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August 19, 2011

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

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

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee and the Securitization and Structured Finance Committee (the "Committees") of the Business Law Section of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission (the "Commission") in its May 18, 2011 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 ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Business Law Section.

The Proposing Release proposes new rules and a wide variety of amendments to existing rules that would apply to credit rating agencies registered with the Commission as nationally recognized statistical rating organizations ("NRSROs"). This letter will focus primarily on those proposals that would implement new Section 15E(s)(4)(A)-(C) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which was added by Section 932(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). Section 15E(s)(4)(A) requires that issuers and underwriters of asset-backed securities ("ABS") make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, Sections 15E(s)(4)(B) and (C) require providers of due diligence services to provide a prescribed certification to any NRSRO that produces a rating to which those services relate, and Section 15Es(4)(D) requires each such NRSRO to disclose that certification publicly.

[1] 76 Fed. Reg. 33420 (June 8, 2011).

I. Proposed Definitions of "Due Diligence Services" and "Due Diligence Report"

The Commission proposes to implement Section 15E(s)(4)(A) of the Exchange Act through re-proposed Rule 15Ga-2. The Commission originally proposed Rule 15Ga-2 in 2010 together with then-proposed Rule 193 under the Securities Act of 1933, as amended (the "Securities Act"), the rule requiring issuer review of the assets underlying registered "asset-backed securities," as broadly defined in Section 3(a)(77) of the Exchange Act (as added by the Dodd-Frank Act) ("Exchange Act-ABS").[2] As originally proposed, Rule 15Ga-2 would have required issuers and underwriters of Exchange Act-ABS to file a Form ABS-15G (or provide prospectus disclosure) with respect to the findings and conclusions of any report of a third party engaged for purposes of performing a review of the pool assets obtained by the issuer or underwriter. As a result of comments received from many commenters, including the Committees,[3] the Commission concluded that Section 15E(s)(4)(A) "should be interpreted to relate more narrowly" to the remainder of Section 15E(s)(4),[4] which addresses the credit ratings process, and did not adopt Rule 15Ga-2 when it adopted the final version of Rule 193. As re-proposed in the Proposing Release, Rule 15Ga-2 would require an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS-15G containing the findings and conclusions of any "due diligence report" obtained by the issuer or underwriter that contains findings and conclusions relating to "due diligence services" as defined in proposed Rule 17g-10(c)(1).

The proposed definition of "due diligence services" identifies four fixed categories of reviews that the Commission preliminarily believes that NRSROs have deemed relevant for ratings of residential mortgage-backed securities. Specifically, the proposed definition includes any "review of the assets underlying [Exchange Act-ABS] . . . for the purpose of making findings with respect to: (i) [t]he quality or integrity of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets; (ii) [w]hether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements; (iii) the value of collateral securing the assets; [and] (iv) [w]hether the originator of the assets complied with Federal, state, or local laws or regulations . . . ." The proposed definition also includes a "catchall" category of "[a]ny other factor or characteristic of such assets that would be material to the likelihood that the issuer of the [Exchange Act-ABS] will pay interest and principal according to its terms and conditions." The Commission indicates that the catchall category is designed to capture other asset classes "to

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[2] Issuer Review of Assets in Offerings of Asset-Backed Securities, SEC Release No. 33-9150, 75 Fed. Reg. 64182 (Oct. 19, 2010) (the "Original Proposing Release").

[3] Letter dated November 17, 2010, from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, Section of Business Law, American Bar Association and Vicki O. Tucker, Chair, Securitization and Structured Finance Committee, Business Law Section, American Bar Association (the "Prior ABA Comment Letter"), available at http://sec.gov/comments/s7-26-10/s72610-50.pdf.

[4] Proposing Release, 76 Fed. Reg. at 33467.

the extent that providers of third-party due diligence services currently provide or in the future begin providing due diligence services with respect to other asset classes and those services, because of the different nature of the assets, do not fall into one of the four other categories."[5]

In our view, this proposed definition of "due diligence services" does not properly address the Commission's intent, as described in the Proposing Release, or the Congressional intent, in enacting Section 932(a)(8) of the Dodd-Frank Act. According to the Commission, it "intends the definition of 'due diligence services' . . . 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," and the proposed rules are only "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."[6] Furthermore, the Commission indicates that third-party due diligence reports "are not the same as the review required by Section 7(d) of the Securities Act and Rule 193"[7] (*i.e.*, the requirement for an issuer review of the assets in offerings of Exchange Act-ABS). As acknowledged by the Commission in the Proposing Release,[8] it seems clear that Congress intended for all of the due diligence provisions of Section 15E(s), including Section 15E(s)(4)(A), to relate to NRSROs and the credit ratings process. Subsection (B) requires that a third-party due diligence services provider deliver a certification to any NRSRO rating the ABS in question. Subsection (C) in turn requires that the format and content of the certification be established by the Commission "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*" (emphasis added). Therefore, we feel strongly that Section 15E(s)(4)(A) was not intended to apply to all manner of third-party due diligence reports that may be obtained by an issuer or underwriter, but instead was intended to apply more narrowly to any third-party due diligence report prepared for an ABS issuer or underwriter *specifically for the purpose of sharing that report with a given NRSRO to meet that NRSRO's ratings criteria.*

Unfortunately, because the categories of "due diligence services" would be fixed by the language of the rule, any service that fits within the enumerated categories would be captured – and the receipt of a written report by an issuer or underwriter containing findings and conclusions of those services would trigger the requirement to furnish Form ABS-15G pursuant to proposed Rule 15Ga-2, even if the services were not required by any NRSRO and were not used by it in the process of issuing its credit rating. For example, the four enumerated categories of "due diligence services" in proposed Rule 17g-10 could be read to capture several types of

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[5] *Id.* at 33472.

[6] *Id.*

[7] *Id.* at 33468.

[8] *See* text and citation at n. 4 above.

due diligence that are fairly common in offerings of ABS, such as an accounting firm's agreed-upon procedures letter with respect to the offering document, a law firm due diligence review of assets underlying Exchange Act-ABS (in connection with, for example, an opinion on the form of certificate of title), or review or assessment of the assets by the servicer. None of these types of services (or any report with respect thereto) is ordinarily required or reviewed by an NRSRO in connection with the credit ratings process. If the definitions of "due diligence services" and "due diligence report" are not clarified to exclude services and reports that are not required by NSRSOs and are irrelevant to the credit ratings process, we are concerned that the providers of these types of services could refuse to permit the findings and conclusions of their reports to be made public and accordingly, these services might no longer be available in offerings of Exchange Act-ABS. The result, instead of achieving the goal of more transparency in the ratings process, could be to decrease the amount of due diligence undertaken with respect to those offerings – a clearly undesirable result.

The catchall provision also poses concerns. Because the language of this component of "due diligence services" is so broad, we believe that it will be very difficult to apply – it would appear to set forth few, if any, limits, on what types of due diligence services might be captured. Furthermore, while the Commission states in the Proposing Release that the catchall category is only for use with respect to asset classes other than residential mortgage-backed securities, there is nothing in the language of the proposed rule itself confirming that position.

We believe that the Commission could, and should, address all of these concerns by modifying the definition of "due diligence services" so that it explicitly applies only to those services that are required to be provided to an NRSRO by, and are used by it in, its credit ratings process. This would conform the language of the proposed rule to both the Commission's and Congress' intent and would make the rule clear and easy to apply. If the Commission accepts our additional comment described below – that these rules apply only to credit ratings that are paid for by the issuer, sponsor or underwriter – then any third-party due diligence report captured by the proposed rule (and any certification with respect thereto required to be provided to an NRSRO) would be required to be posted on a website maintained pursuant to Rule 17g-5(a)(3)(iii), and therefore would be accessible to other NRSROs wishing to rate the Exchange Act-ABS in question. We believe that these changes also would respond to the "fundamental question" posed by the Commission in the Proposing Release, of "how . . . a provider of third-party due diligence services [would] know the identities of the NRSROs producing credit ratings to which its services relate (particularly NRSROs producing unsolicited credit ratings) . . . ."[9]

II. Other Comments on Proposed Rule 15Ga-2

a. The Timing Requirements Should be Clarified.

The "first sale in the offering" is an important concept under the proposed rules. Proposed Rule 15Ga-2(a) would require that an issuer or underwriter furnish a Form ABS-15G with respect to any third-party due diligence reports obtained by the issuer or underwriter five

[9] 76 Fed. Reg. at 33466.

business days prior to the first sale in the offering, though Form ABS-15G would not have to be furnished if the issuer or underwriter obtains a representation from each NRSRO engaged to produce a credit rating that can be reasonably relied upon that the NRSRO will publicly disclose the findings and conclusions of any such third-party due diligence report five business days before the first sale in the offering. This proposed rule does not specify the date on which the first sale in the offering occurs. Presumably, the "first sale in the offering" is identical to the "time of sale" as that phrase is used in Rule 159 under the Securities Act, but it could conceivably be based on a different definition, such as the "date of first sale" as used in Form D under the Securities Act. We ask that the meaning of "first sale in the offering" be clarified in the final rule.

While not explicitly referred to by the Commission in the Proposing Release, the timeframe provided by proposed Rule 15Ga-2(a) is consistent with the timeframe that would be required for filing of a preliminary prospectus for ABS in accordance with proposed Rule 424(h), which was part of the Commission's proposed amendments to Regulation AB and the offering process for ABS.[10] We believe that the timeframe adopted for Rule 15Ga-2 should be consistent with the timeframe adopted for Rule 424(h) – including during any applicable transition periods. In that regard, we also refer you to our prior comments on Rule 424(h),[11] in which we argued, among other things, that five business days is too long for all ABS offerings, as we have heard that most investors consider that a shorter period would give them sufficient time to review the preliminary prospectus. Those prior comments are equally applicable to the five business day period proposed in Rule 15Ga-2, as we believe that most investors similarly would consider that a shorter period would afford them sufficient time to review the findings and conclusions of any third-party due diligence reports.

b. <u>The Rule Should Not Apply to Private Ratings.</u>

In some transactions, an investor or other non-arranger party may hire a rating agency to provide a private rating for internal regulatory capital or other purposes. Proposed Rule 15Ga-2 does not, as drafted, clearly exclude Exchange Act-ABS for which the only rating is a private rating. For transactions in which a non-arranger party hires a rating agency to provide a private rating, there is no rationale for requiring the issuer or underwriter – which were not involved in the ratings process – to be required to publicly disclose information regarding the types of due diligence reports contemplated by the proposed rules – *i.e.*, due diligence reports that rating agencies have deemed relevant for determining credit ratings of Exchange Act-ABS. Therefore, consistent with Rule 17g-5, Rule 15Ga-2 should not apply to an Exchange Act-ABS transaction in which the only rating that is issued is a rating that is paid for by a party other than the issuer, sponsor or underwriter.

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[10] *See* Asset-Backed Securities; Proposed Rules, SEC Release Nos. 33-9117, 34-61858, 75 Fed. Reg. 23328 (May 3, 2010).

[11] Letter dated August 17, 2010, from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, Section of Business Law, American Bar Association and Vicki O. Tucker, Chair, Securitization and Structured Finance Committee, Business Law Section, American Bar Association, available at http://sec.gov/comments/s7-08-10/s70810-150.pdf.

c. The Rule Applies to Initial Ratings Only.

We read the "rating" referred to in proposed Rule 15Ga-2(a) as referring only to an initial rating received at or prior to closing, as opposed to a later rating, or as a result of a ratings upgrade, ratings downgrade or other subsequent rating action. As a practical matter, the proposed rule could not apply to any later rating or rating action, inasmuch as it would not be possible to furnish the required information five business days prior to the first sale in the offering. We note that in instances where the Commission has intended to cover subsequent ratings and rating actions, it has done so explicitly. For example, the proposed amendments to Rule 17g-7 explicitly address disclosures required in connection with rating actions, including subsequent ratings and rating actions.

If the Commission disagrees with this interpretation, we ask that proposed Rule 15Ga-2(a) be clarified, and that its requirements be modified to make compliance possible for rating actions other than initial ratings.

d. Multiple Forms ABS-15G Should Not be Required to be Furnished.

As proposed, Rule 15Ga-2(a) and Form ABS-15G could be read to require that a separate Form ABS-15G be furnished for each receipt of a third-party due diligence report by an underwriter or issuer. In order to avoid the potential confusion caused by multiple filings of the findings and conclusions of the same third-party due diligence reports, Rule 15Ga-2(a) and Form ABS-15G should be revised to permit a single form to be furnished by only one of the obligated parties when the same report is received by the issuer and/or multiple underwriters.[12] We believe it is important that information regarding third-party due diligence reports be both publicly available and comprehensible. Any system that could require redundant, and possibly differing, reports to be furnished would not help to achieve this goal.

e. Rule 15Ga-2 Should Apply Only to Registered Public Offerings, or a Regulatory Safe Harbor Should Be Provided with Respect to the Effect of Form ABS-15G on Private Offerings.

As discussed in the Proposing Release, proposed Rule 15Ga-2 would apply to both registered public offerings and unregistered private offerings of Exchange Act-ABS.[13] As described in the Prior ABA Comment Letter, we believe that Section 932 of the Dodd-Frank Act, under which Rule 15Ga-2 has been proposed, may be interpreted as applying only to registered public offerings. The disclosure obligation set forth in Section 15E(s)(4)(A) of the Exchange Act, as added by Section 932 of the Dodd-Frank Act, specifically applies to issuers and underwriters. Section 3(a)(20) of the Exchange Act provides that the term "underwriter" has the same meaning as set forth in the Investment Advisers Act of 1940, which in turn defines "underwriter" in a manner substantially identical to Section 2(a)(11) of the Securities Act. The

[12] We note that the Commission has permitted similar aggregation of reporting, for example, with respect to information regarding fulfilled and unfulfilled repurchase requests by multiple securitizers. *See* Rule 15Ga-1(b) under the Exchange Act.

[13] 76 Fed. Reg. at 33467.

latter definition identifies parties who perform certain functions in connection with "the *distribution* of [a] security,"[14] a term which has consistently been interpreted as having essentially the same meaning as "public offering."[15] There is no statutory "underwriter" in a private placement or Rule 144A offering. Furthermore, Section 15E(s)(4)(A) requires "public availability" of the findings and conclusions of the due diligence provider as to the asset pool. We believe that this requirement is fundamentally inconsistent with the nature of private placements, which ordinarily require that there have been no general solicitation with regard to the offered securities.[16] A "general solicitation" is any communication that could be deemed to constitute a public "offer" of the securities in question, with "offer" broadly construed to include any information that could be deemed to condition the market for those securities.[17] The information that proposed Rule 15Ga-2 would require to be made publicly available would include detailed information about the pool assets underlying the offered ABS, and we are concerned that this information could easily be deemed to be conditioning the market for the related ABS.

We appreciate the Commission's view, as expressed in the Proposing Release, that "issuers and underwriters can disclose information required by Rule 15Ga-2 without jeopardizing reliance on [private offering] exemptions and safe harbors, provided the only information made publicly available on the form is that required by the proposed rule, and the issuer does not otherwise use Form ABS-15G to offer or sell securities in a manner that conditions the market for offers or sales of its securities."[18] However, the Commission's

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[14] Emphasis added.

[15] *See, e.g., Geiger v. S.E.C.*, 363 F.3d 481, 487 (D.C. Cir. 2004) ("the term 'distribution' refers to the entire process in a public offering through which a block of securities is dispersed and ultimately comes to rest in the hand of the investing public"); *Ackerberg v. Johnson*, 892 F.2d 1328, 1335 (8th Cir. 1989) ("'distribution' should be read in terms of 'public offering'"); *Gilligan, Will & Co. v. S.E.C.*, 267 F.2d 461 (2d Cir. 1959) ("a 'distribution' requires a 'public offering'"); *S.E.C. v. Lybrand*, 200 F. Supp. 2d 384, 393 (S.D.N.Y. 2002), *aff'd*, 425 F.3d 143 (2d Cir. 2005) ("[a] 'distribution' is equivalent to a public offering of securities"); H.R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934).

[16] Securities Act Rule 502(c) expressly conditions the availability of the private offering exemptions in Regulation D on the absence of "general solicitation or general advertising." In the case of the statutory private placement exemption under § 4(2) of the Securities Act, the Commission has stated that "general solicitations of an unrestricted and unrelated group of prospective purchasers for the purpose of ascertaining who would be willing to accept an offer of securities is [sic] inconsistent with a claim that the transaction does not involve a public offering." Nonpublic Offering Exemption, SEC Release No. 33-4552 (Nov. 6, 1962); *see also, e.g.* ABA Federal Regulation of Securities Committee, *Section 4(2) and Statutory Law*, 31 Bus. Law. 485, 497 (1975) (distilling the factors considered by the courts in determining the availability of the § 4(2) exemption and concluding that the essence of the courts' "manner of offering" factor was that "[a]ll forms of general advertising and mass media circulation should be avoided.").

[17] *See, e.g.*, Publication of Information Prior To or After the Effective Date of a Registration Statement," SEC Release No. 33-3844 (Oct. 8, 1957).

[18] 76 Fed. Reg. at 33469.

position is conditioned upon the issuer or underwriter providing in its Form ABS-15G only information that is "required by the proposed rule." Given the ambiguity as to the scope of third-party due diligence reports covered by proposed Rule 15Ga-2, it is possible that an issuer or underwriter, in a good-faith attempt to comply with the rule's requirements, could furnish a report on Form ABS-15G that is later deemed not to be required by the rule. Such a report would not be covered by the Commission's position and could, in hindsight, adversely affect the exemption of the offering from the registration requirements of the Securities Act.[19]

The Commission qualifies its view by requiring that the issuer "not otherwise use Form ABS-15G to offer or sell securities in a manner that conditions the market for offers or sales of its securities." The third-party due diligence reports required to be furnished under Rule 15Ga-2 relate to some of the most fundamental aspects of an Exchange Act-ABS transaction. If adopted as proposed, Form ABS-15G will include summaries of findings and conclusions regarding the quality and integrity of the data concerning the securitized assets, adherence to underwriting criteria, the value of collateral securing the securitized assets, compliance with applicable law, and other factors that clearly would be material to the likelihood that the issuer of the Exchange Act-ABS will pay interest and principal according to its terms and conditions. For these reasons, it would be very difficult for issuers (and their counsel) to conclude that this condition is satisfied with the requisite degree of confidence.

Finally, a statement of the Commission's views in a release would not have the same force and effect as a safe harbor in an adopted rule, and may not offer sufficient comfort to issuers of privately placed Exchange Act-ABS (and their counsel) on this crucial matter.

For all of these reasons, we believe that Rule 15Ga-2 should not apply to private offerings. However, to the extent that Rule 15Ga-2 is not limited to ABS offered and sold in registered public transactions, we urge the Commission to adopt regulations expressly providing that the public availability of the information required by proposed Rule 15Ga-2 will not be deemed to constitute a general solicitation for purposes of any applicable statutory or regulatory private offering exemption or safe harbor from the registration requirements of Section 5 of the Securities Act, without either of the qualifications stated by the Commission in the Proposing Release.

f. Foreign Transactions Should Be Excluded from the Requirements of Rule 15Ga-2.

The proposed rules do not provide any guidance as to the extent to which Rule 15Ga-2 applies to foreign transactions involving Exchange Act-ABS and foreign issuers of Exchange Act-ABS.

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[19] If the Commission does not limit the application of Rule 15Ga-2 to registered public offerings, it should consider the implications of the required disclosures on the availability of exemptions from registration under state "blue sky" laws, which may impose separate limitations on public communications in connection with private offerings.

In the Original Proposing Release, the Commission noted that Section 15E(s)(4)(A) does not specify how it applies to offshore transactions, including unregistered offering by U.S. issuers to offshore investors, as well as offerings by foreign issuers primarily to foreign investors but also to U.S. investors.[20] Although re-proposed Rule 15Ga-2 would require issuers and underwriters to disclose information about unregistered transactions, including those sold outside of the United States, in the Original Proposing Release the Commission cautioned that foreign laws applicable to securities sold offshore and assets originated offshore may raise questions about the appropriateness of Rule 15Ga-2, and that "imposition of a filing requirement in connection with private placements of ABS in the United States may result in foreign issuers seeking to avoid the filing requirement by excluding U.S. investors from purchasing portions of ABS primarily offered outside the United States, thus depriving U.S. investors of diversification and related investment opportunities."[21] The Commission then sought input on whether, and to what extent, proposed Rule 15Ga-2 should apply to "foreign-offered" ABS and to foreign issuers of ABS sold to U.S. investors in an exempt, unregistered public offering. [22] In our view, Rule 15Ga-2 should be clarified to exclude such offerings.

We believe that the application of Rule 15Ga-2 to the offshore transactions described above invokes the same issues and concerns that have been identified in connection with the extra-territorial reach of Rule 17g-5(a)(3), as reflected in the comments received by the Commission in response to its temporary exemption under Rule 17g-5(a)(3) for issuers that are non-U.S. persons.[23] Applying Rule 15Ga-2 to non-U.S. issuers and underwriters is, we believe, beyond the intended scope of the statute[24] and would impact non-U.S. issuers, sponsors and originators that would not expect to be covered by a regulation intended to improve the quality of credit ratings issued by NRSROs. In our view, the proposed rule's disclosure requirements may conflict with foreign securities laws, stock exchange rules and other applicable laws, rules and regulations, such as privacy, corporation and trade practices.[25] In addition, we note that some of the commenters on Rule 17g-5(a)(3) were concerned about the ability of NRSROs to compel foreign arrangers (*i.e.*, the sponsor or underwriter) to comply with that Rule and whether credit

[20] 75 Fed. Reg. at 64189.

[21] *Id.*

[22] *Id.* at 64190.

[23] Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 under the Securities Exchange Act of 1934 and Request for Comment, SEC Release No. 34-62120, 75 Fed. Reg. 28825 (May 24, 2010); Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, SEC Release No. 34-63363, 75 Fed. Reg. 73137 (Nov. 23, 2010).

[24] *Cf. Morrison v. National Australia Bank*, 130 S.Ct. 2869, 2888 (2010) (Section 10(b) of the Exchange Act reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States).

[25] *See, e.g.*, letter dated May 12, 2010 from The European Banking Federation, and letter dated September 22, 2010 from The Investment Industry Association of Canada.

rating agencies might withdraw from registration as an NRSRO rather than risk non-compliance.[26]

Just as commenters urged the Commission to exempt non-U.S. ABS from the scope of Rule 17g-5(a)(3), we request that the Commission clarify, by means of a regulatory safe harbor, that Rule 15Ga-2 would not apply to foreign issuers of unregistered ABS or to underwriters of such ABS. Such a safe harbor should be at least as broad as the safe harbor that ultimately is adopted for foreign related transactions under the recently proposed credit risk retention rules. As it has been proposed, the safe harbor under the credit risk retention rules would exempt transactions in which several conditions are satisfied, including that: (i) the transaction is not required to be and is not registered under the Securities Act; (ii) no more than 10 percent of the dollar value by proceeds (or equivalent if sold in a foreign currency) of all classes of securities sold in the transaction are sold to U.S. persons or for the account or benefit of U.S. persons; (iii) neither the sponsor nor the issuing entity is organized under U.S. law or is a U.S. branch or office location of an entity not organized under U.S. law; and (iv) no more than 25 percent of the assets collateralizing the securities were acquired by the sponsor, directly or indirectly, from a consolidated affiliate of the sponsor or issuing entity that is a U.S.-located entity.[27] In that regard, we also refer you to our comment letter on the proposed credit risk retention rules,[28] in which we strongly supported the concept of including a safe harbor, but also argued for altogether excluding U.S.-based issuers placing securities entirely outside the U.S., and either withdrawing the application of the rules to private placements by foreign issuers or increasing the 10 percent threshold to something more reasonable, such as 30 percent. In our view, those prior comments are equally applicable to any safe harbor for foreign-related ABS adopted as part of Rule 15Ga-2.

g. <u>The Terms "Issuer" and "Underwriter" Should be Clarified.</u>

The Proposing Release states that "the issuer is the depositor or sponsor that participates in the issuance of Exchange Act-ABS."[29] However, while the term "issuer" is defined in that manner for purposes of proposed Rule 17g-10, it is not clear that this definition applies to proposed Rule 15Ga-2. Unless specifically addressed by the language of Rule 15Ga-2, the Commission's intent could be muddied by the more broadly applicable language of Rule 191 under the Securities Act, which provides that the "issuer" of ABS is the depositor, acting solely in its capacity as depositor to the issuing entity.

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[26] *See* letter dated June 25, 2010 from Japan Credit Rating Agency, Ltd., and letter dated April 30, 2010 from Neal E. Sullivan, Bingham McCutchen LLP, on behalf of Rating and Investment Information, Inc.

[27] *See* Credit Risk Retention, SEC Release No. 34-64148, 76 Fed. Reg. 24090, 24140 (April 29, 2011).

[28] Letter dated July 20, 2011, from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, Section of Business Law, American Bar Association and Vicki O. Tucker, Chair, Securitization and Structured Finance Committee, Business Law Section, American Bar Association, available at http://sec.gov/comments/s7-14-11/s71411-133.pdf.

[29] 76 Fed. Reg. at 33467, n. 532.

In the Original Proposing Release, the Commission stated that the term "underwriter" refers to parties that perform functions in private offerings of Exchange Act-ABS that are similar to those performed by underwriters in public offerings of Exchange Act-ABS, including initial purchasers and placement agents.[30] In the Proposing Release, the Commission did not elaborate on the meaning of "underwriter" though, as discussed above, it continues to make clear its view that the proposed rules should apply to unregistered private transactions. We disagree with this view because, as also discussed above, the term "underwriter" generally is used to refer only to an underwriter in a public distribution of securities. Nonetheless, if the Commission continues to believe that proposed Rule 15Ga-2 should apply to unregistered private offerings of Exchange Act-ABS and that the term "underwriter" should include initial purchasers and placement agents in unregistered private offerings of Exchange Act-ABS, then the text of Rule 15Ga-2 should so specify. Otherwise, the Commission's intent would be confused by the definition of "underwriter" in Section 2(a)(11) of the Securities Act, which encompasses only an underwriter in a public distribution of securities.

III. Other Comments on Proposed Rule 17g-10

a. The Term "Relate" Is Not Defined.

Section 15E(s)(4)(B) of the Exchange Act, as added by Section 932(a)(8) of the Dodd-Frank Act, requires that the certification of a third-party due diligence service provider be provided to any NRSRO producing a credit rating to which the due diligence services "relate," a term which is not defined in Section 15E(s)(4)(B) of the Exchange Act or in proposed Rule 17g-10. It is unclear to what extent due diligence services provided in connection with a transaction might be deemed to "relate" to a credit rating, if those services were not required by and their results were not provided to an NRSRO as a part of its rating process.

The Commission appears to recognize this issue and requests comment on how a provider of third-party diligence services might know the identities of the NRSROs to which it is required to provide a certification – including NRSROs producing unsolicited credit ratings.[31] The Proposing Release also asks whether issuers and underwriters should be required to maintain databases through which NRSROs might make themselves known to due diligence service providers for purposes of receiving a summary of the findings and conclusions of the due diligence reports, and due diligence service providers could submit their written certifications.[32]

If the Commission accepts our comment above that "due diligence services" should be limited to those services that are required to be provided to an NRSRO and used by it in its credit ratings process, and that the proposed rules should apply only to credit ratings that are paid for by the issuer, sponsor or underwriter, then these thorny issues would fall largely by the wayside

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[30] 75 Fed. Reg. at 64199, n. 53.

[31] 76 Fed. Reg. at 33466.

[32] *Id.*

because the application of the term "relate" would no longer be unclear. In addition, as described above, the certification provided to an NRSRO requiring a due diligence report would be posted on a website maintained pursuant to Rule 17g-5, and therefore would automatically be accessible to other NRSROs wishing to rate the Exchange Act-ABS in question.

b. Providers May Not Be Willing to Make the Proposed Certification.

Section 15E(s)(4)(C) of the Exchange Act, as added by Section 932(a)(8) of the Dodd-Frank Act, requires the Commission to establish the format and content for the written certifications required under Section 15E(s)(4)(B) of the Exchange Act. The Commission has proposed to implement this requirement through proposed Form ABS Due Diligence-15E and generally requests comments on the proposed form.[33]

Form ABS Due Diligence-15E would require an individual, duly authorized by the provider of due diligence services, to certify that the due diligence service provider conducted a "thorough" review in performing the described due diligence, and that the information in the certification is "accurate in all significant respects."[34] We are concerned that providers may not be willing to make this representation, or would seek to qualify this representation..

In particular, we believe that parties may have varying interpretations as to what would constitute a "thorough" review in performing due diligence services. Section 15E(s)(4)(C) requires that the review be as thorough as necessary to "provide an accurate rating" – which in our view, means thorough enough to justify the due diligence provider's expressed findings and conclusions. As we noted in the Prior ABA Comment Letter, traditional due diligence providers do not generally go beyond the scope of their engagement in performing due diligence services. They may be licensed professionals whose professional obligations impose on them particular standards (such as accountants), or they may not – in which case, their standard of review may or may not match those of other due diligence service providers in the market. Therefore, the use of the word "thorough," without further explanation, may lead investors to develop a false expectation of what a third-party due diligence provider is engaged to produce and to conclude that there is a higher standard of review than actually was performed. This could have the anomalous effect of fostering "undue reliance" on both third-party due diligence providers and the credit ratings based on their services, a result contrary to the Commission's goals[35] (and those of Congress as embodied in Section 939A of the Dodd-Frank Act). We believe that Form ABS Due Diligence-15E, and its required certification, should be clarified to provide investors with a clear understanding of what the diligence provider's review entailed. Toward that end, consistent with our general comments in the Prior ABA Comment Letter, we believe that Item 4 on Form ABS Due Diligence-15E should call for a description of the scope of engagement and

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[33] 76 Fed. Reg. at 33466, 33476.

[34] *See* proposed Form ABS Due Diligence-15E.

[35] *See, e.g.*, Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934, SEC Release No. 34-64352, 76 Fed. Reg. 26550, 26558 (May 6, 2011).

that the form of certification should permit a reference to that described scope of engagement, making it clear that the scope of the certification (and, thus, the due diligence service provider's potential liability) is limited by the scope of engagement.

In the required form of certification, we also question the use of the word "significant" in the phrase "accurate in all significant respects" as opposed to the much more commonly used (and, therefore, better understood) term "material."[36] It is unclear to us whether the use of the word "significant" is intentional and, if so, whether it is meant to be a more or less stringent standard as compared to those standards previously observed by legal counsel and auditors, for example. In our view, the appropriate standard should be that the report, taking into account the scope of the engagement of the diligence provider, contains no untrue statement of a material fact, and does not omit to state any material fact necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading.

IV. Effective Date and Transition Period

The Proposing Release contains no discussion of compliance dates or transition periods for any of the proposed rules.

Implementation of the proposed rules will require coordination among market participants – issuers and underwriters, on the one hand, and third-party due diligence service providers and NRSROs, on the other – as well as the development of industry standards. In all likelihood, current procedures will require significant adjustment, and any changes will have to mesh with other new and pending regulations. The issues raised by the Commission in the various "Request for Comments" sections in the Proposing Release suggest that a number of mechanisms (*e.g.*, contractual provisions between various parties, appropriate disclosure procedures, forms of representation from NRSROs, etc.) will have to be worked out after the final rules are adopted. Issuers, underwriters and NRSROs must be afforded sufficient time to effect this coordination and implementation.

As one point of reference, Rule 193 has a compliance date of December 31, 2011,[37] just over nine months from its effective date (March 28, 2011) and almost a year from the date it was adopted by the Commission (January 20, 2011). Proposed Rules 15Ga-2 and 17g-10 have an even broader reach – Rule 193 applies only to registered public offerings while the proposed rules, as drafted, also would extend to unregistered private offerings. We believe that the transition period for the proposed rules should be at least as long as was afforded in connection with Rule 193.

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[36] *See, e.g., TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (defining information as material when a reasonable investor would consider it important in deciding whether to buy, sell or hold the securities in question and there is a "substantial likelihood that disclosure . . . would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available").

[37] Issuer Review of Assets in Offerings of Asset-Backed Securities, SEC Release Nos. 33-9176, 34-64742, 76 Fed. Reg. 4231, 4238 (Jan. 25, 2011).

V. Required Disclosures by NRSROs when Taking Rating Action under Proposed Amendments to Rule 17g-7

As it has been proposed to be amended, Rule 17g-7 would require NRSROs to make detailed disclosures when taking any "rating action" with respect to an obligor, security or money market instrument in a class of credit ratings for which the NRSRO is registered. The proposed amendments to Rule 17g-7 would broadly define "rating action" to include the publication of an expected or preliminary credit rating, an initial credit rating, an upgrade or downgrade of an existing credit rating, the placement of an existing credit rating on credit watch or review, the affirmation of an existing credit rating and the withdrawal of an existing credit rating.

In addition to requiring that the NRSRO publish any written certifications related to the credit rating and received from third-party due diligence service providers, the proposed rules would require the NRSRO to publish a form containing a laundry list of required information about the rating, including the version of the procedure or methodology used to determine the rating, the main assumptions and principles used in constructing those procedures and methodologies, the potential limitations of the rating, information on the uncertainty of the rating, a description of the data relied upon for purposes of determining the rating and a statement containing an overall assessment of the quality of that information, an explanation or measure of the potential volatility of the credit rating, information on the content of the credit rating (including the expected probability of default and expected loss in the event of default) and information on the sensitivity of the rating to assumptions made by the NRSRO.

Although we recognize the Commission's efforts to provide users of credit ratings with more meaningful information about credit ratings through enhanced disclosure, we are concerned that requiring NRSROs to make such detailed disclosures for each rating action could result in fewer (if any) NRSROs agreeing to take rating actions on a routine basis. In particular, we believe that the inclusion of ratings affirmations as "rating actions" could have significant negative consequences for the market participants and investors alike.

We do not believe that rating affirmations should trigger the disclosure requirements that would be imposed by the proposed amendments to Rule 17g-7. The transaction documents for many securitization and other structured finance transactions currently require the depositor or other interested party to obtain confirmations from the NSRSOs then rating the securities that the proposed action will not result in the withdrawal or downgrade of those credit ratings, before making specified types of non-routine changes to the transaction documents (such as amendments to those transaction documents, and the appointment of a successor servicer). These rating agency confirmations are intended to provide investors in the securities with some assurance that the characteristics of their securities will not be changed by the deal parties in a manner that would negatively impact their creditworthiness. In addition, some transaction structures (such as master trusts) require rating agency confirmations before even ordinary course activities, such as the issuance of new classes of securities.

We are concerned that, as a result of significantly enhanced disclosure requirements for rating actions under the proposed rules, NRSROs may be even more reluctant than they are today

to provide confirmations of ratings on a routine basis. If so, then many existing transactions could be immediately, and significantly, adversely impacted. Absent the availability of a rating confirmation, there may not be an alternative means to accomplish an amendment. Even when the transaction documents provide an alternative route to accomplish the amendment process, in many cases that process would involve obtaining consent of at least a majority of the securityholders. As a practical matter, such consent can be extremely difficult or even impossible to obtain, requiring a significant investment of time and financial resources even when it is possible. It is not clear whether there is any additional mechanism that could be added to existing transaction documents (or included in future ones) that could provide investors with the level of assurance offered by the rating agency confirmation process, without imposing the significant logistical roadblock of obtaining security holder consent.

Without an effective mechanism to approve amendments to transaction documents, even important and noncontroversial changes may be effectively foreclosed. Many master trusts, for example, may be unable to issue new securities, and it may not be possible to replace a resigning service provider. Even more worrisome is the possibility that changes required by existing or future law (such as mortgage loan modification or disclosure requirements) may be impossible to implement. This could result in transactions or the deal parties falling out of compliance with transaction requirements, increasing default rates (and, presumably, contributing to the delay in full economic recovery) with little commensurate upside.

For all of these reasons, we urge that the proposed rules not include rating affirmations as "rating actions." By definition, a rating affirmation does not change the credit rating on a given security; rather, it affirms the validity of the NRSRO's previous credit rating, as to which the NRSRO already will have been required to make the full panoply of disclosures. The receipt of these disclosures in connection with a rating affirmation should be of much less importance to investors than in connection with an initial rating or the upgrade or downgrade of a rating.

We also urge that the proposed disclosure requirements of Rule 17g-7 not be applied to rating actions with respect to transaction documents that were finalized before the effective date of the rules, so that they would apply only to amendment provisions drafted in contemplation of these requirements. This exclusion should be crafted broadly enough to cover term securitizations that close before the effective date of the rules, as well as other transactions (such as master trusts) that may involve issuances after the effective date of the rules but where the transaction documents were finalized before that time.

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Once again, the Committees appreciate the opportunity to submit these comments and we respectfully request that the Commission consider our recommendations. We have endeavored to discuss the Commission's proposals in the level of detail they deserve, while also devoting attention to the many other ongoing legislative and regulatory initiatives affecting securitization. Members of the Committees are available to meet and discuss these matters with the Commission and its Staff and to respond to any questions.

Very truly yours,

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Jeffrey W. Rubin
Chair, Federal Regulation of Securities Committee

/s/ Martin Fingerhut
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