

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

8 August 2011

Proposed Rules for Nationally Recognized Statistical Rating Organizations
Release No. 34-64514
File No. S7-18-11

Dear Ms. Murphy:

Ernst & Young LLP (Ernst & Young) is pleased to submit comments on the Securities and Exchange Commission's (SEC or the Commission) Proposed Rules for Nationally Recognized Statistical Rating Organizations (NRSROs) (Proposal). Investors experienced significant losses in asset-backed securities (ABS) during the recent financial crisis. Analysis has shown that investors, as well as underwriters, issuers and NRSROs, may not have adequately understood the risks of the assets underlying the ABS in certain cases. Section 932 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Act) is intended to help mitigate these issues by providing additional information to potential investors to facilitate their evaluation of the assets underlying the ABS and how that information is used by NRSROs in determining credit ratings.

We recognize that implementation of Section 932 of the Act was originally proposed by the SEC in October 2010, on which we previously provided comments.¹ Our previous comment letter discussed the nature of procedures that accountants have historically performed related to ABS offerings. This letter updates those comments and provides further rationale for our belief that reports rendered pursuant to the professional standards for agreed-upon procedures (AUP) engagements related to information disclosed in ABS offering documents do not constitute "due diligence services" as contemplated by the Act. In addition, such services, which are performed solely in support of an issuer's or underwriter's obligations under the securities laws, are performed to meet requirements specified by the issuer or underwriter, not requirements established by an NRSRO. Further, AUP reports have not been provided to NRSROs for use in the ABS ratings process. Accordingly, we believe that such reports are outside of the legislative intent of Section 932 of the Act, and therefore should clearly fall outside the scope of the Commission's proposed disclosure requirements.

¹ EY comment letter, File No. S7-26-10: Proposed Rules – Issuer Review of Assets in Offerings of Asset-Backed Securities, Issued 15 November 2010

Requirements of the Act

Section 932 of the Act discusses transparency of NRSRO credit rating methodologies for ABS and information reviewed in determining a credit rating by NRSROs. With respect to the use of third-party providers of due diligence services, Section 932(a)(8) of the Act amended Section 15E(s) of the Exchange Act to require:

“(4) DUE DILIGENCE SERVICES FOR ASSET-BACKED SECURITIES. –

(A) FINDINGS. – The issuer or underwriter of any asset-backed security shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

(B) CERTIFICATION REQUIRED. – In any case in which third-party due diligence services are employed by a nationally recognized statistical rating organization, an issuer, or an underwriter, the person providing the due diligence services shall provide to any nationally recognized statistical rating organization that produces a rating to which such services relate, written certification, as provided in subparagraph (C).

(C) FORMAT AND CONTENT. – The Commission shall establish the appropriate format and content for the written certifications required under subparagraph (B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for a nationally recognized statistical rating organization to provide an accurate rating.

(D) DISCLOSURE OF CERTIFICATION. – The Commission shall adopt rules requiring a nationally recognized statistical rating organization, at the time at which the nationally recognized statistical rating organization produces a rating, to disclose the certification described in subparagraph (B) to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by a third party.”

Commission Proposal to Implement Amended Section 15E(s) of the Exchange Act

To establish the appropriate format and content for the written certifications as required under (4)(B) above, the Proposal specifies the certifications to be made in new Form ABS Due Diligence-15E (Form ABS 15-E). This form would require the signature of an authorized person providing the third-party due diligence services along with a representation that such party has conducted a “thorough review” in performing the due diligence described in the form and that the statements made in the form are accurate in all material respects.

Form ABS 15-E would require the following disclosure by the third-party service provider: (1) identity of the third-party that conducted the review, (2) the person that employed the third-party to conduct the review, (3) a representation from the provider of the third-party due diligence services about whether it satisfied published due diligence standards of specified NRSROs, (4) a sufficiently detailed description of the scope and manner of due diligence performed and (5) the findings and conclusions resulting from the review.

Although the Act does not define “due diligence services,” the Proposal defines “due diligence services” to avoid overly broad interpretations that could cause some entities to “needlessly provide” certification to NRSROs. Page 198 of the Proposal explains that:

“The Commission intends the definition of ‘due diligence services’ in the Exchange Act-ABS context to cover services provided by entities typically considered to be providers of third-party due diligence services in the securitization market and does not intend it to cover every type of person that might perform some type of diligence in the offering process. As discussed below, the Commission believes that the scope of Section 15E(s)(4)(A) is intended to address third-party due diligence reports obtained by issuers or underwriters from these specialized providers of due diligence services that are relevant to the determination of a credit rating for an Exchange Act-ABS by an NRSRO.”

Further illustrating the need to narrow the definition of “due diligence services” to those services that are relevant to the determination of a credit rating, page 186 of the Proposal states that:

“.. the Commission believes that the third-party due diligence reports referenced in Section 15E(s)(4) of the Exchange Act are not the same as the review required by Section 7(d) of the Securities Act and Rule 193. Instead, Section 15E(s)(4) of the Exchange Act and, consequently, proposed Rule 15Ga-2 relate to a particular type of report that is relevant to the determination of a credit rating by an NRSRO. By contrast, Section 7(d) of the Securities Act and Rule 193 relate to a more general concept of an issuer review of the assets underlying an Exchange Act-ABS, one aspect of which may (or may not) include a third-party due diligence report.”

In developing its proposed definition, the Commission considered the types of due diligence services routinely performed by specialized third-party providers that NRSROs have deemed relevant for determining credit ratings for an Exchange Act-ABS. The Commission’s proposed definition characterizes these services within four categories, including reviews of the assets underlying an ABS with respect to (1) the quality or integrity of the information or data about the assets included in the ABS provided, directly or indirectly, by the securitizer or originator of the assets, (2) whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria or other requirements, (3) the value of collateral securing such assets and (4) whether the originator of the assets complied with federal, state or local laws or regulations. The proposed definition also includes a fifth catchall category related to reviewing any other factor or characteristic of such assets that would be material to the likelihood that the issuer of the ABS will pay interest and principal according to its terms and conditions (i.e., not default). In sum, it is clear that the primary focus of due diligence services is the credit quality of the assets underlying the ABS.

As proposed, the first category of “due diligence services” relates to a review of the quality or integrity of the information or data about the assets provided to the NRSRO by the originator, securitizer or underwriter. The published due diligence standards of NRSROs contemplate such data testing as an integral part of overall due diligence on the credit quality of the assets underlying the ABS. In practice, we are not aware that NRSROs use third-party due diligence providers to perform tests of data integrity without also performing the other components of due diligence on specific assets, as outlined above.

Typical Services Provided by Accountants

Accountants often are engaged by issuers or underwriters to perform AUP on information included in an ABS offering document. As previously communicated, these procedures can generally be categorized into three areas (i.e., data tape to loan file comparison, recalculation of projected future cash flows due to investors and activities performed on other information included in the offering document). Accountants can be engaged to perform all or a combination of these procedures, depending on the circumstances.² These procedures may assist the issuer in discharging its responsibilities under Section 7(d) of the Securities Act and Rule 193.

Certain procedures typically performed by accountants related to an ABS offering, specifically the data tape to loan file comparison, could be construed to fall within the first category of due diligence services as defined in the Proposal and thus, would potentially be subject to additional reporting and certification. However for the reasons explained below, we do not believe that these types of services represent “due diligence services” as contemplated by the Act, because such services are not performed for the purpose of assisting the NRSRO in determining a credit rating for an ABS. The other categories of due diligence services listed in proposed rule 17g-10 are not services that accountants have traditionally performed for issuers or underwriters of securitizations.

Primary Purpose of Procedures Performed by Accountants

The procedures performed by accountants are done primarily to help an underwriter in meeting their obligations under the Securities Act of 1933 with respect to disclosures in the registration statement and prospectus for the protection of investors. We consider that objective distinct from due diligence performed by specialized providers for the purpose of satisfying an NRSRO’s due diligence criteria in rendering its credit rating determination. The procedures performed by accountants pursuant to an AUP engagement generally relate to the accuracy of disclosures in the offering documents, not the credit quality of the underlying assets. AUP engagements are not performed in contemplation of providing the results to NRSROs to facilitate a credit evaluation, nor are the scope and nature of the accountant’s procedures designed to satisfy the published due diligence standards of any NRSRO.

Sufficiency of Procedures

Accountants perform these procedures pursuant to professional standards for AUP engagements in AT Section 201 (AT 201), *Agreed-Upon Procedures Engagements*, of the AICPA’s 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. Underwriters or issuers specify the particular procedures to be performed by the accountant and, as a result, take responsibility for establishing the criteria to be used in the determination of findings as well as the sufficiency of such procedures for their particular purpose. Those procedures and criteria ultimately define the nature and extent of any findings included in the accountant’s AUP report.

² Refer to EY comment letter issued to SEC on 15 November 2010 re: File No. S7-26-10 for further explanation of typical services provided by accountants.

The findings included in the AUP report to the issuer or underwriter are not formulated or intended to address any requirements specified by NRSROs. As acknowledged by the Proposal, NRSROs often determine and publish standards of performance for third-party due diligence. The procedures and methodologies of the NRSROs prescribe the minimum scope and manner of the due diligence services appropriate for the nature of the ABS (e.g., minimum sample sizes). However, the issuer and the underwriter specify the extent of the accountant's procedures, which typically varies for each ABS offering.

In addition, as previously noted, AT 201 requires that the accountant's report should clearly indicate that its use is restricted to those parties that specified the procedures to be performed. Under AT 201, NRSROs, investors and potential investors would not be entitled to access the AUP report or use it for any purpose because they would not be specified parties who agreed to the sufficiency of the procedures.

If the Commission determines that procedures historically performed by accountants to assist the issuer and underwriter in their review of the accuracy of disclosures in the prospectus meet the definition of "due diligence services," accountants would likely be precluded from performing such engagements because it would violate the standards in AT 201. Further, based on the certification that would be required by proposed Form ABS 15-E, it is unlikely that accountants would be willing to perform any services that do not fall clearly outside the definition of due diligence services. In our view, this result would be detrimental to the protection of investors by limiting the assistance that accountants have traditionally provided to underwriters in their due diligence for ABS offerings.

Timing of Reporting

Clearly the intent of Section 932(a)(8) is to publicly disclose "findings and conclusions" from a thorough review of information that is "necessary for a [NRSRO] to provide an accurate rating." Accountants' AUP reports typically are not delivered until the closing of the securitization transaction, which occurs after the NRSRO determines its credit rating. We believe this further illustrates, from a practical perspective, that AUP reports do not constitute "due diligence reports obtained by issuers or underwriters...that are relevant to the determination of a credit rating."

Recommendation

We believe that AUP reports provided by accountants to underwriters and issuers do not constitute "due diligence services" as contemplated by the Act due to the fact that:

1. Such services are performed to help issuers and underwriters satisfy their obligations under securities laws and are not performed to satisfy the published due diligence standards of NRSROs
2. Because AUP reports are not provided to the NRSRO, they cannot be used or relied on by the NRSRO in connection with its credit rating

Therefore, we recommend the SEC clarify that “due diligence services” subject to public disclosure include only procedures and findings provided by third-parties that are used by the NRSRO to satisfy its published due diligence standards. Such a clarification would better align the scope of the rules with the intent of the Act to address only information that was used by the NRSRO in the development of a credit rating.

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We would be pleased to discuss our comments with members of the Securities and Exchange Commission or its staff.

Very truly yours,

Ernst & Young LLP