American Financial Services Association

November 15, 2010

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

Re: Release Nos. 33-9150 and 34-63091; File No. S7-26-10

Dear Ms. Murphy:

This comment letter is submitted by the American Financial Services Association ("AFSA") in response to the request of the Securities and Exchange Commission (the "Commission") for comments regarding Release Nos. 33-9150 and 34-63091; File No. S7-26-10 (the "Proposing Release")[1], relating to the implementation of Section 945 (Due diligence analysis and disclosure in asset-backed securities issues) and a portion of Section 932 (Enhanced regulation, accountability, and transparency of nationally recognized statistical rating organizations) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). AFSA appreciates the opportunity to provide its comments on the Proposing Release.

AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers. Many of AFSA's members use securitization as a primary source of funding. Securitizations have provided billions of dollars of revenue used to provide credit for consumers in the last two decades.

Securitization is important to many AFSA members. Actions by the Commission and other regulators that increase the cost of effecting securitizations unnecessarily will reduce, and even possibly eliminate, the incentive for our members to utilize securitizations. We understand that the performance of some securitized asset classes during the recent financial crisis was abysmal, and we know that some regulatory changes are appropriate as a response. We also understand that the Dodd-Frank Act mandates the Commission and other regulators to propose regulations in various areas, including the topics covered by the rules we discuss in this letter.

However, we ask the Commission to recognize that problems did not occur across the board in securitizations. As noted in the recent *Report to Congress on Risk Retention* (October 2010) from the Board of Governors of the Federal Reserve System (the "Fed Report"), many asset classes performed well during the financial crisis. For example, the Fed Report pointed out that

[1] 75 Fed. Reg. 64182 (October 19, 2010).

"few, if any, triple-A tranches of auto [asset-backed securities] have experienced a principal write-down in the nearly 25 years of issuance"[2] and "[e]quipment loan and lease [asset-backed securities] in general, and the triple-A rated securities, in particular, have displayed strong performance during the financial crisis."[3] The Fed Report contained statistics indicating that the prevalence of downgrades was far, far lower for asset classes such as credit cards, auto loans, equipment loans and leases and floorplan than it was for residential mortgage-backed securities ("RMBS").[4]

More specifically, we wish to point out to the Commission that the failure of pools of assets to conform to the descriptions of them found in offering materials was not commonplace in many sectors of the asset-backed securities ("ABS") market. We believe that the phenomenon of asset pools not conforming to their descriptions was limited almost entirely to the RMBS market.

Our view is that the Commission has proposed rules under Sections 945 and 932 of the Dodd-Frank Act that go well beyond the Congressional mandate. We believe the Commission is making a mistake in reading these sections much more broadly than we think was intended. If the Commission overlearns the lessons of the financial crisis and imposes additional burdens on ABS sponsors whose securities have performed well, it risks making securitization a market of last resort, to be used only by ABS sponsors who cannot fund elsewhere. Such a result would be a failure of policy, and it would hurt investors as well as issuers.

Summary of the Proposed Rules

Section 945 of the Dodd-Frank Act adds Section 7(d) to the Securities Act of 1933 (the "Securities Act"). Section 7(d) requires the Commission to issue rules requiring the issuer of registered asset-backed securities (as defined in the Dodd-Frank Act, "Exchange Act ABS") to perform a review of the assets underlying such Exchange Act ABS and to disclose the nature of such review. Section 932(a) of the Dodd-Frank Act requires the Commission to issue rules requiring the issuer or underwriter of any Exchange Act ABS to make publicly available the findings and conclusions of any third party due diligence report obtained by such issuer or underwriter.

The Commission proposes to address the requirements of Section 945 by (i) promulgating Rule 193 under the Securities Act to require issuers to perform a review of the assets underlying any registered Exchange Act ABS and (ii) amending Item 1111 of Regulation AB to require issuers to disclose in the registration statement relating to such Exchange Act ABS both the nature of its review and the findings and conclusions of such review. Proposed Rule 193 permits an issuer to engage a third party to perform the requisite review, provided that the third party consents to being named as an expert in the issuer's registration statement.

[2] Fed Report at 57.
[3] *Id.* at 63.
[4] *Id.* at 52, 53, 57, 59, 65.

The Commission proposes giving effect to the relevant portion of Section 932(a) by implementing Rule 15Ga-2 under the Securities and Exchange Act of 1934 (the "Exchange Act"), which would require the issuer or the underwriter of any Exchange Act ABS (whether registered or unregistered) to make available through public filing the findings and conclusions of any report obtained by it from a third party that is engaged for purposes of performing a review of the assets underlying an the Exchange Act ABS. As to such reports obtained by the issuer in a registered offering, the requirements of Rule 15Ga-2 would not apply if the issuer had already made such information available pursuant to amended Item 1111.

Set forth below are our comments relating to the proposed rules.

A. Proposed Rule 193 under Section 7(d)(i) of the Securities Act

Proposed Rule 193 provides that "[a]n issuer of an [Exchange Act-ABS], offering and selling such a security pursuant to a registration statement shall perform a review of the pool assets underlying the [Exchange Act-ABS]. The issuer may conduct the review or an issuer may employ a third party engaged for purposes of performing the review provided the third party is named in the registration statement and consents to being named as an expert in accordance with [Rule] 436 of this chapter."

1. Rule 193 Should Not Specify the Type or Level of Review an Issuer Is Required to Perform

The Commission correctly takes the position in the Proposing Release that Rule 193 should apply only to public offerings. The Commission reaches this conclusion because the requirements mandated by Section 7(d)(1) of the Securities Act require the Commission to issue rules "relating to the registration statement."[5] While we agree that Rule 193 should only apply to public offerings, we do not think the words "relating to the registration statement" should be the sole determining factor in reaching such conclusion. We think it is important to note that Section 7 of the Securities Act is entitled *"Information in a Registration Statement"* and therefore, any addition by Congress to such Section 7 would necessarily relate to registered securities, regardless of whether the specific words "registration statement" are included in any given sub-section.

We agree with the Commission that it is not appropriate to try to design a "one size fits all" rule specifying the precise type or level of review that an issuer is required to perform under Rule 193. The specific nature and number of assets being securitized vary greatly among asset-classes, and mandating a uniform approach and level of review would not translate well across asset classes. For example, a level of review that may be appropriate in a residential mortgage loan securitization consisting of 2,000 loans in a pool may be entirely unreasonable in an auto loan securitization consisting of 100,000 loans in a pool. Further, the Dodd-Frank Act does not require that any specific form of review be required.

[5] See 75 Fed. Reg. at 64183.

The Commission's Request for Comment 2 contained in the Proposing Release[6] asks whether a minimum level of review should be adopted. The Commission also asks whether it should require, at a minimum, that the review provide reasonable assurance that the disclosure in the prospectus is accurate in all material respects. As noted above, we do not believe that the Dodd-Frank Act mandates the specification of any review standard, and we do not support the adoption of one. However, we do believe that if a minimum review standard were to be implemented, a standard that is formulated in terms of the accuracy of disclosure would be preferable to a standard that seeks to define the precise steps required to be taken.

We think that issuers generally understand a standard based on disclosure accuracy. As the Commission notes, issuers in registered offerings have statutory liability for the accuracy of disclosure. We believe that issuers can effect reviews under such a standard. However, we want to point out several considerations that we think are important in formulating this standard.

The first consideration relates to the type of information that would need to be reviewed in connection with the particular offering. We note that prospectuses contain a great deal of "generic" information about the assets in a pool, and we do not believe that this generic information needs to be reviewed specifically in connection with each asset pool. Examples of such information include the standard terms of the contracts under which the assets are documented and the legal aspects of such assets. Generic disclosure such as this does not change from one offering to the next, and it would be extremely burdensome to require issuers to review it specifically for each asset pool. Issuers have in place procedures to maintain the accuracy of these generic disclosures, but those procedures are not repeated upon each offering; they are independent controls.

Any required disclosure accuracy review should only cover pool-specific information, such as the various tables showing pool data; the accuracy of the representations and warranties; and the static pool and portfolio performance data. This pool-specific disclosure is what we think is meant to be covered by Section 945.

The second consideration is that issuers should be entitled to conduct their reviews of the pool-specific information on their own timelines and in light of their own internal processes. The Commission should not require a specific review effected entirely in connection with the ABS offering. Rather, issuers should be entitled to use their existing processes for collecting and verifying information regarding the pool of assets.

Finally, we disagree with Commission's position that a review by an unaffiliated originator will not satisfy proposed Rule 193, such as in the case of a securitization by an aggregator of assets. We think that in many situations where the originator is not affiliated with the sponsor it may be difficult or impossible for the sponsor to gain sufficient access to the loan files in order to conduct an independent review. Even in a whole loan sale situation, an originator that retains servicing is unlikely to grant access to those files to the purchaser so that the purchaser may conduct its own review. This problem would only be magnified where there are multiple

[6] See 75 Fed. Reg. at 64185.

originators. We think that the Commission should permit a sponsor to rely on unaffiliated originators to perform the review required by Rule 193, so long as such fact is disclosed to investors in the prospectus.

2. Third Party Reviewers Should Not Be Required to Be Named as "Experts" for Purposes of the Securities Act

In the Proposing Release, the Commission takes the position that an issuer may rely on a third party review for purposes of satisfying the requirements of Rule 193, so long as such third party is named in the registration statement and consents to being named as an "expert" in accordance with Section 7 of the Securities Act and Rule 436 under the Securities Act.[7] We strongly disagree with this requirement.

As an initial matter, we do not believe such a requirement is mandated by the Dodd-Frank Act. Nothing in Section 7(d)(1) of the Exchange Act suggests that Congress was concerned about the quality of third party due diligence reviews, or explicitly subjects third party due diligence providers to automatic expert status and the attendant potential liability.

We also do not believe that third party due diligence providers fit within the categories of persons who have historically been considered to be experts under Section 11(a)(4) of the Securities Act. By its terms, Section 11(a)(4) covers "every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him," but only when that person has been named as having prepared or certified a part of the registration statement (or a report or valuation used in connection with the registration statement) and given the requisite consent. Accountants, engineers and appraisers are all licensed professionals who perform their tasks in accordance with strict professional standards. In contrast, third party due diligence providers are not subject to licensing, they do not act in accordance with required professional standards, and they do not exercise the sort of professional judgment that other experts do. Rather, they perform only the specific tasks required by the terms of their engagement.

Further, we believe that this requirement will make it impossible, as a practical matter, for issuers to engage third party due diligence providers. As the Commission is aware, by consenting to be named as an expert in the issuer's registration statement, third parties engaged for purposes of performing the review mandated by proposed Rule 193 will become subject to liability for material misstatements and omissions under Section 11(a)(4) of the Securities Act. As a result, we think that it is highly unlikely that third party due diligence providers will consent to being named as experts in the registration statement. We note the similarities between the refusal by third party due diligence providers and accountants to provide expert consent and the recent refusal by rating agencies to provide such consent in the wake of the repeal of Rule 436(g) of the Securities Act. Such refusal effectively caused the ABS markets to cease functioning until the Commission provided relief by temporarily allowing ratings to be omitted from

[7] See 75 Fed. Reg. at 64184.

registration statements, thus eliminating for the time being the need for expert consent from rating agencies.

3. Rule 193 Should Not Be Applied to Accountants Who Are Engaged to Provide "AUP" Letters

In its requests for comment, the Commission asks what entities should appropriately be considered to be third parties engaged for purposes of performing Rule 193 reviews.[8] Among the types of third party reports specifically mentioned by the Commission are various reports that already are customarily delivered in connection with ABS transactions, including "agreed-upon procedures" letters ("AUP letters") performed by accountants.[9] AUP letters ordinarily are obtained by and addressed to an underwriter for purposes of performing a due diligence investigation under Section 11 of the Securities Act. For that reason alone, we do not believe that they should be within the scope of Rule 193. As noted above, Section 7(d)(1) of the Exchange Act, as added by Section 945 of the Dodd-Frank Act, regulates the behavior of issuers, not underwriters. Third party reports should be covered by Rule 193 only if the issuer engages the provider to produce the report, explicitly relies on the report for purposes of its required Rule 193 investigation, and discloses that reliance to investors.

Furthermore, we can uniformly report that our independent auditors would refuse to consent to being named as experts. As delivery of an AUP letter is a condition precedent to a vast majority of ABS transactions, we think that considering the providers of those AUP letters to be third parties engaged for purposes of performing Rule 193 reviews would effectively grind the ABS markets to a halt.

We request that the final rule clarify that a report from a third party is only subject to the requirements of Rule 193 if it is actually used by the issuer to comply with its obligations under Rule 193. Since neither an AUP letter nor a legal opinion is being used for the purpose of meeting the issuer's obligations under Rule 193, these items should not be subject to the requirements of the rule.

B. New Item 1111(a)(7)

Section 7(d)(2) of the Exchange Act, as added by Section 945 of the Dodd-Frank Act, requires disclosure of the nature of an ABS issuer's required due diligence investigation regarding the pool assets. The Commission proposes to implement this requirement through proposed Item 1111(a)(7) of Regulation AB[10]. However, in addition to requiring disclosure of the <u>nature</u> of the

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[8] See 75 Fed. Reg. at 64186 (Request for Comment 9).
[9] The Proposing Release also mentioned legal opinions (such as perfection opinions) provided by attorneys. We think this reference is inappropriate, as legal opinions regarding perfection are <u>not</u> asset-level opinions. These opinions typically cover perfection of, *e.g.*, the security interest of the indenture trustee in all of the assets. They do not cover asset-level issues such as whether a given auto loan has a properly perfected lien on the underlying vehicle.
[10] Proposed Item 1111(a)(7) provides:

issuer's review, proposed Item 1111(a)(7) would also require disclosure of the findings and conclusions of that review. The Commission acknowledges that Section 7(d)(2) does not require disclosure of the issuer's findings and conclusions, but has proposed this additional disclosure requirement in an attempt to harmonize Section 7(d)(2) with the scope of Exchange Act Section 15E(s)(4)(A) (as added by Section 932 of the Dodd-Frank Act), which (as further addressed below) requires public disclosure of the findings and conclusions of certain third party due diligence reports. In the Commission's view, this would "avoid incentives for 'regulatory arbitrage' based merely on whether the review of assets was performed internally by the issuer, or whether instead the issuer hired a third party to perform the review."

We do not believe that the Commission's approach to proposed Item 1111(a)(7) is mandated by statute. Congress adopted both Sections 945 and 932 of the Dodd-Frank Act at the same time, while using different language. We believe that these provisions should be read to require different standards, in order to give meaning to the different language Congress chose to employ. Had Congress meant to require disclosure of the findings and conclusions of the issuer's required diligence review, it would (and could easily) have said so.

Moreover, we believe it is inappropriate to subject an issuer to increased liability by requiring the findings and conclusions to be disclosed. The Securities Act already imposes strict liability on issuers in registered offerings for material misstatements and half-truths. We do not believe it is appropriate to force issuers to detail the findings and conclusions of the reviews that they make to assure themselves of the accuracy of their disclosure. The risk of liability that they already face is an entirely sufficient incentive.

C. New Item 1111(a)(8)

The Commission has also proposed that new Item 1111(a)(8) be added to Regulation AB of the Securities Act.[11]

(a). Provide the following information: . . .

(7)(i) The nature of a review of the assets performed by an issuer or sponsor (required by [Rule] 193), including whether the issuer of any asset-backed security engaged a third party for purposes of performing a review of the pool assets underlying an asset-backed security; and

(ii) The findings and conclusions of the review of the assets by the issuer, sponsor, or third party described in paragraph (7)(i) of this section.

Instruction to Item 1111(a)(7): If the issuer has engaged a third party for purposes of performing the review of assets, the issuer must provide the name of the third party reviewer and comply with the requirements of [Rule] 436 of this chapter."

[11] New Item 1111(a)(8) provides:

"(a). Provide the following information: . . .

Item 1111(a)(8) seems to assume that all originators have uniform underwriting criteria that permit the evaluation of most loans on a mechanical basis. Such may be the case in the origination of residential mortgages. However, in many other asset classes, such as in the case of auto loans, originators do not follow strict underwriting criteria.

Auto loan originators do not have hard and fast guidelines by which most loan applications can be evaluated. Such originators typically use electronic decisioning systems as a first filter for applications. Some applications are approved (for a prime originator, typically between 10% and 40% of total applications) or rejected by this automated process. However, auto originators make decisions on most loan applications through "judgmental underwriting." In this process, all loan applications, other than those definitively accepted or rejected in the initial automated process, are individually reviewed by credit analysts.

A credit analyst will review the information utilized in the electronic decisioning process as well as additional information. The analyst then makes a decision based on his or her assessment of the strengths and weaknesses of the applicant and the terms of the proposed loan. The analyst might condition approval of a loan on the addition of a co-obligor or on a change that would reduce the monthly payment, such as the making of a larger down payment or the substitution of a less expensive vehicle.

The typical auto originator has a variety of levels at which loan applications can be approved in the judgmental underwriting process. The fact that a given loan required a higher level of approval does not mean that the loan should be considered an exception to the underwriting guidelines. There are many reasons why a loan might require a higher level of approval and still fit within the "standard process" of the originator.

Different credit analysts have different levels of authority to approve loan applications. The level of authority given to an analyst depends on such factors as the size of the requested loan, the analyst's experience and the analyst's underwriting track record. Accordingly, a given loan could be approved by one analyst and not another for reasons that have little or nothing to do with the conformity of the loan or the obligor to a set of underwriting standards. For example, on days in which there is a particularly heavy flow of applications, more senior loan officers might supplement the first level analysts and perform these initial reviews. In that situation, it would not be possible to ascertain, after the fact, which of the loans initially approved by a

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(8) If any assets in the pool deviate from the disclosed underwriting criteria, disclose how those assets deviate from the disclosed underwriting criteria and include data on the amount and characteristics of those assets that did not meet the disclosed standards. Disclose which entity (e.g., sponsor, originator, or underwriter) determined that those assets should be included in the pool, despite not having met the disclosed underwriting standards, and what factors were used to make the determination, such as compensating factors or a determination that the exception was not material. If compensating or other factors were used, provide data on the amount of assets in the pool that are represented as meeting each such factor and the amount of assets that do not meet those factors."

senior loan officer could also have been approved by a more junior analyst and which could not have been approved by a junior analyst.

We do not necessarily object to the Commission's formulation of Item 1111(a)(8). However, we want to point out to the Commission that many of the ABS sponsors among us would not provide any incremental disclosure in response to new Item 1111(a)(8). The underwriting guidelines described in these sponsors' prospectuses indicate that they make judgmental underwriting decisions; there are not disclosed standards by which loans are evaluated, so there will not be a need to describe loans that fail to meet those standards.

D. Exchange Act Section 15E(s)(4)(A) and Rule 15Ga-2

New Exchange Act Section 15E(s)(4)(A), added by Section 932 of the Dodd-Frank Act, specifies that "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."

The Commission has responded to this requirement of the Dodd-Frank Act by proposing Rule 15Ga-2.[12]

1. Rule 15Ga-2 Should Not Apply to Private Offerings

The Commission takes the position in the Proposing Release that the requirements of Section 15E(s)(4)(A) were intended to apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act ABS. The Commission reaches this conclusion because the definition of Exchange Act ABS includes securities typically offered and sold in unregistered transactions, and because the Commission contends that, unlike Section 7(d) of the Securities Act, Section 15E(s)(4)(A) is not expressly limited to registered ABS offerings. We disagree with the Commission's conclusions for several reasons.

First, as discussed in more detail above, it is our belief that Section 7(d) applies to registered offerings, not because Congress happened to include the words "registration statement" in such Section, but because Section 7(d) is being added to Section 7 of the Securities Act, which is

[12] Rule 15Ga-2 provides as follows:

> "(a) The issuer or underwriter of any [Exchange Act-ABS] shall file Form ABS-15G containing 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 five business days prior to the first sale in the offering.
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> (b) If the issuer in a registered offering of [Exchange Act-ABS] has included the information required by paragraph (a) of this section in the first prospectus that is required to be filed under [Rule 424] for that offering and filed in accordance with [Rule 424], then the issuer is not required to file Form ABS-15G to include the same information."

entitled *"Information in a Registration Statement."* Therefore, the absence of the words "registration statement" in Section 15E(s)(4)(A) should not be interpreted to indicate the intent of Congress to include private offerings within the purview of such Section. On the contrary, we think it much more plausible that the use of the terms "underwriter" and "publicly" in Section 15E(s)(4)(A) reveal that Congress intended this law to apply only to public offerings.

We do not believe that there is any good policy reason to require issuers in private placements to make this type of disclosure in a public filing and, despite the assurances of the Commission, we are concerned about the effect public filing of such information might have on a private issuer's ability to rely upon the private offering exemption in the Securities Act and the safe harbor for offshore transactions. If the Commission concludes that private offerings must be covered by Rule 15Ga-2, then we recommend that disclosure in the relevant offering document should be sufficient to comply with the requirement.

2. Requiring the Filing of a Form ABS-15G under Rule 15Ga-2 is Unnecessary

The requirement to make an Exchange Act filing under any circumstances is unnecessary and unwarranted. As we have discussed above, we do not believe that Congress intended Section 15E(s)(4)(A) to apply to private offerings. Therefore, we see no reason to require any issuer (either public or private) to make a separate filing in order to satisfy the requirements of the Dodd-Frank Act. Disclosure of the required information in the offering materials should be sufficient.

3. Other Comments and Requested Clarifications

We note that Rule 15Ga-2 may be read to require disclosure of AUP letters, even if Rule 193 does not. We request that the final rule clarify that the filing requirement under Rule 15Ga-2 will pertain only to the findings and conclusions of reports that specifically pertain to a review of the pool assets. If a third party is engaged for multiple purposes, including a review of the pool assets, only the findings and conclusions of the portion of the report pertaining to the review of the pool assets should be subject to the requirement. Furthermore, we ask the Commission to clarify that legal opinions provided by attorneys and AUP letters provided by accountants are not intended to be included within the scope of Rule 15Ga-2, unless and to the extent that they expressly address a review of the pool assets. Such legal opinions and AUP letters are clearly not due diligence reports as contemplated by the statute, nor do they generally contain a review of the assets underlying the ABS. In addition, AUP letters from independent accountants typically contain strict non-disclosure provisions required by their self-regulatory organization, which would prohibit issuers from being able to disclose their contents.

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We very much appreciate the opportunity to provide the foregoing views in connection with the Commission's rulemaking process. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 202-296-5544, ext. 616 or bhimpler@afsamail.org, or AFSA's outside counsel on this matter, Kenneth P. Morrison of Kirkland & Ellis LLP at 312-862-2347 or at kenneth.morrison@kirkland.com.

Respectfully submitted,

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