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15 July 2004

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington DC 20549-0609

*Re: "Asset-Backed Securities (Ref. S7-21-04)*

Dear Mr. Katz:

The Task Force on Disclosures for Asset-Backed Securities (the "Task Force") of CFA Institute<sup>1</sup> is pleased to comment on the Securities and Exchange Commission's ("SEC" or the "Commission") consultative paper, *Asset-Backed Securities* (the "Consultation"). The Task Force is charged with reviewing and responding to new regulatory, legislative, and other developments that may affect offerings, required disclosures and other matters related to asset-backed securities ("ABS"). The Task Force's investment professionals provide viewpoints based on their market experience and expertise, and are able to draw upon the collective knowledge of CFA Institute's global network of investment professionals.

### **General Comments**

#### ***Background***

The purpose of the Consultation is to codify positions the Commission has taken in the past with regard to disclosures relating to the issuance and performance of ABS. These positions helped ensure that investors were able to receive information that is vital for adequate analysis, assessment and valuation of such securities.

The Task Force commends the SEC staff for the thoroughness and relevance of its proposals. The proposed codification of the disclosures contained in the Consultation cover most, if not all, of the information investors need during the life of an ABS issue. This includes, in particular, a) pre-offering information investors need to analyze the securities, including deal structure, supporting entities and arrangements, and assets supporting the transaction; b) ongoing

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<sup>1</sup> With headquarters in Charlottesville, Virginia, U.S.A., and regional offices in Hong Kong and London, CFA Institute is a non-profit professional association of more than 70,000 financial analysts, portfolio managers, and other investment professionals in 121 countries and territories of which more than 57,500 are holders of the Chartered Financial Analyst® (CFA®) designation. CFA Institute's membership also includes 129 Member Societies in 48 countries.



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information about the performance of the underlying assets and the securities; and c) information investors need to understand the risks associated with the termination or early amortization of an issue of securities, as well as terms relevant to the bankruptcy of a sponsor, servicer or other entity critical to the payment of interest and principal on the transaction.

### **Specific Comments**

As a result of the thoroughness and relevance of the proposals, the Task Force's comments and concerns are limited both in scope and in number. These concerns relate to both issues covered and not covered in the Consultation, and are discussed in detail in the paragraphs that follow:

#### *Matters contained in the Consultation*

Research. In section 230.139a, the Commission proposes to permit brokers and dealers participating in an offering of asset-backed securities to publish and distribute research about the ABS that are subject to an offering, so long as the following criteria are met:

- The firm must have previously published or distributed with reasonable regularity research on ABS with substantially similar collateral;
- The research must not i) identify the offered securities, ii) give greater prominence to the offering's structural or collateral-related attributes than is given to the same attributes of other mentioned ABS; and iii) contain any informational and computational material relating to the offering;
- Any recommendation of a specific ABS security must not be more favorable than the published recommendation given in the last research report on such security prior to the firm's participation in the offering;
- There is sufficient information available from at least one other public source to provide a reasonable basis for the view expressed; and
- If the research identifies ABS backed by substantially similar collateral as that backing the offered securities and recommends that such ABS be preferred over other securities backed by other collateral, then the material must explain in reasonable detail the reasons for such preference.

The Task Force recognizes that the investors that participate in such offerings are typically associated with large and/or sophisticated institutions. Consequently, they possess an understanding of the potential conflicts of interest that are inherent in a research report published by a broker or dealer that is participating in the distribution of an ABS offering. Likewise, the Task Force is aware that in many cases, there are a limited number of investment firms that will publish research on such transactions.



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Regardless of these issues, however, the Task Force does not agree with this provision of the Consultation. CFA Institute has advocated both in comments to regulators and in its own *Research Objectivity Standards* that firms engaged in underwriting securities should refrain from publishing research on the securities and the issuing entities until 30 days after issuance. Indeed, CFA Institute's United States Advocacy Committee supported rules proposed by the New York Stock Exchange and the National Association of Securities Dealers and approved by the Commission that sought to impose 30-day quiet periods on initial public offerings, and 10-day quiet periods on secondary offerings, of equity securities.

The Task Force believes that the same concerns that warrant the quiet periods in equity securities are present in ABS offerings, as well. Consequently, it does not agree with the Commission's proposal to grant ABS offerings an exemption from this type of rule. The negative effect, or perceived effect, such an exception will have on the integrity of ABS research is potentially greater than the benefits it is hoped such an exception would produce.

First, permitting brokers and dealers to publish research during this period is unlikely to provide any benefits to the current market for these securities, namely large and/or sophisticated institutions. That is because they will base their investment decisions on their own analyses of the prospectus and computational material, rather than on the analyses and recommendations of the broker or dealer. Consequently, the benefits to the primary audience are likely limited.

However, this rule could prove potentially harmful if retail investors eventually take a more active interest in these securities. If this were to happen, research published without restriction by a broker or dealer participating in an ABS offering could have the same deleterious effects that research on equity securities had in that market in the recent past, namely that the analysts' opinions may be affected by the conflict between promoting the interests of the analysts' firms or their investors.

Moreover, permitting an exemption for ABS offerings could lead brokers, dealers and issuers to create structures that are designated ABS, but are, in effect, equity securities. Indeed, the added marketing boost such research could provide for an offering of such securities to retail investors might warrant the legal steps needed to achieve such a change in designation.

Consequently, in view of these considerations, the Task Force strongly urges the Commission to impose a 30-day quiet period on research concerning ABS offerings as is required of research on offerings of equity securities.

Form 8-K. Items 2.03 and 5.01 under General Instruction G for Form 8-K permits ABS registrants to avoid filing an 8-K for the "creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of a registrant," and "changes in control of the registrant," respectively. The Task Force believes providing exemptions from filing 8-K reports on these matters will deny investors of the information they need to understand the long- and short-term prospects for receiving principal and interest payments on ABS offerings when due.



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In particular, the Task Force believes the exemption from filing a Form 8-K upon creation of a “direct financial obligation” or through an “off-balance sheet arrangement” could produce a situation similar to what occurred with Enron Corp. For example, a firm that sponsors an ABS offering and subsequently also acts as servicer of the underlying assets could create a structure for certain assets or liabilities, thereby preventing market participants from recognizing their value or liability to the registrant’s financial condition.

The only way to ensure investors are able to recognize the costs or benefits of such actions is to require the servicer to disclose such information to ABS investors, most likely through an 8-K filing. However, by exempting companies from filing public reports on these matters would put ABS investors in an inferior trading position relative to both the company and to investors in other securities issued by the company.

Regarding item 5.01, ABS investors would find information about a change in control of the registrant relevant to the value of their investments. For example, the loss of top executives at a servicer, either as a result of poor management or as a result of steps taken by a shareholder could affect the firm’s ability to collect cash flows on the underlying assets and transmit them to ABS investors. Consequently, investors need to receive updates on such matters if they are to continue to make informed decisions about the costs and benefits of holding certain ABS securities.

For these reasons, the Task Force recommends that the Commission remove items 2.03 and 5.01 from the final rule.

#### *Other matters not contained in the Consultation*

*Offering Period.* The Task Force is concerned that despite efforts by the Commission and investors to induce issuers to provide prospectus and computational material in advance of ABS offerings many, if not most, issuers fail to provide such materials until less than 24 hours prior to sale. In some parts of the ABS market, investors receive the information so late that they are unable to review the relevant documentation until after the deal closes.

The inability to review offering documents prior to the purchase of securities means that information essential to assessing the potential risks and returns of the securities and, hence, their appropriate valuation cannot be incorporated in the prices paid for the securities. Thus the efficiency of both market prices and the allocation of capital will be affected.

In a worst case scenario, a number of investment funds would buy securities without having had time to adequately review the documentation only to have those securities ultimately go into default. In such a situation, investors and the courts likely will find fault not only with the issuers who didn’t provide the information until it was too late, but also with the investment firms who bought the securities without a thorough review of the relevant documentation. And if enough deals involving enough funds lose enough money in this manner, it could create political fallout that could impair the efficient functioning of the ABS market.



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Consequently, the Task Force recommends that the Commission incorporate into its final draft a rule that prevents the sale of ABS unless the issuing parties have prepared and delivered the relevant prospectus and computational materials 24 hours or more prior to the launch of the offering.

*Fair Disclosure.* The Task Force also is concerned that the private nature of communications between investors and servicers can create an asymmetry of information relating to asset-backed securities. This is particularly true in cases where the servicer is a private company and is not required to file regular updates with the Commission.

This is a problem, in part, because investors have no other source for information on the performance or other matters relating to specific ABS except the servicer. However, this can create a situation where one investor possesses information that is not readily available to all investors.

Some companies have taken effective steps to remedy this situation and the Task Force considers these a good solution that the Commission should consider adopting. Specifically, these companies have created repositories of the answers given in response to questions from all parties that they make available on their Web sites for all investors to view.

The Task Force endorses such repositories for two reasons. First, they ensure that all investors receive the same relevant information. And second, if updated promptly, they would ensure that such information is not only widely distributed, but that it is distributed in a timely manner, as well.

## Summary

The Task Force on Disclosures for Asset-Backed Securities of CFA Institute appreciates the opportunity to comment to the SEC on its consultation, *Asset-Backed Securities*. If you or your staff have questions or seek amplification of our views, please feel free to contact James C. Allen, CFA, by phone at +1.434.951.5558 or by e-mail at [james.allen@cfainstitute.org](mailto:james.allen@cfainstitute.org).

Sincerely,

*/s/ Patrick M. Miner*

Patrick M. Miner, CFA  
Chair  
Task Force on Disclosures for  
Asset-Backed Securities

cc: Linda Rittenhouse

*/s/ James C. Allen*

James C. Allen, CFA  
CFA Institute Professional Standards & Advocacy