any of the transaction parties, will often hold the portfolio even during the warehousing phase (especially for CLOs, due to the costs associated with transferring, as well as the administrative effort required to transfer, a loan portfolio).

Third, CDO investors actively negotiate the terms of the transaction, including the collateral manager fees, the structure of various tranches, collateral pool guidelines, cash flows, ratings, principal protections, interest rate basis and other criteria.[161] Although equity investors tend to be the most active investors in these negotiations, modifications are commonly made to the structure of every tranche of the transaction to meet the particular needs of the investors in those tranches.[162]

Fourth, managed CDOs do not fit within any of the exemptions from the Investment Company Act that would allow them to be issued pursuant to a registration statement, and therefore CDOs rely on the private fund exemptions, Sections 3(c)(1) and 3(c)(7), with Section 3(c)(7) being by far the preferred exemption. Accordingly, interests in these CDOs are generally sold only to qualified purchasers in the United States, or pursuant to Regulation S.

The most critical performance-based triggers in a CDO are two coverage tests, an overcollateralization ratio test and an interest coverage test. These coverage tests are intended to ensure that the structure maintains enough assets to support the ratings assumptions for the rated tranches and receives sufficient cash flow from interest collections to cover interest obligations and related administrative expenses. Failure to satisfy these coverage tests, which have different trigger levels for classes of different seniority, may have a number of consequences, including suspending the reinvestment period or diverting interest and principal proceeds from junior classes to accelerate repayment of the more senior classes. When these coverage tests come back into compliance, the reinvestment period may resume and the waterfall may return to its prior form.

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161 For example, one structural feature of CDOs that is included to accommodate investors is a combination security, which typically represents an interest in an investment-grade tranche and an interest in a non-investment-grade tranche or in the equity interest, all of which interests are treated as a single security. Combination securities enable investors to structure an investment with much of the security of a senior tranche, some of the upside of a junior tranche, and an intermediate rating that allows the combination security to fit within the investor's investment guidelines.

162 Monoline insurance companies that wrapped the senior tranches of CDOs were also active participants in the structuring of those CDOs.

2. *With fewer risks than other types of CDOs, CLOs have become essential to the availability of corporate loans and should be considered a separate asset class, notwithstanding structuring similarities.*

The performance of CLOs throughout the financial crisis has been generally consistent with, and reflective of, global economic conditions. Few investments of any kind in the capital markets have been immune to the effects of the financial crisis, and CLOs were neither an exception nor an outlier. As of November 2009, nearly 95% of the "AAA" rated tranches of CLOs remained at the "A" rated level or higher.[163] A Moody's publication notes that "[g]iven the sharpest economic contraction since the Depression, CLOs deteriorated largely as one would expect under such circumstances, with widespread downgrades, but few actual tranche defaults."[164]

As the economy stabilizes and the performance of the underlying corporate loans has improved, the performance of CLOs has likewise improved. In June 2009, over 50% of CLOs in the U.S. failed one or more their overcollateralization ratio tests, usually triggering protective features to divert cash flow to the most senior tranches. A year later, that number is down to approximately 15%,[165] as a result of both the strong relative performance of the underlying collateral over the past 18 months and structural features that improve those ratios as senior interests are paid.[166]

CLOs typically invest in pools of syndicated loans that are diversified across obligors and industries[167] and are structured so that disruptions within an industry or distress of a particular obligor would have a limited effect on the CLO's cash flows. The majority of corporate loans in which CLOs invest are broadly syndicated loans of large public companies. The broad syndication of corporate loans contributes to the general liquidity of these obligations, enabling managed CLOs to move in and out of positions. Significant amounts of financial and other

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163 *See* "U.S. CLO AAA notes remain relatively well rated" in the LSTA Presentation. In contrast, the same slide in the LSTA Presentation indicates that more than 90% of the "AAA" rated tranches of the ABS CDOs have been downgraded below investment-grade.

164 *See* Jeremy Gluck, "CLOs versus CDOs: It's the 'L' That Matters" (July 2010) ("Gluck CLO Article") at Moody's CLO Interest, *available at* http://v3.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_SF210409.

165 *See* "U.S. CLOs heal as loan market recovers" in the LSTA Presentation.

166 *See* Gluck CLO Article.

167 *See id.* For example, no corporate obligor may represent more than 2% of a CLO's investment portfolio, and no corporate industry may represent more than 12% of a CLO's investment portfolio. Conversely, the collateral comprising ABS CDOs was highly concentrated in subprime RMBS; and, as the housing market collapsed, the losses to the ABS CDOs were magnified because of this concentrated risk.

information about the obligor are generally available, and the loan market has developed mechanisms to support the restructuring of troubled loans and avoid defaults where possible.[168]

In addition, because these obligations are backed by large public companies, investors have at their disposal a variety of analytical tools to assess the risks of the corporate loans and, by extension, the cash flows to a particular CLO. Over the past eight years, the CLO industry has adopted software and internet platforms that provide investors with detailed information on the performance of CLOs and enable investors to model CLO cash flows under various default and recovery scenarios.[169]

Finally, cash CLO structures are relatively less complex than other CDO structures.[170] Cash CLOs generally have straightforward waterfall priorities for their liabilities and collateral types that are limited (e.g., corporate loans and bonds, first priority or subordinated, secured or unsecured). The CLO usually holds the actual corporate obligations and therefore may participate in any negotiations, typically through the collateral manager.

We believe CLOs should be considered an asset class that is separate from other CDOs and, in particular, from CDOs of RMBS. CLOs invest in a diversified pool of corporate obligations and do not have the concentration of risk that has plagued CDOs of RMBS. They serve an important function in the corporate loan market, providing liquidity[171] and ensuring this market remains robust.[172] CLO structures have been tested through several economic cycles and have proven to be resilient. They have evolved, and continue to evolve, through the efforts of industry participants.[173] Rating agency methodologies continue to be modified in response to the performance of CLOs in various economic environments. Market practices, also, have changed in significant fashion.[174] During the past three years, the CLO market has self-corrected by,

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168 *See* Gluck CLO Article (noting that the bank that serves as the administrative agent for a syndicated loan typically has a close relationship with the obligor on a loan and will monitor that loan and take steps to help the obligor avoid default).

169 *See* "A Sharper Focus" Hardeep Dhillon, Journal of Credit Risk, *available at*: http://www.journalofcreditrisk.com/public/showPage.html?page=94658 (Nov. 1, 2003). The private markets have been improving transparency in structured finance products. The analytic software provided by Intex is widely used by investors today in modeling the cash flows of various ABS, including CDOs and CLOs. *See also* Joy Wiltermuth, "New iBoxx Index Said to Offer View For CLO Investors" (July 14, 2010), at Total Securitization & Credit Investment, *available at*: http://www.totalsecuritization.com/Article/2630882/New_iBoxx_Index_Said_To_Offer_View_For_CLO_Investors.html.

170 While complexity is not necessarily indicative of a poorly performing bond, because of this complexity an investor may be more apt to miscalculate the risks of the investment.

171 *See* "U.S. CLO issuance and market share" in the LSTA Presentation (illustrating that from 2004 to 2007, CLOs purchased more than 60% of new institutional loans).

172 It should be noted that the consumer enjoys "downstream" benefits from a robust corporate debt market.

173 *See* Gluck CLO Article.

174 The LSTA notes that recent "new issue transactions have been driven by strategic equity investors who prefer larger investment size, partnership with a particular portfolio manager and customized product." *See* "2010 CLO primary market participants" in the LSTA Presentation. Furthermore, the LSTA provides that investors

among other things, moving away from riskier collateral, utilizing information sources like Intex and iBoxx, and improving the treatment of defaulted or impaired obligations.[175] Currently, for instance, the CLO market is shifting to very conservative assets. In the past, CLOs that consisted primarily of senior secured loans also permitted small baskets for second-lien loans, subordinated debt, and more esoteric assets such as ABS and credit-linked notes. Many transactions now permit only first-lien, senior secured loans and senior secured bonds.[176] Other aspects of the CLO market have also become more conservative, with higher quality assets overall and the amount of leverage employed by CLOs declining to a ratio of 4.5 to 1, compared to 2007 vintage CLOs that had an average leverage ratio between 10.1 and 14 to 1.[177] As we have suggested earlier, we believe investors are directly causing significant changes in the CLO markets to respond to issues identified during the financial crisis. We believe the CLO market should be allowed to continue to develop, with needed changes determined by investor demand.

3. *The Commission has not provided clear guidelines for CDO disclosures, and disclosures comparable to those that might be required for other asset classes may not be feasible for CDOs.*

The proposed rules essentially provide that issuers or sponsors of structured finance products must comply with the disclosure and reporting requirements under the Regulation AB framework for asset-backed securities as well as the additional information requirements under Regulation S-K in order to comply with the safe harbor provisions of Rule 144A and Rule 506 of Regulation D.[178] While the Commission has given some indications of the types of disclosure it would seek from CDOs,[179] there are important transactional features of CDOs that do not readily comport with certain other Regulation AB reporting requirements for ABS as to which the Commission should provide more definitive guidance. As a result, there is substantial doubt as to the feasibility of participants within the CDO markets to comply with *all* of the disclosure and reporting requirements of the proposed rules.[180]

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currently "view the cash flow based, non-recourse nature of CLO financing as an attractive and stable alternative to market value based structures." *See* "State of the primary CLO market" in the LSTA Presentation.

175 *See* Gluck CLO Article.

176 *See* "Snapshot: 2010 CLOs vs. Older Vintage Transactions" in the LSTA Presentation.

177 *See id.*

178 *See* Proposing Release at 23396.

179 *See id.*, which states:

"For a managed CDO offering, we would expect disclosure regarding the asset and collateral managers, including fees and related party transaction information, their objectives and strategies, any interest that they have retained in the transaction or underlying assets, and substitution, reinvestment and management parameters. For a synthetic CDO offering, we would expect, among other things, disclosure of the differences between the spreads on synthetic assets and the market prices for the assets, the process for obtaining the credit default swap or other synthetic assets, and the internal rate of return to equity if that was a consideration in the structuring of the transaction."

180 See also our discussion of this issue at Part VI.E above.

We have considered whether the transactional features of CDOs may be translated to the disclosure requirements under Regulation AB, and conclude that while there are certain disclosure items that CDO issuers may be able to provide, such as asset-level data in managed CDOs, the degree to which a CDO issuer is able to provide such information, if at all, will vary and will depend on the particular type of CDO, and there are other disclosure items for which there is no analogue. For instance, we are not sure who would be considered the originator of a syndicated loan that a CLO has purchased on the secondary market, or whether that should have any relevance. The presentation of static pool information or financial statements for loan obligors also would be problematic for CDOs. Furthermore, the collateral manager manages the pool of assets, but it does not service them.

We are also not sure how much of the information will be relevant or useful. In Item 1 of Schedule L to the proposed rules, the issuer of a CDO would need to provide general information regarding its structure, including the kinds of assets in which the CDO will invest; certain data regarding such assets such as outstanding principal amount, maturity, interest rate, payment dates and delinquency status; and the identity of the originator and the servicer. Most CDOs currently provide on a periodic basis to their investors detailed information that is similar to, but not the same as, the information being proposed by the Commission. However, this proposed information may have limited utility in predictive models; especially when considered in light of the incremental costs to the CDO in conforming such information to the format prescribed by the proposed rules. In managed CDOs, for instance, the actual portfolio characteristics will likely change (within the portfolio parameters established for the CDO) since the collateral manager usually has, and can be expected to exercise, the discretion to purchase and sell assets during the term of the CDO.

CDO issuers also may not be able to obtain, access or disclose certain types of information. Regulation AB generally contemplates a substantial connection between the ABS issuer and its sponsor or primary originator such that access to the credit characteristics of the underlying assets would be readily available. Because this connection does not exist in most CDOs,[181] the information that a CDO can obtain depends on one or more of the following factors: (i) access to current asset-level data where the obligor for such asset is not a reporting entity; (ii) whether the CDO has privity with such obligor and (iii) whether confidentiality obligations of the CDO preclude such disclosure. For instance, in order to avoid being considered to be engaged in a U.S. trade or business for tax purposes, arbitrage CDOs are generally prohibited from engaging in any sort of origination activity. As a result, these CDOs purchase their assets in the secondary markets from parties that may not have contractual privity

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181 As noted above, CDOs are generally structured as offshore special purpose entities that are "orphans"; i.e., the common shares of the CDO issuer are not owned by the "sponsor" of the CDO, unlike in typical ABS securitizations where an operating company or financial institution indirectly owns the ABS issuer. Furthermore, the affiliation of the CDO's "sponsor" will depend on how the CDO was structured. In many instances, financial institutions may have created the CDO, in others the CDO may have been created by the CDO's collateral manager, and in still others, the CDO may have been created by "reverse inquiry" (i.e., by direction of the primary investor of that CDO).

with the related issuer.[182] In the secondary markets, participants may have limited rights to request detailed information such as financial statements and may have little access to this information for non-reporting companies. The potential inability to access information is even more severe in the context of synthetic CDOs, where the reference obligation may not be owned by either party to the credit default swap. Therefore, a synthetic CDO issuer may not be able to provide as much information as a managed CDO issuer because it does not have the contractual right to demand information from the underlying obligors. With respect to confidentiality issues, in CLOs, for example, credit agreements and privately placed securities may have strict confidentiality provisions based on legitimate business purposes, such as keeping competitively sensitive financial information from the obligor's competitors.

Another impediment to CDOs and securitizations that repackage legacy assets is that such issuers may not be able to obtain the required information from the issuers of those legacy assets, especially with respect to existing ABS and CDOs that may have no provisions for holders to obtain the relevant reporting information. The proposed rules would require a complete "drill down" in relation to the legacy assets, such that an ABS CDO or a securitization with ABS in its asset pool must provide all the information that would be required if the legacy asset itself were being registered. While the market for repackaged ABS or CDOs is not as large as that of the primary issuance market, negating the ability to repackage these assets could significantly harm secondary liquidity for certain market participants.

I. <u>While we support the requirement for the use of proposed Form 144A-SF, we suggest that it be filed in lieu of filing the offering document with the Commission, that the content of the Form be revised and that the consequences of the failure to file a Form 144A-SF be clearer and less severe.</u>

The Commission is proposing to require the filing of Form 144A-SF as notice of the initial sales of structured finance products eligible for resale under Rule 144A. In general, we support this requirement as a means of enabling the Commission to monitor the scope of the private securitization markets and any developments in those markets, but we would suggest it as an alternative, rather than a supplement, to the proposed private market disclosure requirements.[183] Further, we believe the proposed content of the form should be reduced and the consequences of the failure to file should be clearer and less severe.

With respect to the content of the form, our view is that it should be significantly simpler than the proposed version. The Commission indicates that it expects the amount of time

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[182] This issue becomes even more problematic if the originator is a "20% originator" under Item 1110 of Regulation AB. It should be noted that proposed Item 1111(a)(3) may allow CDO sponsors to disclose their own criteria for assets in which the CDO invests; however, we believe the Commission should provide definitive guidance in this respect.

[183] We note that the Dodd-Frank Act will give the Commission substantial new powers to require the registration of and reporting by private fund advisers. To the extent possible, we would encourage the Commission to establish guidelines to ensure consistent reporting of matters that would overlap with the proposed Form 144A-SF disclosures.

necessary to complete each Form 144A-SF to be approximately two hours.[184] We believe the time to complete the Form would be significantly higher given the open-ended nature of the questions that it asks in Part 2, which could make it much more like a summary disclosure document. In addition, identifying the issuers of all underlying securities may disclose the proprietary investment strategies of some CDO managers or may duplicate information gathered by the Commission through its expanded powers to regulate investment advisers. Finally, we are concerned that too much information in the form (or the filing of the offering circular, as proposed by the Commission as an alternative approach) would raise general solicitation issues and may complicate resale by initial purchasers for transactions that have not been fully sold at closing. We believe a form that required only the names of the transaction parties, the names and principal amounts of the securities, the name of the asset class (such as auto loans) or category of securitization (such as CDO), and the name of a contact person who could provide the Commission with more information upon request would facilitate data collection by the Commission without raising other issues for the offering. As we discuss in Part VI.J, however, with respect to proposed alternatives to the Commission's proposed safe harbor restrictions, we believe that requiring an agreement as part of the form filing that the issuer will supplementally provide a confidential copy of the offering document to the Commission upon request could assist the Commission in gathering information about the quality and scope of private market disclosures for structured finance securities.

In addition, we believe that failure to file the form should not make Rule 144A unavailable for resales of "newly issued structured finance products of the issuer or any affiliate of the issuer" until the Form 144A-SF is filed. Would that restriction include the securities of the deal to which the failure related? How would "newly issued" be measured? Does the burden of this rule effectively fall on investors, who may not know that the Rule 144A exemption is unavailable? For offshore vehicles, would "affiliates" includes all entities managed by the same administrator, thereby potentially picking up thousands of unrelated offerings? We believe the proposal as drafted will create unnecessary uncertainty about the availability of the Rule 144A resale exemption. We would suggest, instead, the approach taken in connection with Rule 503 under the Securities Act, which provides for the loss of the exemption only if the Commission has obtained a court order enjoining the issuer or its affiliates as a result of their having failed to file Form D as required.

J. The Commission should consider alternative approaches to the private markets that will pose less risk of deterring capital formation.

As we have indicated, we believe the Commission should not impose disclosure conditions on its transactional safe harbors and should allow the private markets to continue to operate consistently with their fundamental premise, which is that sophisticated investors can fend for themselves in these offerings. As noted, however, we believe the Commission could take several alternative approaches, either singly or collectively, that would strongly influence

184 Proposing Release at 23406. (We believe as well that the number of proposed annual responses to this form requirement—716—either vastly underestimates the size of the Rule 144A market for structured finance securities under normal conditions or assumes that the proposed rules will have the effect of dramatically reducing the number of such offerings. *See* Proposing Release at 23407.)

disclosure practices in the private markets without requiring the equivalent of public disclosures and potentially impairing the regulatory safe harbors and the structured finance markets as a whole. Adoption of these alternatives would not restrict the Commission's ability to take stronger action in the future, such as the proposed safe harbor restrictions, if those were later determined to be necessary for part or all of the market, but would allow the Commission to evaluate those proposed restrictions with more information about both private market disclosure practices and the effects of the adoption of the Regulation AB amendments on public offerings of asset-backed securities.

1. *The Commission should consider sponsoring a pilot program for CDO disclosures.*

Offerings of CDOs are typically not registered with the Commission under the Securities Act because such offerings rely on statutory exemptions from the Investment Company Act that apply only to entities that issue securities that are not publicly offered. Most CDOs rely on the exemption from the definition of investment companies afforded by Section 3(c)(7) of the Investment Company Act, which applies to "[a]ny issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities."[185]

Pursuant to Section 6(c) of the Investment Company Act, the Commission has the ability to exempt entities from registration as investment companies "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter."[186] Many issuers of asset-backed securities rely on the exemption provided by the Commission pursuant to Rule 3a-7 under the Investment Company Act. Because most CDOs permit trading beyond what is allowed under Rule 3a-7, they have not been able to rely on this exemption, nor are they structured in a way that would allow them to satisfy the requirements of the Investment Company Act that apply to registered investment companies. As a result, CDOs have not been able to issue publicly even their most senior securities, and the CDO market has remained relatively opaque. We believe it would be possible for the Commission to design a pilot program to evaluate a possible exemption that would enable CDOs to issue registered, publicly offered senior securities and shed light on these structures while continuing to ensure that an exemption from the definition of investment company in this context remained consistent with the fundamental principles of the Investment Company Act. The Commission could require a very high minimum denomination, such as $250,000, for publicly offered securities (which could be limited to the most senior tranches) and require undertakings that any privately placed securities, such as equity tranches, would be offered only to qualified purchasers or pursuant to Regulation S.

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[185] 15 U.S.C. § 80a-3(c)(7).

[186] 15 U.S.C. § 80a-6(c).

We believe that such a pilot program would foster increased transparency for CDO structures for the Commission and the public, enhance liability standards, and allow the Commission to shape CDO disclosures through the iterative process it has used for other new products, while providing CDO sponsors the benefits of public registration. If the Commission ultimately determined to impose affirmative disclosure requirements on privately issued CDOs as a condition to reliance on the regulatory safe harbors, the pilot program would help ensure that such disclosure requirements were articulated with sufficient clarity to allow issuers to reasonably ascertain whether they were in compliance.

The Commission has previously allowed issuers to participate in pilot programs in which they work closely with the Staff to develop models for disclosures, with filings made public only at the point the disclosures have been finalized.[187] As we note elsewhere, the Commission has sponsored voluntary pilot programs relating to the use of XBRL coding in public company financial statements[188] and to the use of electronic proxy statement delivery. Pilot programs allow the Commission to explore proposed changes in dialogue with committed participants, developing insights into processes and issues that would not otherwise be available to it. We believe a pilot program for public CDO disclosures would provide benefits to all involved and critical guidance to the nature and scope of further rulemaking in this area.

2. *The Commission may wish to consider expanded use of proposed Form 144A-SF to develop an understanding of private market disclosure practices, while being careful to avoid confidentiality and general solicitation issues.*

Although we have made suggestions in Part VI.I above as to the use and requirements of Form 144A-SF, we generally support the data collection goal it would serve. We also believe the form could be used by the Commission to develop a deeper understanding of private market disclosures for structured finance securities.

As we have noted, we have concerns that mandating the public filing of an offering document from an exempt offering would raise significant general solicitation issues as well as issues related to confidential information included in the offering materials. Those issues do not arise, however, to the extent the offering document is furnished only to the Commission. The Commission could consider requiring a commitment from the issuer in a Form 144A-SF filing to furnish the offering document to the Commission upon request. To encourage the filing of Form 144A-SF, we suggest that the Commission indicate that confidential treatment requests related to such offering documents would be granted routinely. We note that under the Dodd-Frank Act, the Commission's ability to maintain the confidentiality of certain documents is enhanced. The Staff could select offering documents for review to gain a deeper understanding of the structured finance securities being offered in the private markets and to determine whether such securities were offered in compliance with Rule 10b-5. In addition, we believe the possibility of such review might serve to elevate disclosure standards throughout the private markets.

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187 *See, e.g.*, the discussion in Part III.E above.

188 *Id.*

3. *The Commission could require that private offering documents include a legend indicating that the disclosure does not meet the standards of Regulation AB.*

A further alternative would be to require the issuer of a structured finance security to provide a legend on the offering documents indicating that the disclosure did not satisfy the standards set by Regulation AB. Although this requirement would not affect the disclosures provided in the same way as the Commission's proposals, the legend would put investors on notice that the disclosures were less complete than those for a transaction registered under the Securities Act, without precluding private offerings, such as resecuritizations of RMBS issued before the effective date of the final amendment, where specific disclosure requirements simply could not be met. Such a legend could also be supplemented with risk factor disclosure, as appropriate.

A more onerous version of this type of approach would be to require issuers to list those disclosure items that would have been required in a public issuance but that the issuer has not provided (or, with respect to periodic reports, does not intend to provide). Such a "negative disclosure" list would allow investors to consider the nature and extent of such omissions and whether they were comfortable making an investment decision on that basis. It would also assist transaction participants in evaluating the totality of the omitted disclosures in light of Rule 10b-5.

The inclusion of a "negative disclosure" list would complicate the marketing of a transaction, but may increase the pressure on the transaction sponsor to provide comprehensive disclosures. If the Commission feels a need for a stronger notification to investors about disclosure gaps than that provided by the proposed legend, such a list would be a possible alternative, and would be preferable to mandating Regulation AB disclosures for the many transactions that will not be able to provide them.

VII. TRANSITION ISSUES

As discussed above, we understand the Commission's desire to make changes to Regulation AB and the offering process for ABS in order to address some of the shortcomings in existing securitization practices identified in the recent financial crisis. The Commission recognizes, however, that some of its proposed amendments, including asset-level and data-tagging requirements, may initially impose significant burdens on sponsors and originators as they adjust to the new requirements, particularly with respect to how information relating to the pool assets is collected and disseminated to various parties along the chain of securitization.[189] While expressing its belief that compliance dates should not extend more than one year past the effective date of the final amendments, the Commission seeks input about feasible dates for implementation of the proposed amendments. The Commission further notes its expectation that, if adopted, the new and amended rules, including the asset-level information requirements and the changes relating to privately issued ABS, would apply to ABS issued after the final

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[189] Proposing Release at 23400.

rules' implementation date (and with respect to resecuritizations, without regard to whether the issuance of the underlying securities predates the implementation date).[190] While we appreciate the Commission's views, we are concerned that too short an implementation period, especially at a time when the securitization industry is attempting to adjust to all of the other regulatory changes affecting market participants (including the myriad changes imposed by the Dodd-Frank Act, the FDIC's proposed changes to its securitization safe harbor, the SEC's new Rule 17g-5, and the changes effected by Statements of Financial Accounting Standards Nos. 166 and 167 issued by the Financial Accounting Standards Board ("FASB")), will impede, rather than facilitate, the resumption of a robust securitization market.

A. <u>Market participants will need significant time to implement the sweeping requirements of the proposed rules.</u>

When Regulation AB was adopted in December 2004, industry participants were given a transition period of more than one year to implement the final regulation, notwithstanding that many provisions of Regulation AB were simply codifications of existing practices. In contrast to the original Regulation AB, the proposed rules are not largely a codification of existing practices. If adopted in their current (i.e., proposed) form, the proposed rules would impose more burdensome requirements on originators, sponsors and other transaction parties than the original Regulation AB, including the development, testing and filing of waterfall computer programs; the compilation and filing of static pool data on EDGAR (rather than the maintenance of such information on sponsors' web sites); the collection and filing of asset-level disclosure in connection with the issuance of ABS and on an ongoing basis, including, for RMBS, some 130 to 150 data points and for credit card issuers "grouped" asset-level data that has never previously been collected and provided to investors; ongoing Exchange Act reporting; changes in the offering process; and the drafting of appropriate disclosure for privately issued ABS.

The changes imposed by Regulation AB required expensive and extensive systems modifications to support different reporting and disclosure standards (with requirements for static pool data being an important example), contract modifications to ensure that the appropriate servicer statements of compliance and accountant attestations could be obtained, procedural changes to implement revised servicing standards and, of course, the drafting of new disclosure for offering documents. While some issuers determined that compliance with Regulation AB would be too costly, given the nature and size of their securitization programs and instead chose to rely on either the Rule 144A market or true private placements (for instance, private placements to asset-backed commercial paper conduits), for the most part, sponsors, originators, servicers and other transaction parties were willing and able to make the required investments in their systems, processes and practices in order to participate in what was then a thriving and robust securitization market. We are concerned that participants will be unwilling or unable to devote the personnel, time and funds needed to comply with the sweeping changes included in the proposed rules when faced with a very real concern about whether such investments can be recouped in the present securitization market.

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190 *Id.* and n.497.

We believe that issuers, in particular, will need significant time to develop processes for collecting and implementing the new data requirements, preparing and testing waterfall computer programs (if retained) and drafting the required new disclosures. For example, the proposed rules largely adopt the data points developed for RMBS by the American Securitization Forum as a cooperative industry effort to standardize disclosure and ongoing reporting on RMBS transactions. However, at the time of their adoption, the ASF disclosure and reporting packages were aspirational in nature. We are not aware of any industry participant that is currently providing periodic reports using those data points, and we believe that few, if any, participants, have in place systems to support that level of disclosure.

We note, as discussed in more detail below and elsewhere in this letter, that the Dodd-Frank Act requires a transition period for the joint rules relating to credit-risk-retention requirements of one year for securitizations backed by residential mortgage loans and of two years for securitizations backed by all other asset classes. Implementation of the credit-risk requirements will take far less time than the other complex requirements imposed by the proposed rules. Accordingly, we urge the Commission to work with the industry to adopt appropriate transition periods that will allow market participants a substantial period of time to develop the systems and processes necessary to comply with the final rules and thereby facilitate resumption of a robust securitization market.

As noted in more detail in Part III in our discussion of the waterfall computer program, we believe that the cost, timing and testing issues for the waterfall computer program will be significantly more than those estimated by the Commission, even assuming that industry participants can find the necessary technical support for developing, implementing and maintaining the programs. If the waterfall computer program requirement is nonetheless retained in the final amendments to Regulation AB, we urge the Commission to consider a trial period program with issuers that volunteer to participate in the program, much like the trial period program the Commission utilized in connection with the adoption and implementation of Regulation AB. At the end of the trial period (assuming that it is successful), the Commission could then adopt a final waterfall computer program requirement that takes into consideration the experiences gained during the trial period.

B. Securitization of legacy assets (including ABS issued before the implementation date) should be exempt from the disclosure requirements with respect to assets originated and ABS issued prior to the effective date of the amendments to Regulation AB.

As we discuss in more detail elsewhere in this letter, we believe that the securitization of legacy assets, including ABS issued prior to the effective date of the final amendments to Regulation AB, will become extremely difficult, if not impossible, except in transactions that are issued in reliance on the exemption provided by Section 4(2) of the Securities Act. In many cases, the legacy assets will have been acquired by the sponsor long before the Commission has issued the proposed rules, and in many instances the originator of the assets is no longer in business, or the assets were acquired under contracts that do not entitle the sponsor to obtain or disclose the type of data and other information required by the proposed rules, or the transaction in which legacy ABS were issued will no longer be filing reports pursuant to the Exchange Act (for registered issuances of ABS) and, in any event, the underlying transaction will not have complied with revised Regulation AB. In each of these cases, the sponsor likely will be unable to obtain all of the data and other information necessary to comply with the disclosure and reporting requirements of the proposed rules. In addition, with respect to legacy ABS, not only would a sponsor be obligated to provide the waterfall computer program (if that concept is retained in the final amendments) for the new transaction, it also would need to develop a waterfall computer program for the underlying ABS, which then might well need to be integrated into the resecuritization waterfall computer program.

In order to allow holders of legacy assets to finance such assets through the securitization markets, we believe that legacy assets should be exempt from the loan-level data and waterfall computer program requirements, as well as any required disclosure that the sponsor in good faith cannot provide. In the alternative, the Commission should provide for a multi-year phase-in period for these requirements as it applies to legacy assets.

C. <u>The final amendments to Regulation AB should be coordinated with mandated joint rulemaking efforts imposed by the Dodd-Frank Act.</u>

Section 941 of the Dodd-Frank Act provides for the adoption by the Commission and the federal banking agencies of rules implementing that Section's risk-retention requirements, including appropriate exemptions and adjustments, with such regulations to become effective, with respect to RMBS transactions, one year after the date on which such rules are published in the Federal Register and, in the case of all other asset classes, two years after the date of publication of such rules. Section 945 of the Dodd-Frank Act also requires the Commission to issue, within 180 days after the date of enactment of the Act, rules requiring issuers of registered ABS to perform a review of the assets underlying the ABS and to disclose in the registration statement the nature of such review. Section 941 also requires the Board of Governors of the Federal Reserve System, together with the Commission and the other federal banking regulators, to conduct a study of the combined impact on particular asset classes of the risk-retention requirements of the Dodd-Frank Act and FASB's Statements of Financial Accounting Standards Nos. 166 and 167, and to submit the report to Congress within 90 days after the date of enactment of the Dodd-Frank Act.

The requirements of the proposed rules are, in certain key respects (particularly as to such matters as risk retention and disclosure), materially different from the requirements of the Dodd-Frank Act, as well as those sought to be imposed by the FDIC in its proposed securitization safe harbor rule. We consider it critically important that all governmental efforts to reform securitization coalesce around a single set of requirements that are consistently applied across regulatory agencies. We therefore urge the Commission to adopt an implementation time frame for compliance with its final amendments to Regulation AB that takes into consideration these additional rulemaking processes and regulatory developments.

VIII. CONCLUSION

For the reasons set forth above, our key suggestions, among others, are that the Commission:

1. Limit any additional disclosure requirements to "hard" data points in connection with securitization transactions, such as MBS, having a relatively limited number of high value assets, but permit issuers to elect in their discretion to include "soft" data points.

2. To the extent the Commission requires disclosure of "soft" data points or issuers elect to include such information, permit issuers to qualify such disclosures, and provide that such disclosures are outside the scope of the issuer's liability except to the extent that such statements are known to be false.

3. For hard data points, make clear that issuer liability is limited to errors in disclosure that are material to the transaction as a whole.

4. Permit issuers to group data points in such a manner as will minimize the risk of compromising proprietary pricing and credit evaluation information.

5. Limit asset-level disclosures to those asset classes for which it is best suited, such as RMBS and CMBS, and eliminate that requirement for asset classes such as automobile loans and leases, student loans, equipment-backed ABS (other than ABS backed by transportation equipment), floorplan receivables, and resecuritizations, for which such disclosure is unsuitable or unobtainable.

6. Eliminate the proposal to require a waterfall computer program or defer any requirements for waterfall computer program disclosure until, at a minimum, a pilot program has been successfully completed.

7. Permit issuers greater flexibility as to the computer language in which any required waterfall program may be provided.

8. Limit any such programs to those that set forth the mechanical means by which assets received by the issuer are to be allocated, rather than requiring disclosure of any predictive models.

9. Clarify that any discrepancy between the allocations set forth in the transaction documentation and those that are inherent in the design of the computer waterfall program will be resolved by reference to the transaction documentation.

10. Provide a meaningful hardship exemption for issuers that are unable to provide a functioning program on a timely basis.

11. Preserve the availability of shelf registration for ABS.

12. For RMBS transactions, allow issuers to provide stronger and more detailed enforcement mechanisms in their transaction documents in lieu of the obligation to obtain third-party repurchase opinions on a quarterly basis, and eliminate the third-party opinion requirement altogether for other asset classes.

13. Require the issuer of the securities, rather than an officer, to provide any applicable confirmations relating to credit quality.

14. Shorten proposed "speed bumps," especially with respect to disclosure changes, and create a category of programmatic issuers that are well known to investors and to which such speed bumps would not apply.

15. Refine the definition of structured finance products to exclude structured notes, covered bonds, hybrid capital securities, private investment fund securities and other securities that may inadvertently be swept up in the definition.

16. Exempt ABCP from the proposed restrictions on safe harbor reliance.

17. Adopt alternative approaches to monitoring and enhancing private market offering disclosures, such as creating a pilot program for CDO disclosures, using Rule 144A-SF to facilitate review of offering documents, and requiring that offering documents that do not provide Regulation AB-compliant disclosures include a legend to that effect (or, alternatively, a list of the specific disclosure items that have not been addressed).

18. Exempt securitizations of legacy assets, i.e. those originated prior to the implementation date of the final amendments, from any requirements to disclose or report information about the legacy assets that would not have been part of the origination of those assets.

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The Committees appreciate the opportunity to comment on the proposal, and we respectfully request that the Commission consider the recommendations set forth above. Although we have approached the proposals with the goal of discussing them in the level of detail they deserve, their scope—and the many competing legislative and regulatory initiatives affecting securitization at the same time—have resulted in certain issues being left unaddressed. We are prepared to meet with the Commission and its Staff to discuss these matters with them in more detail and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
Jeffrey W. Rubin
Chair, Committee on Federal Regulation of Securities

/s/ Vicki O. Tucker
Vicki O. Tucker
Chair, Committee on Securitization and Structured Finance

Drafting Committee:
Ellen L. Marks, Chair of the Drafting Committee

Robin Abraham
Maggie Anderson
Amanda Baker
James Baker
Witold Balaban
Giselle Barth
Rudene Bascomb
Melinda Beres
Kevin Blauch
Willis Buck
Kevin Buckley
Eric Burner
Erick Carlson
R.J. Carlson
Joseph Carney
Zachary Carrier
Pauline Christo
Mark J. Ditto
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Gabriel J. Edelson
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Rafal Gawlowski
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Karsten Giesecke
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J. Michael Hinchcliffe
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Kevin Johnson
Melissa Kilcoyne
Jonathan Kim
Mina Kim
Siegfried Knopf
Kenneth Kohler
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Jason Kravitt
John C. Krocak
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Katrina Llanes
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Carol McGee
Janette McMahan
Kenneth Morrison
Cristeena Naser
Jonathan A. Nunes
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Dean Pettinga
Anthony Pijerov
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Todd Plotner
Vaughn Reynolds
David Rich
John Rickenbacker
Daniel Ro
Carlos Rodriguez
Daniel Rossner
William Rothschild
Jeffrey W. Rubin
Faten Sabry
Kelly Schell
Susannah Schmid
Stuart Schroff
Steven L. Schwarcz
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Boris Segalis
Louis Shansky
Jacob Sheehan
Wendy Spanbauer
Bill Stutts
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Jon Van Gorp
Stephen T. Whelan
Craig A. Wolson
Sara Whyte
Chae Yi

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Paula Dubberly, Deputy Director, Division of Corporation Finance