Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: 212 773 3000
www.ey.com

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

1 August 2011

Credit Risk Retention
(Release No. 34-64148)
Commission File No. S7-14-11

Dear Ms. Murphy:

Ernst & Young LLP is pleased to comment on the Securities and Exchange Commission's (SEC or the Commission) proposed rule *Credit Risk Retention*. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) required regulators to establish rules requiring a securitizer to retain at least 5% of the credit risk of asset-backed securities (ABS). In response, the SEC and other regulators (collectively, the Agencies), including the Federal Reserve and the Federal Deposit Insurance Corporation, jointly issued a rule proposal that would apply to sponsors of an ABS securitizing entity regardless of whether the offering is registered with the SEC under the Securities Act of 1933 (Securities Act).

Our comments are limited to (1) the possible consolidation accounting ramifications of the horizontal risk retention option and (2) the proposed agreed upon procedures report from an independent public accounting firm that would be required for a sponsor using a representative sample as a method to retain risk in the securitized assets. The agreed upon procedures report would comment on whether the sponsor has the necessary policies and procedures to ensure that it complies with the proposal's requirements for constructing and maintaining the representative sample.

Possible consolidation accounting ramifications of the horizontal risk retention option

The proposal asks whether the SEC and other agencies that proposed the rule should consider any additional factors, such as accounting or cost considerations, with respect to horizontal risk retention. We believe a retained horizontal risk interest, in and of itself, would not change how reporting entities and accountants approach consolidation evaluations under ASC 810, *Consolidations*. Rather, reporting entities and accountants will continue to carefully consider the sponsor's interest in the context of the purpose and design of each securitization entity when applying the consolidation guidance.

As a matter of background:

- Securitization entities generally meet ASC 810-10's definition of a variable interest entity (VIE), because securitization entities typically do not have sufficient substantive at-risk equity and (or) the equity holders, as a group, lack the ability to direct the activities that most significantly impact the VIE.
- To consolidate a VIE, an enterprise must have a controlling financial interest in the VIE that is demonstrated by having both (1) **power** to direct the activities that most significantly impact the VIE's economic performance and (2) **benefits** that could potentially be significant to the VIE.
- To meet the power criterion, a sponsor's contractual right to direct the VIE's most significant activities (typically via a decision-maker fee arrangement) must itself be a variable interest.

Decision-maker arrangement

In its consolidation evaluation, a sponsor (or decision maker) would first consider whether its decision-maker fee arrangement gives it power through a variable interest. The guidance in ASC 810-10-55-37 requires a sponsor to consider (among other criteria) whether it holds other interests (e.g., a retained interest) that would absorb more than an insignificant amount of the securitization entity's expected losses or expected residual returns. If so, the sponsor's decision-maker arrangement would be a variable interest. In that circumstance, the sponsor would likely consolidate the securitization entity because it has both power (via the variable interest decision-maker arrangement) and benefits that could potentially be significant to the securitization entity (via the decision-maker fees or other retained interests).

Due to its relative subordination, a retained horizontal risk interest would expose the sponsor to more than an insignificant amount of a typical securitization entity's expected losses or returns. Therefore, the sponsor's decision-maker arrangement would be a variable interest. Consequently, the sponsor would meet the first characteristic of a controlling financial interest since its variable interest conveys **power** to direct the activities that most significantly impact the securitization entity. In addition, the retained horizontal interest, aggregated with any other retained interests, would likely absorb losses that could potentially be significant to the securitization entity (**benefits**). In that circumstance, the sponsor would consolidate the securitization entity.

Compared with other options described in the proposal, the subordinated nature of the horizontal risk retention option exposes the sponsor to additional expected losses. As noted above, when such exposure is more than insignificant, the sponsor would consolidate the securitization entity. Nonetheless, a sponsor would evaluate consolidation the same way for other proposed risk retention options (e.g., vertical, L-shaped).

We understand the FASB will soon issue an exposure draft to amend certain aspects of ASC 810 to clarify when a decision maker (i.e., the sponsor) is acting in the capacity of a principal (i.e., should consolidate) or an agent (i.e., should not consolidate). Based on the Board's decisions to date, purpose and design, as well other specific concepts within ASC 810, will remain relevant including (1) the sponsor's remuneration (decision-making fees), (2) exposure to variability and (3) certain rights held by others (e.g., kick-out rights). We understand the analysis will involve a holistic evaluation of all three factors. However, we also understand that exposure to significant variability from subordinated interests would, absent substantive kick-out rights, be indicative that the sponsor is using its power in the capacity of a principal (and thus would consolidate). Consequently, the Agencies should be aware that a retained horizontal risk interest may not result in a different conclusion from current US GAAP.

Related parties and de facto agents

We believe a risk retention requirement that prohibits the sponsor from selling, transferring or otherwise encumbering its interest may have an unintended consequence of creating a de facto agency relationship between the sponsor and other investors in the securitization entity. A de facto relationship results in a higher likelihood the sponsor would consolidate the securitization entity.

ASC 810-10-55-37A requires a decision maker (i.e., sponsor) to consider not only its own aggregate interests but also the interests of its related parties and a broader group of parties known as de facto agents when evaluating whether the decision maker has power through a variable interest. As defined in ASC 810-10, de facto agents include, among other criteria, parties that cannot sell, transfer or encumber their interests in the securitization entity without prior approval (lock up arrangements) of another party. In these situations, both the constrained party and the party requiring the constraint are considered de facto agents. ASC 810-10 emphasizes the importance of understanding all facts and circumstances and considering substance in the overall evaluation. It does not provide explicit guidance to determine whether a lock up arrangement, imposed by regulatory bodies or other non-variable interest holders presumably to benefit third-party investors, would meet this condition. In practice, reporting entities and accountants evaluate such circumstances in the context of the purpose and design of the entity and often conclude that such restrictions do create de facto agency relationships even in the absence of an express agreement among variable interest holders. In substance, the regulatory body, as proxy for the investors, will have imposed the constraint.

The Agencies should be aware that a consequence of such accounting judgment would be that the sponsor's interest, when aggregated with the interests of its de facto agents (i.e., in this example, all of the other investors in the securitization entity represented by the regulatory body) always would result in the sponsor having power through a variable interest because the aggregate interests of the sponsor and investors would clearly be more than insignificant to the securitization entity's expected losses or returns. If the sponsor has both power and benefits, it would consolidate under ASC 810-10.

Representative sample agreed upon procedures report

With respect to the representative sample option, the proposal asks whether a sponsor should be required to obtain an agreed upon procedures report from an independent public accounting firm as proposed. If not, the proposal asks if there is another mechanism that should be included in the option to help ensure that the sponsor has constructed the representative sample according to the requirements of the rule.

We do not believe that an agreed upon procedures (AUP) report, under existing professional standards, can be used to achieve the Agencies' objectives. This view is based on the professional standards for AUP engagements in AT Section 201, *Agreed Upon Procedures Engagements*, of Statement on Standards for Attestation Engagements.

The basic premise of an AUP engagement is that one or more parties agree in advance to the sufficiency of the procedures for their purposes and the resultant report is restricted to use by only those specified parties. Any reference to the report to other parties would be inappropriate because such users would not have agreed, in advance, to the sufficiency of the procedures and would not have the report to evaluate the results. This is suggested by the proposed rules, which would require the sponsor to tell investors or potential investors that the AUP report had been obtained as required by the proposal. However, pursuant to professional standards on AUP engagements, the investors or potential investors would not be parties to the report and would not be entitled to access it or rely on it for any purpose since they would not be specified parties.

We also note that the suggested procedures would consist of confirming with the sponsor that certain policies exist related to selecting the representative sample. As drafted, there would not be a requirement to determine that the policies had been implemented and are operating effectively, nor would there be any procedures to test the results of the sample selection. We therefore believe that even if such an approach could be employed as a result of revisions to existing professional standards in this area, the contemplated AUP report provision, as drafted, would provide little benefit or protection to investors.

The most appropriate way to involve an independent public accounting firm in providing assurances about the adequacy of the representative sample would be to construct an examination-level attest engagement around a set of criteria developed to meet the needs of investors and other report users. This would provide assurance to investors as to whether (1) appropriate policies and procedures have been implemented and (2) the related controls are operating effectively. However, as such an approach would be resource intensive for all parties involved and could delay related ABS transactions, a cost-benefit analysis for this alternative would need to be performed.

However on a broader basis, we are not convinced that the involvement of an independent public accounting firm is necessary in these circumstances. While the integrity of the representative sample could be verified at the outset by some form of examination, the proposed post-securitization periodic reporting appears to provide sufficient transparency to serve the needs of investors by providing performance results of the sponsor's retained risk pool compared to the performance of the ABS securitization. As such, we recommend that the representative sample approach not require any involvement of an independent public accounting firm.

* * * * *

We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst & Young LLP