



Office of the Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549-1090

15 November 2010

**Re: File No. S7-26-10: Proposed Rules - Issuer Review of Assets in Offerings of Asset-Backed Securities**

Dear Office of the Secretary:

Ernst & Young LLP (Ernst & Young) is pleased to submit comments on the Securities and Exchange Commission's (SEC or the Commission) Proposed Rules related to Issuer Review of Assets in Offerings of Asset-Backed Securities (the Proposal). Investors experienced significant losses in asset-backed securities (ABS) during the recent financial crisis. Analysis has shown that investors, as well as underwriters and issuers, in many cases did not adequately understand the risks of the assets underlying the ABS. We believe that Sections 945 and 932 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") were intended to mitigate these shortcomings by enhancing the understanding by issuers and underwriters of the assets underlying the ABS and by providing additional information to potential investors related to the credit quality of the assets underlying the ABS to better inform investment decisions.

As noted in the Proposal, accountants are often engaged by issuers to perform procedures on information disclosed in the offering documents for ABS. The procedures performed under these engagements are prescribed by the underwriter or issuer and are principally designed for the limited purpose of providing the underwriter with evidence to support the discharge of its due diligence responsibilities under the Securities Act of 1933 related to disclosures in the ABS offering document. The remainder of this letter provides perspective on the nature of the services provided by accountants and rationale for our belief that accountants' reports provided to underwriters and issuers in connection with performing such services should not be included within the scope of the Commission's proposed rule-making implementing the provisions of Section 945 and 932 of the Act.

*Typical Services Provided by Accountants*

As mentioned above, accountants often are engaged by issuers to perform agreed-upon procedures on information included in an ABS offering document. These procedures can generally be categorized into three areas, of which accountants can be engaged to perform all or a combination, depending on the circumstances.

#### Data tape to loan file comparison

Typically, issuers maintain a computer readable file containing detailed data about each financial asset underlying a particular offering. Accountants may perform procedures related to information included in the offering documents that involve comparing either a sample or all of the information included in the data file to the source documents, and report any differences between the information. However, these procedures generally do not include any steps to confirm the accuracy of any information contained within the loan file. Instead, the accountant's procedures consist solely of comparing the information included in the data file to source documents.

#### Recalculate projected future cash flows due to investors

Offering documents contain projections of future cash flows based on a number of assumed scenarios. Accountants are often engaged to recalculate the projections, which procedures typically consist of checking that the outputs of the calculations performed by the issuer are the same as the calculations performed independently by the accountant.

#### Activities performed on other information included in the offering document

Other activities performed generally involve calculating summary statistics from the information contained in the computer readable data file and comparing them to information prepared by the issuer and included in the offering document. This can include, for example, disclosures related to the average coupon rates of loans underlying the ABS, the loans' average remaining term as well as other information related to their geographic concentration. In addition, these activities can include tracing various information included in the offering document to other source documents (for example, if servicing history information is disclosed, accountants may be asked to agree the information to servicer reports from which the information was derived).

As illustrated above, these services are not focused on verifying the accuracy of information contained within the source documents (e.g., verifying information related to income levels in mortgage loan documents to income tax records or W-2s) or providing any evaluation or assurance regarding the credit quality of the underlying assets, adherence to underwriting standards or compliance of the credit origination with applicable laws and regulations. Instead, they primarily consist of recalculating information included in the offering documents or agreeing information, on which the disclosures in the offering documents are based, back to source documents.

#### *Nature of the Engagements Performed by Accountants*

The services described above are conducted pursuant to agreed-upon procedures engagements in accordance with American Institute of Certified Public Accountants (AICPA) Statements on Standards for Attestation Engagements, AT Section 201, *Agreed-Upon Procedures Engagements*. Pursuant to these engagements, underwriters or issuers specify the particular procedures to be performed by the accountant and, as a result, take responsibility for the sufficiency of such procedures for their particular purpose. These engagements allow underwriters or issuers to tailor the particular procedures to be performed by the accountant based on the facts and circumstances of the particular offering, including consideration of other procedures performed

by the underwriter or issuer. Central to these engagements is the understanding among all parties that the underwriter and issuer are responsible for establishing the criteria to be used in the determination of findings, which criteria ultimately define the nature and extent of any findings included in the accountant's report. The accountant's report related to the procedures performed does not render an opinion, but provides a detailed description of the procedures performed and the related findings. Language included in the accountant's report describing these limitations is illustrated as follows:<sup>1</sup>

- The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.
- We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the [subject matter of the engagement]. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.
- We did not obtain written representation concerning matters relating to the completeness and accuracy of the information provided to us. Accordingly, we have not verified the completeness and accuracy of the information provided to us by [underwriter and/or issuer] which we used in performing our procedures.

AICPA professional standards require that the accountant's report of findings be limited to only those parties who have taken responsibility for the sufficiency of the procedures performed.<sup>2</sup> This requirement is intended to prevent other parties from placing reliance on the report for purposes other than those specifically intended by those who engaged the accountant and determined the nature and scope of the procedures. As a result, the accountant's report includes the following language:<sup>3</sup>

- This report is intended solely for the information and use of [names of specified parties who agreed to the procedures] and is not intended to be and should not be used by anyone other than these specified parties.

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<sup>1</sup> Pursuant to paragraph .32 of AT Section 201

<sup>2</sup> Alternatively, accountants could be engaged to provide a letter pursuant to AU 634, *Letters for Underwriters and Certain Other Requesting Parties*, with similar limitations on distribution as described in this section.

<sup>3</sup> Pursuant to paragraph .32 of AT Section 201

*Relevance of Activities to the Intent of the Act and the SEC's Proposed Rule 193 and Rule 15Ga-2*

Proposed Rule 193 would require each issuer of ABS to perform a review of the assets underlying registered ABS offerings and disclose the nature of such a review. However, the Proposal does not define what constitutes a review, provide a minimum level of review or prescribe procedures that must be performed as part of such review. In addition, Proposed Rule 15Ga-2 (pursuant to Section 932 of the Act), would require issuers and underwriters of any ABS, whether registered with the SEC or exempt from SEC registration, to disclose the findings and conclusions of any review performed by a third party that was hired to conduct a review of the pool assets.

As noted above and discussed further below, we believe that the provisions of the Act related to ABS were in response to the realization that many investors who experienced losses during the financial crisis were not fully aware of the risks in the quality of the underlying mortgages (or other financial instruments) within the pools of securitized assets and that the Act's provisions were intended to provide investors with additional information with which to evaluate such risk. We do not believe that the activities described above constitute a "review of assets" as contemplated by the Act due to the fact that the activities are not focused on evaluating any information related to the credit quality of the assets underlying the securitization, nor are the findings included in the accountant's report useful in that analysis.

Providing investors with additional information to assess the credit quality of the assets appears to be the primary motivator of the provisions of the Act according to the related Committee Report of the U.S. Senate Committee on Banking, Housing and Urban Affairs (the Report). The Report indicates that the provisions were influenced, in part, by congressional testimony provided by Professor John Coffee.<sup>4</sup> In his testimony, Professor Coffee noted that there was a lack of due diligence performed on the assets underlying ABS. Professor Coffee describes due diligence as procedures such as "checking credit scores and documentation" as well as services provided by "due diligence firms" who were engaged to perform procedures to verify the quality of collateral in loans underlying the ABS.<sup>5</sup> In our experience, "due diligence firms" often provide services such as, for example, performing detailed reviews of loan documentation, applying prescribed underwriting criteria to such loans and reporting any loans that were included in the securitization pool that did not comply with the underwriting requirements. We note that the results of these procedures would appear to provide investors with improved information about the nature and quality of the assets underlying the ABS.

We note that the Proposal also appears to take a similar view that a review of assets is intended to provide information related to the credit quality of the underlying assets. For example, the types

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<sup>4</sup> Wall Street Reform Bill - Committee Report, available at [http://banking.senate.gov/public/files/Comittee\\_Report\\_S\\_Rept\\_111\\_176.pdf](http://banking.senate.gov/public/files/Comittee_Report_S_Rept_111_176.pdf)

<sup>5</sup> *Enhancing Investor Protection and the Regulation of Securities Markets*, Working Paper available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1372194](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1372194)

of review procedures the Proposal requests comments on include 1) determining whether the underlying assets meet the underwriting criteria as described in the offering document, 2) determining whether loans have been originated in compliance with applicable laws and 3) a review of the accuracy of the property values reported by the originators for the underlying collateral.<sup>6</sup> The results of these procedures would appear to provide potential investors with additional information to assist in the evaluation of the credit quality of the assets included in an ABS.

We do not believe that the services provided by accountants as described above represent a “review of pool assets” or “due diligence” as contemplated by the Act due to the fact that such services do not provide investors with additional information with which to evaluate the credit quality of the assets underlying the ABS. We believe that the procedures performed by accountants, which are performed primarily to support an underwriter’s due diligence defense under the Securities Act of 1933 with respect to disclosures in the registration statement and prospectus, should be considered distinct from activities that are intended to provide additional transparency regarding the nature of the assets included in the securitization. Therefore, we do not believe that the activities performed by accountants pursuant to agreed-upon procedures engagements as described above should be included within the scope of the “review of assets” as contemplated by Proposed Rule 193 or as a “third-party due diligence report” as contemplated by Proposed Rule 15Ga-2.

Finally, including these activities within the scope of Proposed Rule 193 would necessitate the inclusion of the accountant’s report in an offering document, which would be prohibited under current professional standards and would likely prevent accountants from performing such procedures. With respect to Proposed Rule 15Ga-2, which would require issuers and underwriters to disclose the findings and conclusions of any third party due diligence report obtained, we note that accountant’s reports pursuant to these activities contain descriptions of items identified through the performance of such procedures and typically relate to calculation errors or data transfer errors, which are often corrected as part of the development of the offering document. These factors, combined with the nature of the underlying activities performed, would significantly limit the utility of the reports and their findings to investors for the purpose of evaluating the credit quality of the assets underlying the ABS.

Therefore, we recommend the SEC explicitly clarify in the final rule that accountant’s agreed-upon procedures engagements of the type described above do not address the credit quality of the underlying assets in an ABS and do not fall within the scope of Rule 193 or of Rule 15Ga-2.

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<sup>6</sup> See question 4 of the Proposal

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

Sincerely,

*Ernst + Young LLP*