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September 3, 2008

Via e-mail: rule-comments@sec.gov

Ms. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release Nos. IC-28327; IA-2751 (File Number S7-19-08): References to Ratings of Nationally Recognized Statistical Rating Organizations; Release No. 33-8940; 34-58071 (File Number S7-18-08): Security Ratings

Dear Ms. Harmon:

We respectfully submit this comment letter in response to (i) Release Nos. IC-28327; IA-2751, dated July 1, 2008 (the "1940 Act Proposing Release"), in which the Securities and Exchange Commission (the "Commission") has requested comments on proposed amendments to rules under the Investment Company Act of 1940, as amended (the "Investment Company Act"), and Investment Advisers Act of 1940, as amended (the "Investment Advisers Act"), that reference credit ratings of nationally recognized statistical rating organizations ("NRSROs") and (ii) Release No. 33-8940; 34-58071, dated July 1, 2008 (the "1933 Act Proposing Release" and, together with the 1940 Act Proposing Release, the "Proposing Releases"), in which the Commission has requested comments on proposed amendments to certain rules and form requirements under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that reference credit ratings of NRSROs.

We commend the Commission and its staff for its efforts in re-examining the current Investment Company Act, Investment Adviser Act, Securities Act and Exchange Act rules, regulations and forms relating to NRSRO ratings in light of recent turmoil in the credit markets and appreciate the opportunity to comment on the proposed amendments. As a general matter, however, we share the views expressed by other parties in comment letters submitted to the Commission that: (i) other pending reform efforts targeted at matters relating to NRSRO ratings should be given time to have their intended effect before considering additional remedial measures; (ii) implementation of

the proposals included in the Proposing Releases would not necessarily address the perceived issue of undue investor reliance on credit ratings, (iii) several of the proposals will lead to a migration of asset-backed offerings from the public domain to the private market with an attendant loss of Commission regulatory oversight and (iv) the proposed amendments to the rules under the Investment Company Act could have unforeseen consequences for money market funds and their boards, investors and the capital markets. In the discussion below, except as otherwise indicated, we have limited our comments to the proposed changes to the availability of Rule 3a-7 for public offerings of "investment grade securities" by structured finance vehicles (the "Rule 3a-7 Proposals") and the availability of short-form registration on Form S-3 for "investment grade" asset-backed securities (the "Form S-3 Proposals"), in each case with a specific focus on the impact of such proposals on funding agreement-backed note programs.

We represent several issuers in connection with their funding agreement-backed note programs. Under these programs, multiple series of notes may be issued to institutional or retail investors, with each series of notes to be issued by a special purpose vehicle, such as a statutory trust, and secured by one or more funding agreements issued by the sponsoring insurance company. We believe that the Rule 3a-7 Proposals and Form S-3 Proposals will unnecessarily and irreparably affect the ability of issuers of funding agreement-backed notes to provide retail investors with access to a product that is qualitatively distinguishable from, and more attractive for the retail market than, more traditional asset-backed securities ("ABS"). Although we have discussed the Proposing Releases with our clients, the comments set forth in this letter reflect our views and are not necessarily the views of any of our clients.

This comment letter is divided into two sections:

- the first section responds to certain of the Commission's requests for comments regarding the Rule 3a-7 Proposals; and
- the second section responds to certain of the Commission's requests for comment regarding the Form S-3 Proposals.

I

Responses to certain of the Commission's requests for comments regarding the Rule 3a-7 Proposals

- **What are the advantages and disadvantages of eliminating the NRSRO rating requirement from the Rule?**
  - ➢ *Issuers of funding agreement-backed notes would lose access to a large segment of the capital markets and retail investors would lose access to an attractive investment option.*

Funding agreement-backed notes are attractive to both issuers and, as importantly, retail investors. If the Rule 3a-7 Proposals are adopted in their current form, the Commission would deprive retail investors of access to a product that is:

- generally less complicated than other more traditional ABS;
- secured by an asset of higher quality than many pool assets securing typical ABS; and
- secured by funding agreements that have a higher priority in insolvency in the case of a rehabilitation or liquidation of the sponsor's insurance company than unsecured medium-term notes issued directly by such insurance companies; whereas holders of more traditional ABS are effectively secured general creditors with respect to the relevant asset pool.[1]

In addition, while insurance companies would retain their ability to issue unsecured medium-term debt to retail investors, these same insurance companies would be unable to sponsor programs for the issuance of funding agreement-backed notes. We believe that significant differences between funding agreement-backed notes and more traditional ABS and the curious result noted in the previous sentence illustrate the defect in the "kitchen sink" approach to all ABS in the 1940 Act Proposing Release, regardless of quality, structure or composition. While we believe that the Commission should retain Rule 3a-7 in its current form, should the Commission decide to adopt the proposed changes to Rule 3a-7, we recommend that funding agreement-backed notes be permitted to continue to rely on the "public offering" prong of current Rule 3a-7.

➢ *The Rule 3a-7 Proposals will effectively eliminate registered funding agreement-backed note programs.*

All retail issuances under funding agreement-backed note programs rely on the public offering prong of Rule 3a-7. Without radical restructuring of their existing programs, which may not be practicable given relevant accounting, insurance and other requirements, issuers of funding agreement-backed notes to retail investors would be unable to rely on any other exemption from the Investment Company Act. As such, if the Rule 3a-7 Proposals are adopted in their current form, issuers of funding agreement-backed notes would have to register as investment companies under the Investment Company Act in order to sell notes to retail investors. The added costs and regulatory burden of such registration would be prohibitive and would most likely cause sponsors of funding agreement-backed note programs to utilize either: (i) unregistered funding

[1] Funding agreements, by virtue of their status as policyholder obligations under applicable state insurance law, generally rank senior to the obligations of general creditors, including unsecured note holders.

agreement-backed note programs with only qualified institutional buyers as potential investors with the attendant loss of Commission regulatory oversight[2] or (ii) registered unsecured medium-term note programs that may be, for the reasons stated above, less attractive for retail investors.[3] Further, any such developments in this market could have a negative impact on the liquidity of the existing trading market for funding agreement-backed notes and, consequently, impair the ability of current retail holders to sell or otherwise transfer their notes at un-discounted prices or at all.

- *The reference to ratings downgrades in Rule 3a-7(a)(3)(ii) should not be removed and the related proposed amendments should not be adopted.*

We believe that the subjective and strict nature of the proposed amendments to Rule 3a-7(a)(3)(ii) will make it difficult for issuers of ABS to rely with any certainty on Rule 3a-7 in connection with the acquisition of eligible assets or the disposition of assets. We believe that the reference to ratings downgrades in connection with any such acquisition or disposition is an objective and more appropriate standard than the test set forth in the proposed amendments.

- **Is our understanding that structured financings are generally not marketed to retail investors correct? If not, should we retain an exclusion for structured finance offerings to the general public?**

  - *Over $5 billion of funding agreement-backed notes have been issued to retail investors under programs in reliance on Rule 3a-7 since November of 2003.*

The market for funding agreement-backed notes is significant in size. In November 2003, the first registered funding agreement-backed note program was declared effective by the Commission. Since then, four Fortune 500 insurance companies have established registered funding agreement-backed note programs. Notes may be sold under each of these programs to either institutional or retail investors and our understanding is that each of these programs relies on Rule 3a-7 for its Investment Company Act exemption. Since November 2003, over $5 billion of funding agreement-backed notes have been issued to retail investors through these programs. In addition,

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[2] The development of the institutional market for privately placed funding agreement-backed notes pre-dates the development of the market for registered funding agreement backed-notes, and funding agreement-backed notes have gained broad acceptance in the private institutional market.

[3] We respectfully advise the Commission that in the 1933 Act Proposing Release, the Commission states that it believes that funding agreement-backed note programs could be registered on Form S-1. *See* the 1933 Act Proposing Release at footnote 69. For the reasons discussed above, if Rule 3a-7 is not available to these programs, only the institutional portion of a funding agreement-backed note program could be registered on Form S-1, and we believe the sponsoring insurance companies would instead implement unregistered programs.

there are many existing unregistered funding agreement-backed note programs through which tens of billions of dollars of secured notes have been sold under Regulation S outside of the United States to various types of investors, including retail investors in reliance on Rule 3a-7.

- *The exclusion for structured finance offerings, specifically funding agreement-backed note offerings, to the general public should be retained.*

As briefly noted in the second paragraph of this letter, we believe that Rule 3a-7 should be retained in its current form. However, should the Commission determine that changes to Rule 3a-7 are warranted at this time, we believe that the Commission should specifically permit funding agreement-backed note programs to continue to rely on the public offering prong of Rule 3a-7. Funding agreement-backed note programs are distinguishable from more traditional ABS programs as summarized below:

- funding agreement-backed notes are generally less complicated than other more traditional ABS;
- funding agreement-backed notes are secured by an asset of higher quality than many pool assets securing typical ABS;
- the source for all cash flows for any particular series of funding agreement-backed notes is the funding agreement(s) securing those notes and not an unrelated pool of third-party assets or a collection of assets of varying quality;
- funding agreement-backed notes are secured by assets that have a higher priority in insolvency in the case of a rehabilitation or liquidation of the sponsoring insurance company than unsecured notes, including medium-term notes, issued directly by any such insurance company; whereas holders of more traditional ABS are effectively secured general creditors with respect to the relevant asset pool;
- investors in funding agreement-backed notes receive disclosure regarding the sponsoring insurance company (*i.e.*, the underlying credit) that is in excess of that required by Regulation AB;
- the sponsoring insurance company is subject to additional regulatory oversight and scrutiny by its insurance regulator; and
- the financial strength rating of the sponsoring insurance company is a primary factor used by investors in evaluating a decision to purchase funding-agreement backed notes.

Because of these fundamental differences, we believe the Commission's concern regarding undue reliance on credit ratings with respect to funding agreement-backed note programs is unfounded.

If, notwithstanding the comments herein, the proposed changes to Rule 3a-7 are adopted, it will be necessary to include appropriate grandfathering and transition provisions to eliminate any uncertainty about whether current issuers of funding agreement-backed notes, as well as other ABS issuers, can continue to rely on Rule 3a-7 for sales of notes to the public.

II

Responses to certain of the Commission's requests for comment regarding Proposed Form S-3

- **Should Form S-3 limit initial sales of eligible asset-backed securities to qualified institutional buyers? Are there particular kinds of ABS offerings that are sold to investors other than qualified institutional buyers?**

  - *Form S-3 should not limit initial sales of eligible asset-backed securities to qualified institutional buyers.*

We do not believe that Form S-3 should limit initial sales of ABS solely to qualified institutional buyers. However, should the Commission determine that changes to Form S-3 are warranted at this time, we believe that the Commission should specifically permit funding agreement-backed note programs to continue to use Form S-3 to register securities for sale to retail investors. As discussed in Part I of this letter, funding agreement-backed notes are qualitatively distinguishable from, and more attractive for retail investors than, more traditional ABS. Because of these fundamental differences, we believe that the Commission's concern regarding undue reliance on credit ratings with respect to funding agreement-backed note programs is unfounded. In addition, the retail market for funding agreement-backed notes registered on Form S-3 is significant in size with over $5 billion of funding agreement-backed notes sold to retail investors under programs registered on Form S-3. Amending Form S-3 to limit initial sales of eligible ABS to qualified institutional buyers could negatively affect the value and liquidity of notes previously sold to retail investors. As noted above, the Form S-3 Proposals, when coupled with the Rule 3a-7 Proposals, would likely cause sponsors to abandon their registered programs and implement unregistered private programs with an attendant loss of Commission regulatory oversight. Finally, sponsoring insurance companies with registered funding agreement-backed note programs will effectively write off substantial start-up and maintenance costs incurred in connection with their existing programs.

- **We note that there are two types of ABS offerings that may not meet this new criteria, unit repackagings, and securitizations of insurance funding agreements. Can the offer and sale of these securities be effectively registered on Form S-1?**

  - *Funding Agreement-Backed Note Programs Cannot Be Effectively Registered on Form S-1.*

All existing registered funding agreement-backed note programs have been registered on Form S-3 and may be sold to retail investors. As such, if the revisions to Form S-3 are adopted as proposed, issuers of funding agreement-backed notes would have to register these programs on Form S-1 in order to maintain the retail component of their programs. However, as discussed in Part I of this letter, the proposed changes to Rule 3a-7 would leave issuers of funding agreement-backed notes without an exception from the Investment Company Act for sales to retail investors, and as a result, these issuers would be effectively precluded from using Form S-1 to register these notes. Furthermore, retail programs are characterized by consistent and periodic offerings (some issuers have posted new offerings on a weekly basis and such frequent offerings may be for an aggregate principal amount of as little as $1 million), and, because Form S-1 does not allow for forward incorporation by reference, issuers will face substantially increased expense and burden in maintaining current and accurate program offering documents. The added cost and regulatory burden of registering funding agreement-backed notes on Form S-1 would be prohibitive and would most likely cause sponsors of funding agreement-backed programs to utilize either: (i) unregistered funding agreement-backed note programs with only qualified institutional buyers as potential investors with an attendant loss of Commission regulatory oversight or (ii) registered unsecured medium-term note programs that may be, for the reasons stated above, less attractive for retail investors.[4] As discussed above, any such developments in this market could have a negative impact on the liquidity of the existing trading market for funding agreement-backed notes and, consequently, impair the ability of current retail holders to sell or otherwise transfer their notes at un-discounted prices or at all.

- **We note that these securities are typically listed on a national securities exchange. Should we instead add an alternative eligibility requirement that would provide eligibility to use Form S-3 for securities listed on a national securities exchange?**

[4] Funding agreement-backed note programs generate returns based on the spread between the return generated on the investment of the proceeds from an offering of notes and the interest rate or other return paid to investors on the notes. Any increased costs make these programs significantly less attractive to sponsoring insurance companies.

- *If the Commission does not retain the current eligibility requirements for Form S-3, it should provide for S-3 eligibility for ABS listed on a national exchange.*

We believe that the Commission should retain the current eligibility requirements for use of Form S-3 to register ABS. However, if the Commission decides to modify the Form S-3 ABS eligibility criteria, we support the adoption of an eligibility requirement that allows ABS issuers to use Form S-3 to register (i) securities listed on a national securities exchange and (ii) securities that would constitute "covered securities" under Section 18 of the Securities Act. Specifically, we see no reason why a "covered security" under Section 18(b)(1)(C) of the Securities Act (*i.e.*, a security that is equal in seniority or is a senior security to any other security of the "same issuer" which is listed or authorized for listing) should be precluded from being registered as an ABS under Form S-3 simply because it is not listed on a national exchange.

As with the 1940 Act Proposing Release, if, notwithstanding the comments herein, the Form S-3 Proposals are adopted, it will be necessary to include appropriate grandfathering and transition provisions to eliminate any uncertainty about whether funding agreement-backed notes currently registered on Form S-3 can continue to be sold to retail investors.

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We appreciate the opportunity to comment on the Proposing Releases. Please feel free to contact Matthew E. Kaplan at (212) 909-7334 with any questions about this letter.

Very truly yours,

/s/ Debevoise & Plimpton LLP

Debevoise & Plimpton LLP