S7-21-04

CONSUMER MORTGAGE COALITION
MORTGAGE BANKERS ASSOCIATION OF AMERICA

4

February 18, 1997

Mr. Brian J. Lane
Director
Division of Corporation Finance
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Lane:

The Mortgage Bankers Association of America (the "MBA") representing approximately 2,700 companies involved in real estate finance, including private conduits, independent mortgage companies, banks and thrifts and mortgage company subsidiaries, mortgage insurers, and others who service the mortgage industry, and the Consumer Mortgage Coalition (the "CMC"), an industry group of the nation's largest mortgage lenders and servicers, appreciate the opportunity to suggest substantial changes to the current disclosure system under the federal securities laws for public offerings of mortgage-backed and asset-backed securities. During 1996, the residential mortgage-backed securities market totaled approximately $110 billion, excluding securities issued or guaranteed by federal agencies. Because the members of the CMC and MBA include many large, periodic issuers of mortgage-backed securities, this letter focuses primarily on the market for mortgage-backed securities issued under shelf registration statements. Mortgage-backed securities and asset-backed securities will be referred to herein collectively as "asset-backed securities".

Some of our members, together with other issuers of mortgage pass-through certificates, submitted a letter dated December 22, 1994, to Abigail Arms, Associate Director (Legal) of the Division of Corporation Finance of the Securities and Exchange Commission (the "Commission"). In addition to describing the asset-backed securities market, the letter urges the Commission to adopt rules permitting (i) the use of a summary prospectus after the effectiveness of a registration statement but prior to

the delivery of a prospectus supplement and (ii) the distribution by underwriters during such period of computational materials, without the requirement to file such materials with the Commission. We have enclosed for your convenience a copy of the December 22, 1994 letter. We refer to that letter as the "1994 letter".

The purchasers of asset-backed securities usually are institutional investors who specify their investment objectives and request the information they need when the securities are structured. Public offerings of asset-backed securities typically consist of securities rated investment grade by one or more nationally recognized statistical rating organizations based on the nature of the underlying assets, the cash flow structure of the transaction and the type of credit enhancement provided. An investment in such asset-backed securities involves the consideration of significantly different types of information compared to the information which is useful in making an investment decision regarding equities or unsecured debt, which involves the consideration of the financial condition and other factors relevant to operating companies. Indeed, many investors in asset-backed securities make an investment decision primarily on the basis of evaluating sensitivities of yield, average life, duration and maturity under various scenarios of prepayments, interest rates and losses, with the assumed scenarios selected by the underwriter or the investor itself. Furthermore, while the issuer and the underwriter generally "price" the sale of securities based upon a pool of assets which will back the securities, the underwriter typically structures the cash flow among multiple classes of securities such that the characteristics of the classes often change based on the specific investment objectives of the prospective investors. Therefore, a prospectus supplement cannot be prepared prior to the time when an investor typically makes an investment decision because structuring the securities entails multi-party negotiations between the underwriter and prospective investors intended to provide those investors with the desired securities and because the pool of assets frequently is not final until shortly before the issuance of the securities.

In light of the practicalities of the asset-backed securities market, we have attempted to achieve two objectives in suggesting comprehensive revisions to the disclosure system: (i) providing sufficient information for the investor in the primary and secondary market, and (ii) maintaining the benefits to consumers derived from a lender's access to the capital markets

in an efficient, cost-effective manner. To meet the first objective, we support several approaches which would provide additional information to investors. First, we encourage the availability of a "transaction summary" and computational materials before the prospectus supplement is available. The transaction summary in term sheet form and computational materials would be supplemented by the base prospectus included in the registration statement and the prospectus supplement distributed to investors when available. Second, we encourage the distribution of information contained in periodic remittance reports to parties who may request such data throughout the life of a transaction and the availability of more timely information to third party data providers. To meet the second objective, we support streamlining the disclosure documentation, avoiding cumbersome filings of computational materials and imposing reasonable liability standards. The imposition of a high standard of liability on an issuer for a transaction summary is onerous since a transaction summary would be used precisely because of the insufficient time to prepare a prospectus supplement. The imposition of any liability on an issuer for computational materials would be onerous since such materials relate to matters not within the unique knowledge of the issuer and those materials typically are prepared by the underwriter in consultation with prospective investors without any involvement of the issuer. In both cases, the transaction summary and computational materials would be superseded by the prospectus supplement, to which a high standard of liability applies.

We believe that many of our suggestions are consistent with key objectives in the Report of the Advisory Committee on the Capital Formation and Regulatory Processes of the Commission dated July 24, 1996 (the "Wallman Report"). In Part I of this letter, we briefly discuss certain objectives in the Wallman Report. In Part II of this letter, we suggest an approach to providing investors with meaningful information prior to the time when a prospectus supplement can be distributed. In Part III of this letter, we suggest specific proposals for an integrated disclosure system for asset-backed securities. At the conclusion of the letter, we request an opportunity for further discussion of these issues with the Commission staff.

PART I. THE WALLMAN REPORT

A. <u>The Wallman Report</u>. The Wallman Report discusses the policies underlying the federal securities laws and how to best

implement these policies in the context of current financial markets. Although the Wallman Report focuses on ongoing business enterprises, many of its objectives can be applied to structured finance transactions by modifying the approach to take into account the characteristics of the asset-backed securities market. These characteristics include timing constraints and factors outside of the issuer's knowledge.

B. Key Objectives. A central tenet of the Wallman Report is registration of companies as distinguished from registration of securities issued by companies. The company registration system is intended to be effectuated in a manner that provides investors in the primary and secondary markets with information material to an investment decision. Issuers in routine transactions may tailor the disclosure delivered to investors in a prospectus to meet the informational needs of investors in light of the nature of the transaction, as assessed by the issuer and underwriter in marketing securities.

C. Timely Information. The Wallman Report notes that the prohibitions under the federal securities laws against improper soliciting activities during the registration process may chill or delay the disclosure of information that is beneficial to the marketplace. In general, following the effectiveness of the registration statement, the final prospectus containing information mandated by Section 10 of the Securities Act of 1933 (the "Securities Act") must be sent or given to investors before or at the time written selling materials are sent or given. As noted on page 34 of Appendix A of the Wallman Report, this provision curtails the availability of term sheets and computational materials which would provide useful information to investors:

> The prospectus delivery requirements thus make it difficult to deliver term sheets or computational material or otherwise provide useful information in writing to investors prior to the availability or finalization of all mandated information.

D. Prospectus Flexibility. As stated on pages 18 to 19 of the Wallman Report, the prospectus delivery requirements should be recast so that issuers would have greater flexibility to decide what information would be meaningful to investors:

> Rather than imposing formal, full-fledged delivery requirements in connection with all issuances of securities to the public, the appropriate style and

> level of company and transactional disclosure that physically would be delivered to investors would be determined in most offerings by considerations relating to informational demands of participants in the particular offering, thereby facilitating more useful and more readable ("plain English") disclosure. . . . The Committee expects that the information that actually is delivered to investors in the form of a term sheet, selling materials or a more formal prospectus, would be the information that the issuer deems most relevant and material to the investment decision.

As noted on page 12 of the Wallman Report, in addition to the benefits to investors, issuers could realize significant cost savings as a result of the more flexible prospectus delivery requirements.

E. Differences between Asset-Backed Securities and Ongoing Business Offerings. Since the Wallman Report focuses on operating companies, it emphasizes filing sufficient and timely information with the Commission, incorporating such information by reference in materials distributed to investors, and imposing standards of liability which assume that the information material to the offering is uniquely within the issuer's knowledge. Such an approach is not suitable to the asset-backed securities market due to the interactive process of the issuer, the underwriters and the investors. Specifically, the structure of an asset-backed securities offering is typically developed by the underwriter in consultation with investors, and the computational materials are mathematical calculations based on various assumptions selected by the underwriter or unique to a particular investor. As a practical matter, a prospectus supplement or equivalent information filed with the Commission simply cannot be prepared prior to the time an investment decision is made. Therefore, any mandated disclosure and liability standards must be cognizant of these differences between offerings of ongoing business enterprises and offerings for structured finance transactions.

F. Asset-Backed Market. In the asset-backed securities market, we believe that a shelf registration for investment grade asset-backed securities is the equivalent of registration of a seasoned company engaged in routine transactions. Therefore, we propose that investors in the primary market for asset-backed securities would have better information through a four step disclosure process: (i) the base prospectus included in the registration

statement which describes the parameters of the issuer's ongoing securitization program, (ii) a transaction summary in term sheet form prior to the time when a prospectus supplement is available, (iii) computational materials if the underwriters elect to distribute them, and (iv) a prospectus supplement when available. After the closing date for an issuance of asset-backed securities, investors would have better information through (i) the availability of periodic reports throughout the life of the transaction and (ii) the availability of more timely information to third party data providers. A transaction summary as well as computational materials are discussed in greater detail in Part II of this letter; the other aspects of such an integrated disclosure system are discussed in Part III of this letter.

PART II. TRANSACTION SUMMARY AND COMPUTATIONAL MATERIALS

A. Introduction. We would like the opportunity to discuss with the staff how to facilitate the availability of more meaningful information to investors on a timely basis. In this connection, we believe that investors in asset-backed securities would benefit from a "transaction summary" similar to a term sheet as well as computational materials prior to the time when a prospectus supplement is available.

B. Transaction Summary/Term Sheet. In the 1994 letter, various issuers requested the Commission to adopt a rule permitting certain information regarding the structure of the securities and underlying assets to be included in a "summary prospectus" within the meaning of Section 10(b) of the Securities Act for the purposes of Section 5(b)(1) thereof. In the 1994 letter, such issuers also requested the Commission to adopt a rule by which computational materials would be deemed not to involve an "offer for sale" within the meaning of Section 2(10) of the Securities Act and accordingly not to constitute a "prospectus" within the meaning of Section 2(10) and Section 5(b)(1) of the Securities Act. Such computational materials usually are illustrations of yield, average life, duration and maturity at various assumed prepayment speeds, interest rates and losses, and additional materials often are generated by the underwriter in response to a specific prospective investor's needs. The reliance on the provisions for a summary prospectus under Section 10(b) of the Securities Act was based in part on the concern that the Commission had limited rule-making authority.

C. Additional Considerations. Since the 1994 letter was submitted, the Commission has been granted broader rule-making authority under the Capital Markets Efficiency Act of 1996.

Therefore, the Commission need not rely on the provisions for a summary prospectus to provide for the availability of information to investors. The Commission could permit a "transaction summary" similar to the summary prospectus described in the 1994 letter. The information permitted in a transaction summary would include a description of the characteristics of each class of asset-backed securities, the interest and principal priorities, the "payment rules", certain characteristics of the assets and possibly other relevant information regarding such series. We believe that any regulations for a transaction summary should take into account its preparation as an abbreviated term sheet during a short time period, its need to be updated as the pool of assets and structure change and the desirability of recirculation to investors when it is updated. Furthermore, we question whether filing with the Commission should be required, and if filing is required, we urge no filing except for the filing of a final transaction summary when the prospectus supplement is filed. As explained below, we strongly believe that computational materials should not be required to be filed with the Commission.

D. Liability for Transaction Summary. The standards of liability for a transaction summary should take into account that the transaction summary would be delivered because time is insufficient to prepare a prospectus supplement. Different standards of liability have been recognized in various provisions of the federal securities laws. For example, as discussed in the 1994 letter, Section 10(b) of the Securities Act specifically authorizes the Commission to adopt rules or regulations permitting the use of a summary prospectus, and that section provides that a summary prospectus would not have liability under Section 11 of the Securities Act. Even if a transaction summary would not have Section 11 liability, subject to the safe harbor proposed below, investors would be protected by Section 10 and Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act"). The investor will have common law remedies if the transaction as disclosed in the prospectus supplement is materially different from the transaction agreed upon by the investor at the time of the sale of the securities. In addition, the investor will have the customary remedies available for misleading statements in the prospectus supplement. Under these circumstances, we believe that the Commission should encourage underwriters to distribute transaction summaries by providing a safe harbor for a transaction summary prepared in good faith using reasonable efforts given the time constraints and by eliminating liability for any preliminary transaction summary if the final transaction summary is delivered by the underwriter to

the investor. A safe harbor for transaction summaries would include a safe harbor for material omissions since a brief summary by its nature will not include a complete description of all the characteristics of the transaction.

E. Liability for Computational Materials. No liability should be imposed on the issuer for computational materials. The imposition of liability on the underwriter under Section 10 and Rule 10b-5 of the Exchange Act for the preparation and dissemination of the computational materials should be sufficient protection for investors. We understand that the staff may be concerned with computational materials because many investors make an investment decision based on yield, duration, maturity and similar information. However, disclosure in a public offering has traditionally focused on facts within the unique knowledge of the issuer. Registrants have not been required to disclose research reports by analysts even though the assessment of a third party may influence an investment decision. In the case of computational materials, certain mathematical calculations could be performed by any sophisticated third party based on the description of the asset pool and the payment rules for the securities. The issuer has no unique knowledge and typically is neither aware of nor given an opportunity to review the computational materials before they are distributed. In addition, the materials often vary for the individual investor based on the price negotiated with that investor by the underwriter and the investor's assessment of prepayment speeds and other characteristics. The investor may also have special circumstances such as the interest rate sensitivity parameters which a regulated institution is obligated to examine in accordance with the Federal Financial Institutions Examination Council's "Supervisory Policy Statement on Securities Activities" dated January 25, 1992. For these reasons, the filing of computational materials with the Commission and related liability to the issuer for such filing is not justified by any meaningful protection of investors.

PART III. INTEGRATED DISCLOSURE SYSTEM FOR ASSET-BACKED SECURITIES

A. Introduction. We encourage several modifications to the shelf registration procedure applicable to asset-backed securities. In addition to the availability of a transaction summary and computational materials, we recommend streamlining the offering materials, simplifying the prospectus delivery requirements, providing periodic reports throughout the life of a

transaction and providing more information to third party data providers.

B. Shelf Registration. Shelf registration is vital to the efficient operation of the marketplace. Shelf registration typically is available because the securities meet the requirements for asset-backed securities under Form S-3. These requirements limit the securities to debt-like instruments rated investment grade by a rating agency. The type of securities and the typical investors in such securities do not warrant allocating limited staff resources to review of offering materials prior to a public offering. If shelf registration were not available, the dramatic increase in cost of issuance would result in higher costs to consumers borrowing funds for the purchase of homes, goods and services, without increased benefits to investors.

C. Base Prospectus in Registration Statement. We believe the registration statement should include a base prospectus which contains information generally applicable to any transaction off the shelf. If the registrant or an affiliate is the originator and servicer, such information may include origination and servicing standards. Typically the base prospectus would also include a description of factors such as prepayments that could affect an investor's yield, issues such as perfection and foreclosure processes with respect to the underlying assets and consequences of the transaction under the Internal Revenue Code and the Employee Retirement Income Security Act of 1974. In addition, the base prospectus would briefly discuss the type of assets, cash flow structures and credit support which may be used in transactions. However, we do not believe a more lengthy description of various alternatives is helpful since the description will be superseded by disclosure in the prospectus supplement. Moreover, we think the issuer should have discretion to determine the asset types or groups of asset types covered by the registration statement. In some cases, the issuer may prefer limiting the assets covered by the registration statement for marketing reasons. In other cases, the issuer may want the flexibility to include more than one asset type, provided the prospectus is organized so that the portions relevant to each asset type are easy to ascertain.

D. Form of Prospectus Supplement in Registration Statement. We suggest that the issuer have discretion to determine whether to include a form of prospectus supplement in the registration statement. Since the actual prospectus supplement may vary with the nature of the transaction, many registrants submit a

prospectus supplement from a past transaction deleting numerical information, and even the registrants which submit a prospectus supplement showing bracketed alternatives do not attempt to show every possible variation.

E. Transaction Summary and Computational Materials. As discussed in more detail in Part II of this letter, we would permit the availability in either hard copy or electronic form of a transaction summary and computational materials prior to the time that a prospectus supplement is available. The transaction summary would necessarily be in abbreviated form because of the time constraints and would also be subject to revision from time to time as the asset pool and structure change. As was discussed in Part II of this letter, we strongly believe that computational materials provided by the underwriter should not be filed with the Commission or give rise to any liability to the issuer.

F. Prospectus Supplement and Base Delivery. We would permit the availability, in either hard copy or electronic form, of the prospectus supplement and base prospectus. As currently provided by the Securities Act and regulations thereunder, the prospectus supplement would be delivered to investors when available and filed with the Commission within two business days of first use. Although the staff and certain commentators have considered requiring the delivery of a prospectus supplement prior to the delivery of a confirmation, we would address an investor's need for information by permitting distribution of a transaction summary in term sheet form prior to the availability of a prospectus supplement, as distinguished from changing the delivery and filing requirements for the prospectus supplement. Because the base prospectus largely contains background information and many "repeat" institutional investors under an issuer's shelf registration program for asset-backed securities would have previously obtained the base prospectus, we would not require delivery of the base prospectus unless (i) an institutional investor specifically requests it or (ii) an individual investor has not been previously furnished the base in connection with the current or prior offerings. Eliminating delivery of the base prospectus would be analogous to incorporation by reference of Exchange Act filings for seasoned companies and consistent with the Wallman Report's endorsement of flexible prospectus delivery requirements. As suggested in the Wallman Report, it would also save significant costs to issuers without detriment to investors.

G. Concise Prospectus Supplement. The prospectus supplement would be more user friendly and meaningful to investors if it

were a more concise document. The cover page should more simply identify the securities being offered and the underlying assets. The summary should be a brief summary, most likely in term sheet form, similar to the transaction summary. We strongly recommend encouraging brevity in the summary through the Commission's adoption of a safe harbor provision covering a good faith, reasonable summary of the major features of the transaction, provided all material information regarding cash flow structure and other elements of the offering are included in the body of the prospectus supplement. Current summaries -- which often are 20 or more pages long -- defeat the point of a summary. Special considerations should focus on the special features of the individual transaction and not features described in the base prospectus and generally applicable to most securities backed by similar assets. The body of the prospectus supplement should avoid repetition. Terms should be defined only once either in the text or a glossary.

H. Financial Statements. Asset-backed securities are typically structured so that the performance of the securities should not be affected by the financial condition of the issuer of the securities, the seller of the assets to the issuer or the servicer of the assets. Accordingly, financial information about the issuer, the seller or the servicer is not appropriate in the vast majority of transactions. The immateriality of such information is especially evident with respect to first lien mortgage loans because many servicers are qualified to service the assets and the seller has a repurchase obligation only in the event of a deficient document or a breach of representation. Nonetheless, we recognize that, for an occasional transaction, limited financial information may be material to an investor. As an example, a transaction may have an early termination date if the seller in a revolving structure becomes insolvent and no longer originates receivables. In this case, the issuer is in the best position to determine whether limited financial information of the seller would be material to an investor and accordingly should be disclosed in the prospectus supplement and, in some cases, even in a special considerations section.

I. Historical Performance. When feasible, most registrants provide information about servicing history, including delinquency and loss information on a portfolio basis. Some commentators have suggested to the staff that the prospectus contain such information for each prior securitization or by year of origination. We do not believe a requirement to provide such information is appropriate. First and foremost, disclosure of all information about past transactions and origination practices

would be confusing and misleading to an investor because the current transaction may have different product types, servicers and other factors. Second, especially if the registrant is a small issuer, it may not track the information, and even if it tracks the information, the cost of auditing the information to provide comfort to the underwriters may be prohibitive. Third, if the registrant is a large issuer, requiring information about all past transactions and origination practices would entail a massive disclosure obligation. We believe the issuer needs to make a determination as to whether such data is material and to disclose such data only to the extent it is material.

J. Periodic Reports. We encourage the availability of periodic reports throughout the life of the transaction. Periodic reports which generally are prepared on a monthly basis are transmitted to investors in connection with each payment. In lieu of routinely granting no action relief from Exchange Act reporting requirements after the issuer files an exemption request, we recommend that the Commission prescribe by rule minimum requirements for such reports, which would be similar to the standards currently included in a typical exemption. In addition, such reports could continue to be filed with the Commission to the extent required by the Exchange Act. Even though the filing requirement may terminate after the first fiscal year of the entity issuing the securities, we would support the Commission encouraging the trustee or master servicer to furnish copies of the periodic reports and other readily available information upon request to any person. Many issuers currently provide such information to electronic data providers.

K. Structural and Pool Information. After issuance, we believe that the issuer and underwriter should be permitted to provide structural and pool information about asset-backed securities to a third party data provider, such as Bloomberg, provided that a prospectus supplement is available upon request. Since such information is beneficial to the investment community, the Commission should expressly indicate that such data could be made available at any time after the issuance of the securities even if it is provided during the prospectus delivery period. The availability of structural and pool information to a third party data provider is consistent with the Wallman Report's encouragement of the disclosure of information that is beneficial to the marketplace.

L. Pre-funding. We do not believe the current restrictions on pre-funding accounts are warranted. Rather than setting maximum limits for such accounts through staff comments, the prospectus

supplement could describe the parameters required for additional assets and describe any material risks associated with a pre-funding account. The rating agency provides some protection in this regard, since a transaction will not be rated unless the rating agency agrees with the collateral parameters. In addition to the use of pre-funding accounts for securitizations of credit card accounts, home equity lines of credit and trade receivables, when the tax provisions for Financial Asset Securitization Investment Trusts become available on September 1, 1997, pre-funding accounts may become more prevalent in mortgage securitizations.

M. Resecuritizations. We do not believe any restrictions should apply to resecuritizations of asset-backed securities, provided material information about the underlying assets is disclosed to investors. In such case, the new securities would be registered under the Securities Act and investors would be protected by the Securities Act. Issuers especially would benefit from the ability to resecuritize residential subordinate securities which were rated below investment grade at the time of issuance. After a period of seasoning, when such subordinated securities are deposited into a new trust which issues securities with different levels of subordination, the more senior classes may meet the investment grade standards for a public offering of asset-backed securities under Form S-3.

N. Staff Positions. The structured finance industry would greatly benefit from a more uniform policy regarding the formulation and dissemination of staff positions. The staff frequently takes a position with one issuer which could affect other issuers. For example, the staff has suggested that securities must be in the secondary market for various time periods before the securities may be deposited into a trust issuing new securities. An issuer may be disadvantaged in some cases because its attorney has had recent discussions with the staff and in other cases because its attorney has not had recent discussions with the staff. Many issuers and underwriters would like a more level playing field as well as more procedures applicable to the staff in taking informal positions. One approach would be for the staff to publish its positions on a electronic bulletin board together with the rationale for those positions.

We would appreciate a meeting with the staff to discuss our views and understand the staff's concerns. We would be pleased to provide any supplemental information or analysis which may be useful to the staff. For questions concerning the matters

contained herein or to arrange for further discussion with representatives of CMC and MBA, please contact Starr L. Tomczak at Stroock & Stroock & Lavan LLP (telephone: (212) 806-5601).

MORTGAGE BANKERS ASSOCIATION OF AMERICA

By: Robt M. O'Toole

CONSUMER MORTGAGE COALITION

By:

cc: Commissioner Steven M.H. Wallman
Martin Dunn