July 27, 2010

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

      RE: File Number S7-08-10

Dear Secretary Murphy,

Introduction

Transparency has long been recognized as a critical factor in creating efficiencies in markets. The Truth in Securities Act, or the Securities Act of 1933, strove to ensure transparency in corporate reporting as one of its central precepts. The Securities Exchange Act of 1934 addressed transparency in the equity market and laid the foundation for a marketplace with equal access for all investors. In the years since, the United States equity market has become a model of efficiency and transparency upon which many newer markets have been based. Investor confidence has been instilled through disclosure of corporate information, open access to traded equity prices, and daily closing prices for valuation of investments.

The recent financial crises have shaken the confidence of investors and threaten the efficiency of the public security markets. At the center of the controversy are a host of securities, such as mortgage backed securities (MBS) and collateral debt obligations (CDOs), that rely on complex structuring that transforms more basic products into new securities with vastly different pricing and risk characteristics than the original ones. Limitations on access to information regarding these complex and sometimes illiquid securities have put at risk the basic principles of the Truth in Securities Act. Specifically, access to information about many of these structured securities' terms and conditions, traded prices, and closing prices or fair market valuations are not accessible by all market participants. As a result, opacity has been added to the security markets, as well as to the financial institutions that hold these securities. The current crises have demonstrated the need for transparency to broaden from companies and corporate reporting to any and all securities offered for sale in public security markets.

MSCI inc. is a leading provider of investment decision support tools to investors globally, including asset managers, banks, hedge funds and pension funds. MSCI's products and services include indices, portfolio risk and performance analytics, and governance tools. MSCI supports the Securities Exchange Commission's proposed rule file number S07-08-10, entitled "Asset Backed Securities."

In the sections below, we respectfully submit our comments for consideration.

Data Disclosure and Reporting Practices

Securitization has transformed the process of financial intermediation. Since its inception and until the recent financial crisis, the market for asset backed securities (ABS) had experienced steady growth, with an increasing demand for ABS products. However, in the recent market turmoil, ABS holders suffered significant losses, and the ABS market has been relatively dormant since. Attributable in large part to the current state of opaqueness in data disclosure and reporting policies, many investors were not completely aware of the risk in the underlying mortgages within the pools of securitized assets. Hence, given the inherent complexities in the ABS asset class, including contractual complexities, demystifying the structural and collateral characteristics through transparent data disclosure is essential to understanding the allocation and transfer of risk among the different parties involved in an asset-backed transaction.

The current proposal is reasonably substantive and is a step in the right direction. However, it is vital to note that any such overhaul of current practice would work effectively only if viewed as an iterative process rather than a one-step fix.

We commend the SEC for the current proposal of a standardized and homogenous asset-level reporting system. Furthermore, in the case where no industry standard exists, setting a novel standardized disclosure norm is an exercise worth pursuing.

In what follows, we provide some broad comments:

- We welcome the SEC's proposed requirement of ABS issuers to file standardized "loan level information" about the specific loans in the pool, both at the time that the asset is securitized and on an ongoing basis. Given the intricacy of the ABS structures, this would be a highly effective tool for investors to assess better the risk associated with the collateral and the ABS structure.
- As proposed, providing "grouped" asset data for ABS backed by credit cards and charge cards would be an effective approach. The increased number of records at the Asset level may not add any significant and commensurate value to the analysis.
- Expanding the current scope of the disclosure requirement to include representative order statistics at the asset level will be a helpful addition. For instance, it will be useful to know the minimum and maximum FICO scores, as well as the minimum and maximum account balances, on the credit card accounts underlying the ABS issuance. This would provide additional clarity in terms of valuing the asset pool while simultaneously preserving privacy of the obligors.
- Basic descriptive statistics, such as the mean and median of the aforementioned asset-level data fields, among others, could be used for further analysis.
- One approach to obtaining "grouped level" data to deal with the potentially large number of accounts backing the credit and charge card pools is to use a clustering algorithm that would reduce the large set of records to a smaller and more parsimonious group, while still preserving much of the underlying trend information. Hence, data reporting at the cluster level (i.e., averages or weighted averages among the records comprising each cluster) would be a useful measure of the credit quality of the corresponding ABS. The clustering algorithm could be based either on a quantitative measure (such as an appropriate distance metric) or on a qualitative measure (such as a rule-based metric). The specific algorithmic details would need to be examined, as well.
- Knowledge of the obligor's employment status, level of education, and debt-to-income ratio might be indicators to some degree of their level of credit risk. However, as far as the data coding scheme is concerned, it would be preferable to provide the information in a consistent format, i.e., in an ordinal fashion (where there is a logical ordering to categories, such as the likert scale) for all such data types.
- Disclosure of static pool data delineating historical performance statistics of previously securitized pools will enable investors to evaluate collateral performance. This would facilitate the detection of pool asset performance trends that may not be evident from aggregate data.

Alongside the need for increased transparency and standardization in the data reporting structure of ABS offerings, a parallel and perhaps more challenging goal is to reduce the complexity of ABS products. For instance, one possibility is to decrease the number of tranches or bond classes. Another possibility is to increase the level of collateral homogeneity required to securitize. Increasing collateral homogeneity would minimize the issuer's ability to engage in risk-layering practices.

Although one might argue that the inherent complexity in ABS transactions is driven primarily by investors' appetites for higher yields and innovative risk-budgeting mandates, it is essential to realize that the recent market turmoil has underscored the urgency for more effective risk control. Reducing, not compounding, the complexity inherent in such instruments would go a long way

toward achieving that goal. As with any new endeavor, a reasonable amount of time would be required to adapt to new standards, but considering the benefits that the new standard could reap, it could be time well spent.

The Prospectus as a Document for Automation

Given that the waterfall[1] is a fundamental determinant of cashflow behavior, understanding how the waterfall affects a given tranche under different economic scenarios is paramount for developing an informed valuation assessment. Yet, waterfalls are often extremely complex, usually containing layered references to other structural aspects of the SPV[2]. Offering a facility for automated cashflow generation would promote clarity as to the actual behavior of a tranche in a given scenario, even if the waterfall itself were not well understood.

Rather than requiring collateral data submission in XML format and waterfall specifications in Python, a nonproprietary XML-Schema-based standard could be established to describe all structural aspects affecting cashflow behavior. If structural aspects are declared according to an XML standard, the development of automatable services such as cashflow generation, document validation[3], and acceptance testing can proceed in any programming language, under any license.

The primary aim is to decouple the semantic rules governing the declaration of structural entities from the layer of software that implements their behavior. Essentially, by separating declaration from implementation, evolution in the underlying software architecture is accommodated. It also facilities the development of both proprietary and open-source components.

Otherwise, as the Python language itself evolves, there eventually will be a repository of Python-based waterfalls that, unless carefully maintained and tested, will not function properly. Furthermore, if every issuer submits not only the Python-based waterfall but also the other requisite software (e.g., an SIFMA[4]-compliant cashflow generator), it will be difficult to standardize the quality of these components across the industry, notwithstanding the duplication of the same feature set in disparate code bases.

The process of creating a prospectus for automation services to consume is a multistage workflow, where each stage declares a structural component of the SPV. Elements declared in one stage can reference elements declared in another stage. Failure to complete any required stage would invalidate the prospectus for automation.

The result of each stage is an XML document fragment that conforms to a nonproprietary XML Schema specification. Due to the complexities inherent in these structures, a bottom-up approach, where actual issuance is used for vetting proposal candidates, is recommended for standards development.

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[1] The set of rules that map cashflows from collateral and credit enhancement facilities to tranches
[2] Special Purpose Vehicle (the legal entity that the prospectus describes)
[3] Two layers of document validation are often required: a schema (data structure) layer; and a business logic (complex rules) layer.
[4] Securities Industry and Financial Markets Association

Stage 1 — Declare Reference Rates

Most SPV structural elements such as collateral, tranches, and credit enhancement facilities depend on interest rates. For example, coupons for Adjustable Rate Mortgages and floater tranches can depend on benchmark rates such as COFI[5] and LIBOR. Also, SPVs often contain interest rate derivatives such as swaps and caps. These types of derivatives are employed to mitigate basis risks (e.g., ARM collateral depends on 6-month LIBOR, but tranches depend on 1-month LIBOR). The reference rates must be declared in a manner amenable to automated consumption by other structural aspects.

Stage 2 — Declare Collateral

SPV collateral can consist of any of the following:
- Pools of contractual receivables (e.g., residential mortgages, auto leases, mutual fund 12B-1 fees)
- Securitized pools without structured waterfalls (e.g., MBS Passthroughs)
- Tranches of SPVs with structured waterfalls (e.g., CMO Tranches)
- Credit derivatives and synthetic instruments (e.g., CDS securities)

The submission of an asset-level data file would further the aim of an executable prospectus, although the asset-level data file alone is not sufficient for full specification of the collateral for automation purposes. There should be a standard for reporting other types of collateral, such as securitized pools and REMIC[6] tranches. Furthermore, the dependency on specific reference rates must also be declared.

Stage 3 — Declare Credit Enhancement Facilities

SPV credit enhancement facilities come in various forms, a few of which are as follows:
- External lines of credit
- Capital reserve funds
- Interest rate derivatives
- Pool-level and loan-level insurance
- Collateral performance triggers

Each type of facility, if employed in the structure, is important in determining the overall behavior of the tranches.

Stage 4 — Declare Tranches

In this stage, each tranche's notional, reference rates, coupon structure, and controlled amortization features (e.g., TAC/PAC/NAS schedules) must be specified appropriately.

Stage 5 — Declare Waterfall

Waterfalls consist of the following:
- Principal and interest distribution rules
- Writedown rules
- Performance trigger effect on distribution rules

Even for relatively simple structures, waterfall descriptions can be complicated, warranting a test-case-driven, bottom-up approach for standards development.

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[5] Cost of Funds Index
[6] Real Estate Mortgage Investment Conduit (the primary securitization vehicle for RMBS)

Stage 6 — Declare Economic Scenarios

Another prerequisite for automated cashflow generation is the specification of economic scenarios and collateral behavior under those scenarios. This usually entails projecting interest rate levels and the corresponding prepayment, default, and loss rates. Once the interest rate and collateral behavior (e.g., SMM[7], MDR[8] loss severity) paths have been specified, then cashflow generation consistent with SIFMA specification can ensue.

Stage 7 — Report Cashflow Forecasts and Model-Based Valuations

Once cashflows are reported in a standard format, they can be used by another layer of software that performs valuation services. Ultimately, the goal is to transform a set of cashflow forecasts into valuations. This process could be handled by a specialized layer of software that employs various valuation methodologies.

Open Source Initiative

We advocate an open-source project that would prototype the proposed standards. The open-source software development paradigm is a powerful initiative and is transforming software development and distribution around the world. Furthermore, prototyping a standard in a sandboxed environment could help uncover design issues earlier. We also recommend the creation of a nonprofit or similar organization to help lead the development effort under an open-source license[9] and to house the resulting intangible assets.

Below is a list of automation services that could grow around the core XML standards:
- Validation engines (validate instance documents and test the output of the waterfall engine)
- Waterfall engines (SIFMA-standard compliant)
- Pricing engines (model-based valuation)
- Rendering and user-interface engines

Python would be an excellent candidate for implementing these automation layers, but it would not be suitable for waterfall declarations.

Respectfully submitted,

Will Gajate,
Srinivas Maloor,
Phil Jacob,
Martin Nemeth

MSCI Inc.

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[7] Single Monthly Mortality
[8] Monthly Default Rate
[9] An open license, such as the GNU Public License or the Apache 2.0 License