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November 7, 2011

VIA E-MAIL RULE-COMMENTS@SEC.GOV

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Attn: Ms. Elizabeth M. Murphy, Secretary

Re: Release No. IC-29779; File No. S7-35-11

Ladies and Gentlemen:

Dechert LLP ("***Dechert***") appreciates this opportunity to comment, on behalf of certain of its clients,[1] on Release No. IC-29779; File No. S7-35-11, dated August 31, 2011 (the "***ANPR***") in which the Securities and Exchange Commission (the "***Commission***" or the "***SEC***") requested comment on various matters related to Rule 3a-7 under the Investment Company Act of 1940 (the "***Investment Company Act***"). For the reasons discussed in this letter, we believe that Rule 3a-7 continues to be well suited to serve the purposes for which it was adopted and that significant changes to Rule 3a-7 are unwarranted. Since Rule 3a-7 was adopted in 1992, it has worked well to distinguish asset-backed issuers from investment companies, address investor protection concerns under the Investment Company Act and permit the growth and innovation of the asset-backed securities markets that provide important capital and liquidity to financial institutions engaged in providing credit to consumers and businesses, including small and middle market businesses that drive job creation in the U.S. economy. Investors, consumers and businesses have all benefitted from the growth, liquidity and diversity that asset-backed securities transactions provide.

In providing these comments, we urge the Commission to consider that Rule 3a-7 Issuers (as defined below) are distinct in many important ways from investment companies. We believe that any changes to Rule 3a-7 itself or the manner in which finance companies that utilize Rule 3a-7 Issuers are treated under the Investment Company Act would have a significant and negative impact not just on our clients but also on the many consumers and businesses who rely on these companies to provide them credit in the capital markets. As we discuss in this letter, Rule 3a-7 Issuers, like Section 3(c)(5) issuers,

[1] Dechert LLP is an international law firm with wide-ranging financial services, corporate and securitization practices that serve clients in the United States and abroad. The views expressed in this letter are views being expressed on behalf of certain of our clients but do not necessarily represent the views of all of our clients or of the firm as a whole. Our law firm is also submitting other comment letters which either reflect the views of other clients or our own views as set forth in such letters.

are fundamentally different from investment companies.[2] Likewise, finance companies that utilize Rule 3a-7 Subsidiaries (as defined below) to pursue their finance business to provide capital to small- and medium-sized businesses are fundamentally different from investment companies. There is no reason, from an investor protection standpoint or otherwise, to change the manner in which these finance companies are treated under the Investment Company Act. It is our view that subjecting these companies to the strictures of the Investment Company Act is inappropriate and could have a crippling effect on the ability of finance companies that utilize Rule 3a-7 Subsidiaries (and the constituencies that they serve) to access capital markets, harming market efficiency, competition and capital formation.

FINANCE COMPANIES THAT USE RULE 3a-7 SUBSIDIARIES DIFFER SUBSTANTIALLY FROM INVESTMENT COMPANIES

Certain of our clients are companies (other than banks) that provide capital to a variety of primarily middle-market companies (some of which themselves provide capital to consumers and small businesses), across multiple asset classes through a variety of financing structures, including corporate and asset based loans, mortgage loans and asset-backed securities ("***ABS***"). These clients are not, and do not hold themselves out as, investment companies as that term is commonly understood (*i.e.*, a pool of assets whose only purpose is to allow others to invest or speculate in a portfolio of securities). Unlike an investment company, these clients do not seek profits based on changes in the value of, and income generated by, their investments; rather, like banks, these companies profit from the difference between the interest income earned on their assets and the interest expense incurred on their liabilities – net interest margin. Thus, the business of these companies is very different from that of an investment company that seeks to profit from the income and capital appreciation of its portfolio securities. As described below, our clients' utilization of Rule 3a-7 Subsidiaries helps to facilitate their non-investment company business purpose of seeking to maximize net interest margin.

Although they are a source of financing, these clients differ from banks in that they do not accept deposits from customers. However, they serve a similar function in the capital markets in facilitating the extension of credit, directly or indirectly, to consumers and businesses. In particular, as banks have found it more difficult to lend or have limited lending activities to different subsets of the markets, these companies have stepped in to provide much needed credit and liquidity to borrowers who previously may have sought out bank financing. As a result, our clients represent an important innovation in the capital markets, promoting efficiency and competition in the financing space and promoting capital formation.

To access low-cost capital and for other reasons, including tax and bankruptcy remoteness reasons, our clients typically are structured as holding companies, with wholly- or majority-owned subsidiaries, some of which may rely on Rule 3a-7 (a "***Rule 3a-7 Issuer***") and others of which may rely on Section 3(c)(5) or other statutory or regulatory exceptions or which are wholly outside the scope of the Investment Company Act. For example, debt providers to these companies often require that the assets against which they extend credit, the cash flow from which is used to repay the debt, be segregated in bankruptcy remote special purpose vehicles meeting the requirements of Rule 3a-7. Consistent with the holding company structure, interests held by the parent company in a wholly- or majority-owned subsidiary that is a Rule 3a-7 Issuer (a "***Rule 3a-7 Subsidiary***") do not represent "investments." Rather,

[2] Section 3(c)(5) of the Investment Company Act exempts structured financings that are comprised of obligations representing all or part of the sales price of merchandise, insurance and services or mortgages and other liens on or interests in real estate.

as stated above, the use of Rule 3a-7 Subsidiaries is an essential component of the non-investment company business of these types of companies.

Because our clients' businesses rely on financings that include Rule 3a-7 Subsidiaries (and other subsidiaries) to allow them to provide competitively priced capital to many consumers and businesses, we are particularly concerned with the possibility, discussed in the ANPR, that the long-standing treatment of interests in a Rule 3a-7 Subsidiary for the purpose of determining the parent company's status under Section 3(a)(1)(C) of the Investment Company Act might be altered.[3] Currently, interests issued by a majority-owned Rule 3a-7 Issuer are not investment securities and, therefore, are treated as "Good Assets" for purposes of the "Forty Percent Test" (each as defined in footnote 3).

While our clients may engage in financing activities through subsidiaries that rely on the exemption set forth in Section 3(c)(5), such financing activities, whether loans made in connection with the purchase of specified goods or services or real estate, generally comprise only a portion of a company's financing business and may not be of sufficient size to permit the parent company to pass the "Forty Percent Test". General purpose corporate loans to small and middle market companies generally are not the types of financing activities that come within the exemption of Section 3(c)(5), and so they are securitized through Rule 3a-7 Subsidiaries. Forcing our clients to limit their financing activities to Section 3(c)(5) favored businesses through the disparate treatment of Rule 3a-7 Subsidiaries as compared to Section 3(c)(5) subsidiaries with respect to the Forty Percent Test would significantly impact the small and middle market companies that rely on our clients for capital. This is the case even though the securitization process and the general nature of the finance subsidiary do not vary based on whether the financing activity is or is not within the purview of Section 3(c)(5). There is no reason for disparate treatment of the interests in these subsidiaries as investment securities based on whether they rely on Rule 3a-7 or Section 3(c)(5) for exemption from investment company status, as the difference between these exemptions stems from the type of assets being securitized rather than the nature or purpose of the financing.

Our clients typically engage in financings, or sponsor securitizations to provide financings, that are excepted pursuant to Section 3(c)(5) (when available) or Rule 3a-7; consequently, a holding company structure where interests in both Rule 3a-7 Subsidiaries and Section 3(c)(5) subsidiaries continue to be treated as "Good Assets" for purposes of the "Forty Percent Test" is necessary to avoid applying the

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[3] Section 3(a)(1)(C) of the Investment Company Act defines as an investment company "any issuer which is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of each such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis" (this is commonly referred to as the "Forty Percent Test"). In discussing the Forty Percent Test, practitioners often refer to investment securities (which are defined by Section 3(a)(2) of the Investment Company Act as any security other than "(A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which (i) are not investment companies and (ii) are not relying on the exception from the definition of investment company in [Section 3(c)(1) or (7) of the Investment Company Act]") as "Bad Assets", as they increase the numerator making it more likely that the issuer will "fail" the Forty Percent Test (and, potentially, be an investment company), while referring to securities that are not investment securities or government securities (as well as assets that are not securities) as "Good Assets" since these increase the denominator without impacting the numerator, making it more likely that the issuer will "pass" the Forty Percent Test (and, generally, not be an investment company). For ease of reference, this terminology is used throughout our comment letter.

"regulatory barriers presented by the Investment Company Act" to our clients' businesses.[4] As discussed below, equivalent treatment of both Section 3(c)(5) subsidiaries and Rule 3a-7 Subsidiaries as "Good Assets" for purposes of the parent company's "Forty Percent Test" is consistent with the purposes of the Investment Company Act because it reflects the fact that, these subsidiaries, unlike private funds that rely on Section 3(c)(1) or Section 3(c)(7), are engaged in a business distinct from that of an investment company. Moreover, equivalent treatment of interests in Rule 3a-7 Subsidiaries and Section 3(c)(5) subsidiaries is consistent with the purpose of these subsidiaries, namely to facilitate the finance activities of a holding company.[5]

RULE 3a-7 ISSUERS ARE LIKE SECTION 3(c)(5) ISSUERS NOT FUNDS

Rule 3a-7 has worked well to distinguish Rule 3a-7 Issuers from investment companies[6] and has allowed for widespread growth and innovation in the structured finance market beyond what was available under Section 3(c)(5) prior to the adoption of Rule 3a-7, thereby providing an important source of capital to many businesses and consumers. Rule 3a-7 Issuers, generally and as used to facilitate the finance activities of our clients, serve an important role in our capital markets by providing necessary capital and liquidity to a wide array of consumers and businesses, including American small- and mid-sized businesses which are the primary engine of U.S. growth and employment. The potential changes discussed in the ANPR to the treatment of Rule 3a-7 Issuers would be ill-advised at a time of heightened financial uncertainty and decreased availability of credit as they could further disrupt the structured

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4 Release No. IC-18736, at 8 (May 29, 1992) [57 FR 23980 (June 5, 1992)] (the "Rule 3a-7 Proposing Release").

5 The Investment Company Act's definition of an "investment company" is structured specifically to assure that the Act applies to *investment* companies and not to *holding* companies. Section 3(a)(1)(A), itself, applies only where an issuer is primarily engaged in investing, reinvesting or trading in securities – not where the issuer merely owns or holds securities – even if a substantial portion of the issuer's assets are securities. The Staff has recognized this distinction in no-action guidance. For example, the Staff granted relief to a company whose assets consisted substantially of securities representing interests in majority-owned subsidiaries that were not investment companies, noting that such a company:

> "would not be an investment company as defined in section 3(a)(1)[A] because its primary business will be owning or holding securities rather than 'investing, reinvesting, or trading' in them . . . and that [the requestor] would not be an investment company as defined in section 3(a)[(1)(C)] because 'investment securities' is defined to exclude securities issued by majority-owned subsidiaries of the owner which are not themselves investment companies."

United Asset Management, at 4 (pub. avail. Nov. 2, 1981).

6 Several provisions of Rule 3a-7 enforce the distinction between Rule 3a-7 Issuers and investment companies. For example, Rule 3a-7(a)(3)(iii) requires that a Rule 3a-7 Issuer may only acquire or dispose of eligible assets if "the assets are not acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes . . ." and Rule 3a-7(a)(1) requires that securities issued by Rule 3a-7 Issuers "entitle their holders to receive payments that depend primarily on the cash flow from eligible assets." As a result, securitizations relying on Rule 3a-7 are "cash flow" rather than "market value" vehicles and, as a general matter, eligible assets are selected based on credit quality and anticipated cash flows rather than on the expectations of increasing market values. By contrast, investment companies may, and do, generally trade specifically to recognize gains or decrease losses resulting from market value changes and the value of investment company shares relates directly to the current market values of the underlying assets. Similarly, like Section 3(c)(5) issuers, Rule 3a-7 Issuers are precluded from issuing redeemable securities while mutual funds (which make up the bulk of U.S. registered investment companies) are required to issue redeemable securities. We note that both (i) the cash flow rather than market value conditions of Rule 3a-7 and (ii) the preclusion with respect to redeemable securities for Rule 3a-7 and Section 3(c)(5) issuers were intended by the Commission and Congress, as applicable, to assure that securitization issuers are not confused with mutual funds. If a Rule 3a-7 Subsidiary fails to meet the requirements of Rule 3a-7, it would be treated as a Bad Asset for purposes of the Forty Percent Test.

finance market and consequently curtail the availability of capital to many businesses. This would particularly hurt the small and middle market businesses that turn to these finance companies because large commercial banks are often unwilling to devote resources to this segment of the loan market and lend to these businesses because the size of the loans are too small. The Commission has recognized that the Investment Company Act includes a number of provisions that are inconsistent with financing businesses.[7] Indeed, in proposing Rule 3a-7, the Commission recognized that "[t]he regulatory barriers presented by the Investment Company Act have broader economic implications. Many sectors of the economy are prevented from fully using structured finance to address capital needs."[8] Given that these finance companies use structured financings as a financing technique to maximize net interest margin rather than an investment strategy, we see no reason that these finance companies should be forced to treat majority interests in Rule 3a-7 Subsidiaries as "Bad Assets", particularly since majority interests in Section 3(c)(5) subsidiaries continue to be treated as "Good Assets".

The history of Rule 3a-7 clearly ties Rule 3a-7 Issuers closely to Section 3(c)(5) issuers and distinguishes both from private funds and investment companies. Rule 3a-7 finds its genesis in the 1992 Protecting Investors Report in which the Staff of the Division of Investment Management (the "Staff") surveyed the then fifty-year history of the Investment Company Act (as well as the Investment Advisers Act) and made recommendations for potential improvements.[9] One such recommendation was to "develop a coherent approach to the treatment of structured financings"[10] so as to close the gap between structured financings for which Section 3(c)(5) is available and those for which it was not.[11] In particular, the Staff noted that the limitations as to asset type in Section 3(c)(5) "distorts the market by enforcing a distinction that does not reflect the economic reality that any asset with a relatively predictable cash flow, whether it may be classified as a 'commercial' instrument or a 'financial' instrument may be securitized."[12] Indeed, in the Rule 3a-7 Proposing Release, the Commission acknowledged the Staff's recommendation stating, ". . . under the present regulatory framework, a structured financing may be entirely exempt from the [Investment Company] Act, or it may be subject to the [Investment Company]

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7 Similarly, Section 3(c)(5) represents Congressional recognition that regulation under the Investment Company Act is inconsistent with, and unnecessary for, financings related to the types of assets covered thereunder (e.g., receivables, real estate) which were the primary asset types covered by non-bank lenders at the time of the adoption of the Investment Company Act. Banks, of course, enjoy a separate exception from the Investment Company Act under Section 3(c)(3). We believe that, had companies that engage in the same type of business as our finance clients existed in 1940, they too likely would have been provided an exception, similar to that provided to factors, mortgage lenders and persons who make small loans or engage in industrial banking (which is excepted pursuant to Section 3(c)(4) of the Investment Company Act.

8 Rule 3a-7 Proposing Release, at 8. This is consistent with the Staff's observation, in a 1992 report, that "structured finance primarily is a financing technique that integrates the capital markets with borrowers seeking access to those markets; the sponsors of securitizations are seeking a source of financing." *Protecting Investors: A Half Century of Investment Company Regulation*, The Treatment of Structured Finance under the Investment Company Act 1-101 (May 1992) ("Protecting Investors Report").

9 Protecting Investors Report; Rule 3a-7 Proposing Release; *Exclusion from the Definition of Investment Company for Structured Financings*, Release No. IC-19105 (Nov. 19, 1992) [57 FR 56248 (Nov. 27, 1992)] (the "Rule 3a-7 Adopting Release").

10 Protecting Investors Report, at 76.

11 For example, as observed by the Staff, at the time of the Protecting Investors Report, structured "[f]inancings that [did] not fit within section 3(c)(5) . . . either must be privately placed in the United States or sold overseas." *Id.*

12 *Id.* The Staff further suggested that "[a]ll structured financings, regardless of their assets . . . be able to rely on the exemption."

Act and thus sold overseas or in private placements, depending solely on the nature of the assets securitized. Ironically, the result does not depend on the structure and operation of structured financings or the credit quality of the securitized assets."[13]

Proposing to change the manner in which the securities issued by Rule 3a-7 Subsidiaries must be treated by their holding company parent to mirror the treatment of interests issued by a private fund, rather than a Section 3(c)(5) securitization, for Investment Company Act status purposes,[14] fails to recognize this important distinction underpinning Section 3(c)(5) and Rule 3a-7 on one hand and Sections 3(c)(1) and (7) on the other. The Commission's decision to exclude Rule 3a-7 Issuers from the Investment Company Act was based on the Commission's view that these issuers were fundamentally different from investment companies in operation and purpose. In this respect, in making its recommendation in the Protecting Investors Report that led to Rule 3a-7, the Staff noted the "distinctions between structured financings and investment companies" and that "[a]s a practical matter, structured financings cannot register as investment companies because they cannot operate under the [Investment Company] Act's provisions." In contrast, the private fund exceptions recognize that private funds are not operationally or functionally distinct from registered investment companies, but instead the nature of their investors is such that regulation as investment companies is not needed. Thus, the Staff noted that Section 3(c)(1) "reflects Congress's belief that federal regulation of private investment companies is not warranted" and, similarly, the Staff's recommendation in the Protecting Investors Report that led to the addition of Section 3(c)(7) as an additional exception for private funds to existing Section 3(c)(1) was "premised on the theory that 'qualified purchasers' do not need the [Investment Company] Act's protections because they are able to monitor such matters as management fees, transactions with affiliates, corporate governance and leverage."

As noted above, our clients are engaged in a separate and distinct business from that of an investment company or private fund. Rule 3a-7 Subsidiaries are used by our clients in a manner that is functionally equivalent to other securitizations that rely on Section 3(c)(5). Like Section 3(c)(5) securitizations, Rule 3a-7 securitizations are intended to provide efficient financing to these companies to maximize their net interest margin, a purpose that is markedly different from a company holding an interest in a private fund that seeks income and capital appreciation.[15]

It is clear that the Commission and the Staff, at the time that the Protecting Investors Report was issued and Rule 3a-7 was adopted, understood that the exemptive rule would have the effect of treating interests in Rule 3a-7 Subsidiaries in a manner equivalent to interests in Section 3(c)(5) subsidiaries for

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13 Rule 3a-7 Proposing Release, at 8.

14 *See* ANPR, at n.105.

15 In the Protecting Investors Report, the Staff recommended amending the definition of "investment security" to make clear that it did include interests issued by a company reliant on Section 3(c)(1) to prevent companies from "avoid[ing] regulation under the [Investment Company] Act by 'downstreaming' their investment activities through" a private fund subsidiary. Protecting Investors Report, Chapter 2 at n.18. (This same treatment was given to companies reliant on Section 3(c)(7) which was adopted as a result of the Protecting Investors Report) Implicit in this is the recognition that unlike other statutory exceptions or regulatory exceptions under Section 3 of the Act, companies reliant on Section 3(c)(1) or (7) are excused from registration based on their investor base and private nature. This is a sharp contrast to the Commission's view of Rule 3a-7, which the Commission adopted to remove "an unnecessary barrier to the use of structured financings" by permitting "structured financings to offer their securities publicly in the United States without registering under the Act and complying with the Act's substantive requirements." Rule 3a-7 Adopting Release, at 1.

purposes of the Forty Percent Test. Despite this knowledge, neither the Protecting Investors Report, nor the Proposing or Adopting Releases for Rule 3a-7 suggested that there was then any need for disparate treatment of interests in Rule 3a-7 Subsidiaries, as opposed to Section 3(c)(5) subsidiaries.[16] The lack of any such suggestion is, however, consistent with the views expressed by the Staff and the Commission as to the "fundamental[] differen[ce]" between structured financings and investment companies, and the intent of Rule 3a-7 to provide "a coherent approach to the treatment of structured financings" whether or not Section 3(c)(5) was available. We do not believe that a need for disparate treatment of these very similar vehicles under the Forty Percent Test has developed in the interim.

COST/BENEFIT ANALYSIS — IMPACT OF A CHANGE ON THE CAPITAL MARKETS AND ECONOMY

Given the fundamental differences between the business of certain of our clients and the investment company business, these companies cannot, and should not need to, operate within the bounds of the Investment Company Act. If required to operate within the bounds of the Investment Company Act, our clients do not believe that they would be able to address their businesses' capital needs in order to extend credit in sectors of the economy that are not well served by traditional capital providers – which is an issue that the adoption of Rule 3a-7 was explicitly intended to remedy.

Moreover, those of our clients that are publicly traded are already subject to multiple layers of disclosure and regulation, including among others, the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act and various rules and regulations under each. Therefore, altering the treatment of interests in Rule 3a-7 Subsidiaries for our clients and others who use Rule 3a-7 Subsidiaries to facilitate the operation of non-investment company businesses would serve only to apply the "regulatory barriers presented by the Investment Company Act" to a business which Congress and the SEC seem to have long recognized as "fundamentally different" from that of an investment company.[17] Moreover, the possible changes discussed in the ANPR would significantly limit the availability of capital for our clients through the use of securitizations as well as the ability of small and middle market businesses to access capital through these companies and would certainly have negative repercussions in the current fragile economic climate.

From a cost/benefit perspective, there would be significant costs in requiring our finance company clients to restructure their business or subject themselves to the provisions of the Investment Company Act. Significant changes to the terms of Rule 3a-7 or the treatment of interests in Rule 3a-7 Subsidiaries as "Good Assets" would likely force our clients to terminate, or drastically alter their business, structures and operations and preclude them from extending credit to many small and middle market businesses that they now are able to support. At a minimum, the proposed changes would compel

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[16] In this respect, it is interesting to note that, as discussed in note 15, above, another of the recommendations in the Protecting Investors Report was to allow for private funds that include more than 100 beneficial owners to be exempt provided that each owner meets certain qualifying standards in excess of those required for Section 3(c)(1). In making this recommendation, the Protecting Investors Report included suggested statutory language amending the definition of "investment security" in the Investment Company Act to prevent circumvention of the Investment Company Act through investments in issuers relying on Section 3(c)(7). Protecting Investors Report, at 117. The Staff's language both for the Section 3(c)(7) exception and the altered definition of investment security were enacted by Congress in [1997], in substantially similar form to what was in the suggested statutory language included in the Protecting Investors Report.

[17] Rule 3a-7 Proposing Release, at 8 and at n.10.

our clients and other participants in the structured finance market to scale back or eliminate the use of Rule 3a-7 Subsidiaries or to restructure their operations to operate under the Investment Company Act (which, as observed by the Commission and its Staff would likely be impossible and, even if possible, would have a significant negative impact on shareholders as a result of the additional costs and burdens associated with the Investment Company Act).

We do not believe there would be significant benefits in changing the treatment of our finance company clients under the Investment Company Act. We are not aware of any actual abuse or harm suffered by shareholders, including public shareholders, of finance companies that utilize Rule 3a-7 Subsidiaries, as a result of those subsidiaries. As we noted, those finance companies which are publicly traded are subject to multiple layers of disclosure and regulation under the various U.S. securities laws that seek to protect the shareholders. Thus, we believe the costs would far outweigh any potential benefits.

MODIFYING THE TREATMENT OF INTERESTS IN RULE 3a-7 SUBSIDIARIES IS A DECISION BEST LEFT TO CONGRESS GIVEN THE SIGNIFICANT DEPARTURE FROM PAST PRACTICE AND LEGISLATIVE AND ADMINISTRATIVE HISTORY

Congress has, several times since the adoption of Rule 3a-7, amended the Investment Company Act without altering the definition of "investment security" to include issuers relying on Rule 3a-7. As discussed above, Congress and the SEC were clearly aware that securities issued by a majority-owned subsidiary relying on any new exception or exemption from the definition of an investment company would qualify for treatment as a "Good Asset" in the hands of its parent company.[18] We believe, therefore, that current Section 3(a)(2) represents (or at least implies) Congress's intent that interests of the type held by our clients in Rule 3a-7 Subsidiaries should be treated as "Good Assets". Although we are certainly opposed (for the reasons set forth throughout this letter) to any change that would result in interests in Rule 3a-7 Subsidiaries being treated as "Bad Assets", we believe that such a sweeping change, which would likely have profoundly deleterious effects on efficiency, competition and capital formation in the U.S. economy, should be implemented only through legislative rather than administrative action.

CHANGES TO RULE 3a-7 RATING AGENCY REFERENCES ARE NOT NECESSARY FOR INVESTOR PROTECTION OR REQUIRED BY THE DODD-FRANK ACT

The Commission promulgated Rule 3a-7, in large part, to permit investment grade rated asset-backed securities to be sold to the public in instances where the Section 3(c)(5) exception was unavailable for the assets being securitized.[19] In adopting Rule 3a-7, the Commission considered that then-current securitization practices, including certain structural safeguards commonly required by rating agencies, could provide investor protections while promoting efficiency, competition and capital formation. The Commission included the rating conditions to assure that rating agency methodology and processes would be available as a proxy for addressing Investment Company Act concerns, especially as they relate to

18 *See supra* n.3.

19 Indeed, in proposing Rule 3a-7, the Commission recognized that "[t]he regulatory barriers presented by the [Investment Company] Act have broader economic implications. Many sectors of the economy are prevented from fully using structured finance to address capital needs." Rule 3a-7 Proposing Release, at 8.

public investors, and not to assure actual credit worthiness.[20] This remains true today and we believe that the references to rating agencies in Rule 3a-7 should be retained. The Rule 3a-7 references to rating agencies differ from references to rating agencies in other rules that require reliance on a credit rating for an assessment of credit-worthiness. As a result, we do not believe that Section 939A of Dodd-Frank compels the removal of rating agency references from Rule 3a-7.[21]

Based on the nearly 20 year history of Rule 3a-7, it seems clear that the structural requirements which were incorporated in Rule 3a-7 through the rating conditions applicable to public deals, and which the market typically requires even in unrated cash flow asset-backed securities transactions, have provided and continue to provide an appropriate level of investor protection to address concerns that may arise under the Investment Company Act. At the same time, these structural requirements have allowed for continued innovation in securitization structures. Applying additional requirements or limitations would not likely serve the investor protection goals of the Investment Company Act, and would likely diminish the flexibility afforded by Rule 3a-7 and thereby negatively impact the ability of the securitization market to continue to play a vital role in capital formation.

Additionally, given that Rule 3a-7 already includes sufficient investor protections, we believe that substituting the requirement of an independent reviewer for the rating agency conditions, requiring additional review of asset-backed securities transactions by additional or different parties, or requiring additional opinions or certifications would not provide any significant benefit to investors. Indeed, investors and markets could be harmed because these changes would increase the costs and burdens associated with asset-backed financings, and slow the asset-backed securities market until providers and processes develop for such reviews, opinions or certifications. During the recent financial crisis, a slowdown in securitizations for a number of asset classes (*e.g.* student loans and auto loans), reduced or eliminated the ability of consumers to access capital, and today's recovering markets can ill afford similar constrictions in the flow of capital.

CONCLUSION

We are concerned that if the Commission were to implement certain of the concepts introduced in the ANPR, including particularly the treatment of interests in Rule 3a-7 Subsidiaries as "Bad Assets",

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20 *See* ANPR, at n.38 (noting that the Adopting Release for Rule 3a-7 emphasized that, "although ratings generally reflect evaluations of credit risk the rating requirement [was] not intended to address investment risks associated with the credit quality of a financing.") We believe that concerns, including those expressed in the ANPR, regarding rating agencies' methodologies and processes during the recent financial crisis are more related to predictions concerning credit worthiness of certain rated transactions rather than the efficacy of the rating agency requirements that the Commission built into Rule 3a-7 for investor protection purposes in 1992.

21 Section 939A states:

> "(a) Agency Review — Not later than 1 year after the date of the enactment of this subtitle, each Federal agency shall, to the extent applicable, review— (1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings. (b) Modifications Required — Each such agency shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." Public Law 111–203 §939A.

structured finance would effectively return to its pre-Rule 3a-7 status as it relates to certain of our clients that may lack sufficient other financing activities to fall outside of the definition of an investment company or otherwise enjoy preferred status under the Investment Company Act as, for example, a bank or where the securitized assets conform to Section 3(c)(5). This would result in the Investment Company Act "treat[ing] similar types of structured financing very differently"[22] and would have the effect of reducing the availability of credit to small and middle market businesses that are not currently well served by banks at precisely a time in the economic cycle when ready access to credit can be crucial to the continued viability of such businesses which are the primary drivers of job growth in the United States. Such a result is contrary to the Commission's goal in adopting Rule 3a-7 to remove unnecessary barriers to the use of structured finance in our capital markets,[23] and to Section 2(c) of the Investment Company Act which requires the Commission, when "engaged in rulemaking. . . to consider or determine whether an action is consistent with the public interest [to] also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation."

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We appreciate the opportunity to comment on the ANPR on behalf of our clients. If you have any questions about our comments or would like additional information please contact Bill Bielefeld (202.261.3386 or william.bielefeld@dechert.com), Richard Horowitz (212.698.3525 or richard.horowitz@dechert.com), Mike Sherman (202.261.3449 or michael.sherman@dechert.com), Cindy Williams (617.654.8604 or cindy.williams@dechert.com), or Ken Young (215.994.2988 or ken.young@dechert.com).

Respectfully yours,

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22 As noted in the Rule 3a-7 Adopting Release, this is precisely what Rule 3a-7 was intended to mitigate.

23 *See supra* n.4. Among these barriers would be that only certain types of companies such as banks or insurance companies would be able to engage in structured finance transactions which would unnecessarily limit the availability of capital to businesses.