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OFFICE OF THE SECRETARY

Hon. Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Email: alj@sec.gov

RE: *In re Harding Advisory LLC & Wing F. Chau*, Admin. Proc. No. 3-15574

Dear Judge Elliot:

The Division pointed out in its Reply Brief that Respondents' counsel incorrectly attributed certain transcript citations and testimony excerpts to Ira Wagner on certain pages of Respondent's Post Hearing Brief. (Div. Reply Br. at Preliminary Statement, 42-43; *see* Resp. Br. at 264-67.) We immediately looked into this matter. Much to our regret and embarrassment, the Division is substantially correct. (One of our citations to Mr. Wagner's testimony on page 265 at 4835:5-9 is correct.) We apologize sincerely for this mistake. We can represent to the Court that this was an inadvertent editing and cite-checking error.

Although these citations and attributions were in error, our basic point was correct: Ira Wagner's testimony (cited below) does corroborate Mr. Chau's testimony quoted on pages 264 through 267 of Respondents' Brief that Brett Kaplan's analysis (and in particular the 10.17% write-down number reflected in Division Exhibit 217) did not indicate that the Norma BBB bonds were impaired at the time Harding purchased them. (Resp. Br. at 264.)

The point of the relevant section of Respondents' Brief, and Mr. Chau's testimony, is that losses in the pools of *loans* collateralizing RMBS did not translate directly, on a one-to-one basis, into losses in the Norma CDO which was collateralized by the relevant RMBS. That is to say that (1) each RMBS had credit enhancements that absorbed losses in the underlying portfolio of loans, (2) those credit enhancements were designed to grow over time if the RMBS produced excess cash from its pool of loans, (3) losses and gains were distributed among tranches of RMBS in a manner designed to reduce the risk of non-payment to the higher tranches, and (4) the pooling of RMBS within Norma also diversified risk. As a result, the underlying pools of loans could have experienced significant write-downs or defaults over the life of the Norma CDO without impairing the RMBS that were in Norma or the Norma bonds that Harding purchased. This is essentially how securitizations work; they direct losses first to investors in more junior tranches (for example, the credit enhancement tranche and the BBB- tranche for the BBB securities) and gains first to investors in more senior tranches, such as the BBB bonds. This separation and redirection of losses and gains permitted the creation of investment-grade securities even when the underlying collateral loans were sub-prime and were expected to experience defaults.

These are not controversial propositions and, of course, Mr. Wagner agreed. (Wagner at 4833:5-4834:20 (testifying about loss absorption by the credit enhancement: "If there would be excess spread and if the losses in either case were generally less than the excess spread amount, then excess spread would either cover them, and if there is excess after that, it would probably accumulate."); 4835:5-23 ("[w]hen losses are very low and spread out and they are able to be covered by the excess spread, there generally won't be write-downs" on the RMBS tranches); Wagner at 4843:3-20 ("So although there are a few more losses in early curves in the base loss ramp, this is what I am talking about. In other words, they are spread out and they are well below these excess spreads numbers, and that is why you are not going to necessarily see write-down in that."); Wagner at 4697:12-4698:17; 4743:6-10 (testifying that generally the losses from a pool of the loans were first absorbed by the lower rated tranches); Wagner at 4896:17-4897:3 ("Q. On RMBS securities – let me see if I have this correct. So you pool a bunch of residential mortgage loans and then there is a liability structure of some sort in the RMBS. Is that right? A. That's right. Q. So it is kind of like what we have seen with CDO's, where you have a waterfall of liability subordination and returns. Is that correct? A. That's correct.").)

Turning to the specific issue of the 10.17% projected write-down number in the Kaplan CDO commentary, which was the subject of the specific Wing Chau testimony cited and quoted on pages 264 through 267 of the Respondents' Brief and erroneously attributed to Mr. Wagner, while we disagree with Mr. Wagner's ultimate conclusions (which relied extensively on investigative testimony not in the record) as to whether Harding properly analyzed the Norma bonds (*see* Resp. Br. at 240-272), his expert report also made clear that the 10.17% write-down in the Kaplan CDO commentary related to Harding's RMBS analysts' review of the loan-pool collateral underlying the RMBS collateralizing the Norma CDO (*see* Div. Ex. 8001 at ¶¶ 155-158), and therefore, it was *not* an analysis of the expected write-downs on the Norma CDO bonds themselves. Indeed, Mr. Wagner's complaint in that portion of his report was that Harding should have performed *additional analysis* to understand how the projected losses in the pools of loans underlying the RMBS might *impact* the performance of the Norma CDO. (*Id.* at ¶ 156-58.)

In short, we made a mistake and we apologize for attributing certain of Mr. Chau's quotes to Mr. Wagner. However, Mr. Wagner's statements referenced above did corroborate Mr. Chau on the relevant issues.

Respectfully submitted,

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Office of the Secretary of the U.S. Securities and Exchange Commission (via Federal Express)