



September 5, 2008

By E-Mail: rule-comments@sec.gov

U. S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549
Attn: Florence E. Harmon, Acting Secretary

Re: Release No. 33-8940; 34-58071 (File No. S7-18-08); Release No. 34-58070 (File No. S7-17-08); Release Nos. IC-28327; IA-2751 (File No. S7-19-08)

Ladies and Gentlemen:

The American Securitization Forum (the “ASF”) submits this letter in response to the request for comments made by the Securities and Exchange Commission (the “Commission”) in Release No. 33-8940; 34-58071 (the “Disclosure Release”), Release No. 34-58070 (the “1934 Act Release”) and Release Nos. IC-28327; IA-2751 (the “IC/IA Release” and, together with the Disclosure Release and the 1934 Act Release, the “Proposing Releases”; the rules proposed thereunder, the “Proposed Rules”), which propose to make specified amendments to the Commission’s rules promulgated under the Securities Act of 1933 (the “1933 Act”), the Securities Exchange Act of 1934 (the “1934 Act”), the Investment Company Act of 1940 (the “Investment Company Act”) and the Investment Advisers Act of 1940 (the “Advisers Act”).

The ASF seeks to promote the efficient growth and development of the securitization markets by engaging in a variety of legal, regulatory, accounting, market practice and educational initiatives. Members of the ASF include investors, issuers, underwriters, servicers, trustees, credit rating agencies (“CRAs”), law firms, accounting firms and other professional participants in the asset-backed securities market.¹ The ASF, therefore, is uniquely positioned to provide the Commission with comprehensive, balanced and practical recommendations reflecting a meaningful consensus among the various participants in the securitization markets, including investors and issuers.

The ASF has assembled a membership task force (the “Task Force”) to review the Proposing Releases and prepare specific comments to the Proposing Releases that address the issues and

¹ A description of the ASF and its activities is available at its website, <http://www.americansecuritization.com>. ASF is an adjunct forum of the Securities Industry and Financial Markets Association (“SIFMA”).

questions raised in the Proposing Releases of most concern to the ASF's members. This Task Force is comprised of individuals representing the broad constituency of the ASF. On July 25, 2008, the ASF submitted a comment letter (the "July 25 Comment Letter") to the Commission in response to the Commission's request for comments in Release No. 34-57967, "Proposed Rules for Nationally Recognized Statistical Rating Organizations" (the "June 16 Release").² With regard to proposed amendments not addressed in this letter, the ASF joins in the views expressed by The Securities Industry and Financial Markets Association ("SIFMA"), an affiliate of the ASF, in its comment letter submitted to the SEC on September 4, 2008.

As the Commission observed in the final release of Regulation AB,³ since the inception of the structured finance industry, the Commission staff has attempted to accommodate the different nature of structured finance products through numerous no-action letters and interpretive positions. In that regard, the Task Force and the ASF would like to offer the comments below on the topics indicated.

Executive Summary

The Task Force has considered the potential effects of certain aspects of the Proposed Rules that are of particular interest to the ASF's membership. In particular, the introduction of an investor qualification and minimum denomination standard in Form S-3, and the removal of credit ratings as a required element of a money market fund's investment analysis in Proposed Rule 2a-7, cause us the greatest concern. We have also commented on various other aspects of the Proposed Rules that pertain to structured finance products.

The ASF believes that credit ratings are, and should continue to be, an important element of the regulatory regimes applying to structured finance products. There are a number of important reforms already proposed or underway that will substantively address the quality, accuracy and integrity of, and concerns surrounding over-reliance on, credit ratings for structured finance products, by improving disclosure about the meaning of ratings, models used to derive ratings and the information about the underlying assets used by the CRAs. Various CRAs themselves have already initiated a number of such reforms. In particular, the Commission's proposals in the June 16 Release, when adopted in final form (the "Final June 16 Rules"), will benefit investors both by improving disclosure about the meaning and limitations of ratings, and by improving the credit ratings process itself. We believe that these reforms will substantively address any issue of undue or inappropriate reliance by investors on ratings, thereby reducing or eliminating any perceived need to remove references to credit ratings in the Commission's rules under the 1933 Act, the 1934 Act, the Investment Company Act or the Advisers Act as set forth in the Proposed Rules.

Moreover, assuming that the substantive reforms discussed in the preceding paragraph move forward, we see no reason why limited references to NRSRO ratings as they exist today in the Commission's rules would not continue to be appropriate. The purpose of these reforms ultimately is to restore credibility in the credit rating process, while at the same time disincentivizing investors from unduly relying on credit ratings in the future. If these goals are

² See <http://www.sec.gov/comments/s7-13-08/s71308.shtml>.

³ Release Nos. 33-8518; 34-50905; File No. S7-21-04 (December 22, 2004).

achieved, then we believe that the changes proposed by the portions of the Proposed Rules discussed below would generally be unnecessary, as we believe that CRA ratings should continue to be an important element of the overall regulatory and market paradigm, particularly with respect to banks and other financial institutions.

It has been observed that some investors became overly reliant upon credit ratings for structured finance products in recent years. This undue reliance was caused by a number of market-driven factors, as well as areas needing improvement in the credit ratings process itself for structured finance products and in the underwriting of the underlying assets. However, we are not aware of any evidence to support the contention that the frequent reference to NRSRO ratings in the rules promulgated under the 1933 Act, the 1934 Act, the Investment Company Act or the Advisers Act contributed in any way to investor over-reliance on credit ratings, or that these references are or were taken as any sort of “seal of approval” by the Commission as to the quality or accuracy of those ratings for any given security. Registration of an offering under the 1933 Act does not imply that the securities are approved by the Commission, which is reflected in the required prospectus cover page legend. Accordingly, we do not believe that the changes in the Proposed Rules would in any meaningful way reduce undue investor reliance on credit ratings, and we do not believe that the Proposed Rules are necessary or desirable for that stated purpose.

1. Release No. 33-8940; 34-58071 - The Disclosure Release

Form S-3 Eligibility Requirements

Currently, issuers of asset backed securities (“ABS”) are allowed to use Form S-3 to file a shelf registration statement for the public offering of ABS on a delayed basis, provided that, among other requirements, the ABS are rated at the time of offering in one of the four highest rating categories (that is, “investment grade” or “BBB-” (or equivalent)) and above by at least one NRSRO. The eligibility of ABS issuers to use Form S-3 was first established in 1992, and was further refined as part of Regulation AB.

As proposed by the Commission in the Disclosure Release (the “S-3 Eligibility Proposed Rules”), asset-backed securities offered for cash may be Form S-3 eligible, provided that (a) both initial sales, and subsequent resales, are made in minimum denominations of \$250,000, and (b) initial sales are made only to qualified institutional buyers (as defined in Rule 144A(a)(1)) (“QIBs”).⁴ Under this proposal, the rating requirement would be removed, but the other requirements established by Regulation AB would be retained.

We believe first and foremost that the rating requirement for ABS Form S-3 eligibility should not be removed, and should not be replaced with another criterion. As discussed above, assuming that substantive CRA reforms go forward, we believe the requirement that an ABS be rated investment grade in order to be eligible for Form S-3 shelf registration would continue to be a reasonable way to identify those classes of ABS that are not exposed to concentrated credit risk on the underlying assets, and that are therefore appropriate for streamlined registration subject to the detailed disclosure and reporting requirements of Regulation AB.

⁴ We note that, as stated in the Disclosure Release, the Commission specifically declined to propose including institutional accredited investors (as defined in Rule 501 of Regulation D) (“IAIs”).

The ASF has broad practical and policy concerns about the S-3 Eligibility Proposed Rules. The public registration process has historically been designed to provide a “level playing field”, based on an integrated disclosure and reporting regime, for both public investors and registrants who choose not to engage in private placements and instead publicly register their securities offerings.

We are concerned that the S-3 Eligibility Proposed Rules as proposed would provide a significant incentive to conduct ABS offerings through the private placement market. For most types of ABS, Form S-3 shelf registration is the only practical means of registering ABS for a public offering in a manner that is workable in light of the typical marketing schedule for an ABS offering. An alternative of filing a registration statement on Form S-1 would, for most if not all ABS Issuers, be prohibitively time-consuming and expensive. Under the S-3 Eligibility Proposed Rules, there would be a materially diminished incentive⁵ for an ABS Issuer to choose to publicly register an offering of its securities that could only be sold to QIBs, as opposed to offering and selling such securities to QIBs⁶ in a Rule 144A offering and/or to institutional accredited investors (“IAI”s) in a traditional private placement.⁷ The ASF believes that these unregistered QIB / IAI offerings might become the primary, if not exclusive, means of offering and selling securities by ABS issuers. Under the rules as proposed, an ABS issuer in an unregistered offering would have access to a substantially broader investor base than it would under a registered offering. An ABS issuer would further benefit from avoiding the expense of SEC registration fees as well as the minimum denomination requirement. As a result, investors in asset-backed securities would lose the benefits of registration under the 1933 Act and the protections offered thereby. A net result of fewer ABS offerings being made via a public registration statement would not advance the goals of transparency and quality of information, and would negatively impact capital raising and liquidity in all asset classes.⁸

We strongly believe that establishing eligibility for use of Form S-3 based on the qualifications of the investors to whom offers and sales are to be made, would be unduly disparate from the treatment afforded non-ABS issuers under Form S-3, and would also be inconsistent with the

⁵ We note that a number ASF members that are ABS issuers with effective S-3 registration statements have indicated that if the S-3 Eligibility Proposed Rules were to be enacted as proposed, they would turn to the private placement markets for ABS offerings, as a material number of investors in such ABS issuer’s securities are non-QIBs.

⁶ We note that Rule 144A is a resale exemption only; for purposes of this discussion, we are assuming a 4(2) initial sale, with resales under Rule 144A to QIBs. We also note that under Rule 144A, a reasonable belief standard applies to the identification of QIBs; a reseller of securities is protected by Rule 144A if such reseller (and any person acting on its behalf) reasonably believes that the buyer is a QIB. Rule 144A also provides additional guidance on non-exclusive methods that resellers can rely on in determining QIB status. However, the Disclosure Release does not state whether this helpful guidance would apply to the proposed new limitations in Form S-3, Rule 415 and Rule 3a-7.

⁷ In addition, any requirement to police the nature of investors in a public offering of ABS would present a speed bump in the offering process as some evidence of investor status would need to be obtained prior to settlement. Further, the nature of the disclosure regime in a private offering can provide additional flexibility, and there are fewer timing and filing constraints.

⁸ We also note that under the S-3 Eligibility Proposed Rules, if ABS issuers did continue to publicly offer only the more senior classes of ABS from a senior/subordinate structure, then a non-QIB would be able to purchase lower-rated privately-offered ABS, which do not carry the benefits and protections of the public 1933 Act registration process, but would not be able to purchase higher-rated publicly-offered ABS. In our view, this would be an anomalous result.

Commission's past practice of maintaining registration and disclosure criteria that do not vary depending on the characteristics of the investor; i.e., all investors should be treated equally.

We further note that limiting initial sales to QIBs would be inappropriate, because in a registered ABS offering, it is typical for many of the initial purchasers to be non-US investors. It is quite common for these non-US investors to be substantial, sophisticated financial institutions, which do not technically fall within the definition of "QIB" because that definition refers in numerous instances to institutions that are chartered under US law. While sales to these investors could be made under Regulation S, a registered offering is preferred for liquidity reasons. We believe that it would not be appropriate (and perhaps was not intended) for the S-3 Eligibility Proposed Rules to exclude this category of investor.

With respect to requiring minimum denominations, the ASF strongly believes that no minimum denomination requirement should be required, and that imposing a minimum denomination requirement would be unduly disparate from the treatment afforded non-ABS issuers. Minimum denomination requirements trace their history to traditional procedures used in connection with Section 4(2) private placements, in earlier eras where large minimum denomination requirements were a meaningful way to help ensure that the securities being offered would not be placed with unsophisticated investors less able to "fend for themselves", a bedrock concept in the U.S. securities laws. We note that a minimum denomination restriction is not necessary for the protection of retail investors, as ABS are generally not offered to retail investors.⁹ Further, broker-dealers are subject to investor suitability requirements, which protect retail investors. The minimum denomination proposed in the S-3 Eligibility Proposed Rules would be substantially more restrictive than market practice for ABS to date (in this regard, we note that for certain asset classes, \$25,000 minimum denominations placed with institutional accounts was a typical market practice). We believe that to impose a minimum denomination requirement would not serve to protect investors (and in fact may contribute to concentration risks in investor portfolios), and would further reduce liquidity in a market that is already distressed.

Should the Commission, notwithstanding the foregoing, determine to apply a minimum denomination requirement in the final rules, the ASF believes that such a requirement should only apply to initial sales, and not subsequent resales. Such a requirement would be difficult if not impossible for ABS issuers to enforce, except through reliance on deemed representations addressing minimum denominations. For example, for book-entry securities, DTC does not monitor or enforce denomination requirements. We believe that an ABS issuer's inability to control subsequent resales of its securities should not negatively impact or impair its ability to maintain its Form S-3 eligibility.

With respect to exchange-listed ABS, we would support allowing Form S-3 eligibility for all exchange-listed ABS. We note that there have been only a limited number of ABS offerings to date that have been listed on a "national securities exchange".

⁹ In the IC/IA Release, the Commission states that "based on staff experience [a retail] market, if it exists, represents a very small amount of all structured finance products (perhaps less than 1% of the \$306.7 billion in asset-backed securities issued in 2007)." We note, however, that certain securities subject to Regulation AB, such as notes backed by insurance company funding agreements and repackaged corporate and Treasury securities, are offered and sold to retail investors.

Finally, we believe that special consideration should be given to effective date and grandfathering issues, with respect to any rule change for Form S-3 eligibility for ABS issuers. An ABS issuer with an effective Form S-3 registration statement may have made a substantial investment in setting up an ABS shelf program, and paid substantial shelf registration fees. A rule change such as the one proposed by the Commission that would condition the use of Form S-3 by an ABS issuer on limiting initial sales to QIBs only, would fundamentally alter the utility and value of that investment in the existing registration statement. Accordingly, we recommend that if the Commission should add new restrictions on the ability of an ABS issuer to use a Form S-3 registration statement, then all existing Form S-3 registration statements of ABS issuers should be grandfathered such that they could be used under existing rules for a period of two years from the effective date of the rule change.¹⁰

Mortgage Related Securities and 1933 Act Rule 415

As the Commission noted in the Disclosure Release, in addition to being shelf eligible by meeting the requirements of Form S-3, a particular subset of ABS may also be shelf eligible by meeting the requirements in 1933 Act Rule 415, which enumerates the securities that are permitted to be offered on a continuous or delayed basis. Among those securities are “mortgage related securities, including such securities as mortgage-backed debt and mortgage participation or pass through certificates.” By specifically referring to mortgage related securities, Rule 415 has permitted such securities to be offered on a delayed basis, even if the offering cannot be registered on the Form S-3 short form registration statement because it does not meet the eligibility requirements of Form S-3.

Under the proposed revisions to Rule 415 (“Proposed Rule 415”), mortgage-backed securities, having the same characteristics as mortgage related securities under the Section 3(a)(41) definition, regardless of the security rating, could be offered on a delayed basis provided that (a) initial sales and any resales of the securities are made in minimum denominations of \$250,000; and (b) initial sales of the securities are made only to QIBs.

Although we agree with the Commission’s observation that it is appropriate that mortgage-backed securities be treated the same as all asset-backed securities, we have the same concerns with respect to the proposed changes to Rule 415 as with respect to the proposed Form S-3 changes discussed above with respect to minimum denomination and investor qualification requirements. Further, the enactment of SMMEA was designed to increase liquidity in the MBS markets, and Proposed Rule 415, if enacted as proposed, would serve to constrain the benefits Congress intended when enacting SMMEA.

Item 1100 of Regulation AB

Under the existing Item 1100(c) of Regulation AB, if a significant obligor meets the registrant requirements for Form S-3 or Form F-3 and the pool assets relating to the obligor are non-convertible investment grade rated securities, then an ABS issuer’s filings may include a

¹⁰ We also believe that the two-year grandfathering period should also extend to any new registration statement under Form S-3 of the same issuer which is consolidated under Rule 429 during such two-year grandfathering period due to the lapse of the three year effectiveness limitation for Form S-3 registration statements.

reference to the financial information of the obligor rather than presenting the full financial information of the obligor.

The Commission now proposes to amend this provision of Item 1100(c) to remove the ratings reference and permit incorporation by reference of third party financial statements if the third party meets the registrant requirements of Form S-3 and the pool assets relating to such third party are non-convertible securities, other than common equity, that were issued in a primary offering for cash that was registered under the 1933 Act.

Subject to our general comments under “Executive Summary” relating to the Proposed Rules, the ASF supports the Commission’s proposed changes to Item 1100 of Regulation AB.

Items 1112(b) and 1114 of Regulation AB

The Commission’s current rule requires disclosure of financial information regarding significant obligors and significant credit enhancement providers relating to a class of ABS. Items 1112(b) and 1114 provide exemption of disclosure if the assets or enhancement providers are backed by the full faith and credit of a foreign government and the assets are investment grade securities. Alternatively, if the assets or credit enhancer are not investment grade, information required by paragraph (5) of Schedule B of the 1933 Act may be provided instead. The Commission’s proposed change as set forth in the Disclosure Release removes the “investment grade” requirement.

Subject to our general comments under “Executive Summary” relating to the Proposed Rules, the ASF supports the Commission’s proposed changes to Items 1112(b) and 1114 of Regulation AB.

Item 10(c) of Regulation S-K, and Rule 436(g)

As the Commission noted in the Disclosure Release, currently, the Commission allows, but does not mandate, disclosure of security ratings in an issuer’s filings under the 1933 Act under Item 10(c) of Regulation S-K. Under this Item, the Commission asks registrants to consider, but does not mandate, additional disclosure if a registration statement includes disclosure of a rating.

The Commission’s proposal as set forth in the Disclosure Release is to leave Item 10(c) as is, and to amend Rule 436(g) such that applicability would no longer be limited to NRSROs. The ASF’s membership does not support this aspect of the Disclosure Release, as we believe that the applicability of Rule 436(g) should not be expanded to include non-NRSROs, which are not entities subject to Commission regulation.

The Commission has also asked for feedback as to whether the Commission should revise its disclosure policy to prohibit disclosure of security ratings in an issuer’s 1933 Act registration statements or Exchange Act periodic reports, and whether the Commission should simply delete Item 10(c) and provide no established disclosure policy regarding credit ratings. In answer to the Commission’s query, the ASF does not support either such approach.

The Commission has also noted that while Item 10(c) currently only recommends disclosure, commenters on the 1994 Ratings Release expressed that most issuers provide this disclosure in

their 1933 Act filings, and asked for feedback as to whether issuers generally provide this disclosure today and whether disclosure about an issuer's securities rating is appropriate disclosure for their 1933 Act filings. We believe that it is. The Commission has also asked whether it is appropriate disclosure for periodic Exchange Act filings. We do not believe that such disclosure would be appropriate for an issuer's periodic Exchange Act filings, for the reasons described further below.

The Commission has also asked, in addition to the security rating disclosure that Item 10(c) currently recommends, whether it would be valuable for investors to have additional disclosure of all material scope limitations of the rating and any related designation (or other published evaluation) of non-credit payment risks assigned by the rating agency with respect to the security to assist investors in better understanding the credit rating and assessing the risks of an investment in the security. The ASF believes that this disclosure would be valuable for 1933 Act filings, but should not be expressly required.

The Commission has also asked whether disclosure of unsolicited ratings should be required. The ASF does not support such a requirement. As we noted in the July 25 Comment Letter, we believe that non-solicited ratings are generally less accurate than solicited ratings, because they would be based on less information and may be based on more adverse assumptions as compared to solicited ratings. CRAs that choose to issue unsolicited ratings are free to publish them or provide them to investors as they see fit; however, an ABS issuer should not be required to disclose any such unsolicited rating,¹¹ particularly with regard to unregulated CRAs. This is consistent with our view that disclosure of solicited ratings should not be expressly required in 1933 Act filings.

The Commission has also stated that "such ratings may not reflect the level of information on the security that is reflected in a solicited rating, at least in part because of a lack of access to the issuer by the unsolicited credit rating agency." The ASF agrees with this statement.

The Commission also notes that in the June 16 Release, the Commission expressed its concerns about ratings shopping by issuers and the potential for credit rating agencies to use less conservative rating methodologies in order to gain business, presumably lessening the value of the ratings. The Commission has asked whether, if an issuer would be required to provide ratings disclosure where the issuer has obtained either a preliminary security rating or a final security rating from a rating agency, such disclosure would enhance investors' understanding of, and therefore the value of, the ratings. The ASF believes that it would not enhance investors' understanding of ratings to require disclosure about preliminary ratings,¹² particularly in light of the potential inaccuracy of such preliminary ratings (including due to appropriate changes to the

¹¹ An ABS issuer may not even be aware of such unsolicited ratings; further, the issuance of the unsolicited rating would likely occur at a time that the ABS issuer is offering its securities, thereby effectively forcing the ABS issuer to postpone (or even cancel) the offering due to issues surrounding disclosure and timing of such disclosure. Without further consideration of a more comprehensive framework whereby any possible benefit of unsolicited ratings and the impact on the offering process can be more fully considered, the ASF views any disclosure requirements relating to unsolicited ratings at this time as more problematic than helpful.

¹² Our concerns on this point are similar to those expressed in the ASF's July 25 Comment Letter regarding possible investor reliance on unsolicited ratings, and the quality and accuracy thereof. *See* July 25 Comment Letter at p. 11.

structure or other terms of the related security between the time of issuance of such preliminary ratings and closing) as compared to a CRA's final ratings.

The Commission has also asked whether a disclosure requirement for indications of a rating prior to a preliminary rating should be included in the final rules, and whether disclosure of an indication from a credit rating agency of a likely or possible rating would be appropriate. We believe that such disclosure should not be required.

The Commission has also asked whether a Form 8-K would provide investors with material and timely information about an issuer's security ratings and changes in those ratings, and whether periodic reports on Form 10-K, Form 20-F, Form 10-Q and Form 10-D would provide investors with material and timely information about an issuer's security ratings and changes in those ratings. The ASF believes these reports would not do so. Any change in ratings should be published or otherwise provided to investors by the related CRA, and any filing by the issuer describing the rating change would inevitably not be timely as there would be some delay between the CRA's publication or provision of notice and the issuer's filing. Moreover, the issuer would not have any information about the rating change other than information available to the CRA. Therefore, investors should look only to the rating agencies for current information regarding changes in ratings.

The Commission has also asked whether the information that would be provided regarding a material change in a rating in a Form 8-K is already provided by the credit rating agency. The ASF believes that such information is already provided by the CRA and that investors should look solely to the CRA for any additional information relating to a rating change.

The Commission has also asked whether, if a credit rating agency does not publicly disclose the security rating of an issuer's securities, the Commission should require disclosure of the rating in a Form 8-K or in the issuer's periodic reports. The ASF believes that if such information is to be required, that the rating agencies, rather than the issuer, should provide this information. The ASF believes that issuer disclosure in this scenario would defeat the purpose of subscriber-paid ratings. Rather, the rating agency should make any disclosures about changes in its ratings. We note that the Commission has also asked whether the existence of subscriber-paid credit rating agencies would affect the response to this question; it would not. Any obligation to provide updated disclosure to investors as to a subscriber-paid rating should be imposed solely on the CRA that issued that rating.

The Commission has asked whether the consent of a credit rating agency should be required for the use of its security rating by an issuer. Subject to our other views expressed above, the ASF believes that consents should not be required, as such a requirement would only impede free flow of information.

Rule 134(a)(17)

The Commission states in the Disclosure Release that Rule 134(a)(17) permits the disclosure of security ratings in certain communications deemed not to be a prospectus or free writing prospectus, and that the Commission is not proposing to eliminate this reference to security ratings in its rules. The Commission further states that it is proposing to revise the rule to allow

for disclosure of ratings assigned by any credit rating agency, not just NRSROs, and disclosure must also note that the credit rating agency is not an NRSRO, if that is the case. The ASF supports this approach.

2. Release No. 34-58070 - The 1934 Act Release

Rules 101 and 102 of Regulation M

Under current Rules 101 and 102 of Regulation M, issuers, selling security holders, underwriters, brokers, dealers, and other distribution participants are prohibited from bidding/purchasing a covered security until the restricted period has ended. The only securities excepted from this are “investment grade non-convertible and asset-backed securities” (rated investment grade by at least one NRSRO). The Commission has proposed that in place of these exceptions, asset-backed securities be excepted from Rules 101 and 102, if the related securities are registered on Form S-3.

With respect to this proposal, the ASF has the same concerns as those expressed in 1. above relating to Form S-3 eligibility requirements.

3. Release No. IC-28327; IA-2751 - The IC/IA Release

Rule 2a-7

Rule 2a-7 under the Investment Company Act governs the operation of money market funds. As the Commission noted in the IC/IA Release, the Investment Company Act and applicable rules generally require funds to calculate current net asset value per share by valuing their portfolio instruments at market value or, if market quotations are not readily available, at fair value as determined in good faith by the board of directors. Such valuation requirements are designed to prevent unfair share pricing from diluting or otherwise adversely affecting the interests of investors.

As the Commission further noted, Rule 2a-7 exempts money market funds from these provisions but contains maturity, quality, and diversification conditions designed to minimize the deviation between a money market fund’s stabilized share price and the market value of its portfolio. Among these conditions, Rule 2a-7 limits a money market fund’s portfolio investments to securities that have received credit ratings from the “Requisite NRSROs” in one of the two highest short-term rating categories or comparable unrated securities (“Eligible Securities”).

Rule 2a-7 further restricts money market funds to securities that the fund’s board of directors (which typically rely on the fund’s adviser) determines present minimal credit risks, and specifically requires that determination “be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO.”

In the IC/IA Release, the Commission has proposed (“Proposed Rule 2a-7”) to eliminate references to ratings by amending Rule 2a-7 in four ways:

1. Minimal Credit Risk Determination: The Commission would rely on money market fund boards of directors to determine that each portfolio instrument presents minimal credit risks, and whether the security is a “First Tier Security” or a “Second Tier Security” for purposes of the rule. A security would be an Eligible Security if the board of directors determines that it presents minimal credit risks, which determination would be required to be based on factors pertaining to credit quality and the issuer’s ability to meet its short-term financial obligations. A security would be a First Tier Security if the fund’s board had determined that the issuer has the “highest capacity to meet its short-term financial obligations.” A security would be a Second Tier Security if it is an Eligible Security but is not a First Tier Security.

2. Portfolio Liquidity: The Commission would require that a money market fund must hold securities that are sufficiently liquid to meet reasonably foreseeable redemptions in light of the fund’s obligations under Section 22(e) of the Investment Company Act and any commitments the fund has made to its shareholders. The Commission would expressly limit a money market fund’s investment in illiquid securities to not more than 10 percent of its total assets. A “Liquid Security” would be defined as a security that can be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the money market fund.

3. Monitoring Minimal Credit Risks: The Commission would require that, in the event the money market fund’s investment adviser becomes aware of any information about a portfolio security or an issuer of a portfolio security that suggests that the security may not continue to present minimal credit risks, the money market fund’s board of directors would be required to reassess promptly whether the portfolio security continues to present minimal credit risks. Such provisions would replace the provisions in the current rule that generally require a money market fund board to promptly reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks, and take such action as the board determines is in the best interests of the fund and its shareholders.

4. Commission Notice of Rule 17a-9 Transactions: The Commission would require that money market funds provide the Commission with prompt notice when an affiliate of the money market fund (or its promoter or principal underwriter) purchases from the fund a security that is no longer an Eligible Security, pursuant to Rule 17a-9 under the Investment Company Act.

The ASF strongly opposes any changes to existing Rule 2a-7.

First, the ASF is not aware of any instances of over-reliance on credit ratings by money market funds under existing Rule 2a-7, and we note that any reliance on credit ratings as part of the subjective minimal credit risk determination component of existing Rule 2a-7 would not, by its terms, be in compliance with existing Rule 2a-7.

Second, we are concerned that Proposed Rule 2a-7, if adopted as proposed, could have adverse short- and/or long-term negative effects on liquidity in the ABS markets, in particular the market for asset-backed commercial paper (“ABCP”). While we acknowledge that money market funds have made, under existing Rule 2a-7, and would continue to make, under Proposed Rule 2a-7, a minimal credit risk determination, and that removal of the objective ratings standard could potentially, at least in the short term, increase liquidity for lower- or non-rated securities that a particular fund determined presented minimal credit risk for purposes of Rule 2a-7 if adopted as proposed, we are concerned that eliminating references to credit ratings would remove a beneficial “checks and balances” element that references to credit ratings provide in existing Rule 2a-7. For example, the removal of the ratings leg of the Rule 2a-7 standard could result in at least a temporary halt in investing¹³ – which in the context of ABCP, could cause a failure to roll the paper – with the attendant consequences that such a failure to roll would produce in the ABCP markets, as investors pause to reassess their decisions in the absence of the objective leg of the standard that minimum credit ratings represent. It is also possible that some investors will decide to avoid the sector altogether.

Third, by removing the independent credit rating agency assessment element of existing Rule 2a-7, we are concerned that, at least in some cases, a broader range of standards could be applied, and certain money market funds seeking higher yields could purchase lower quality, higher risk securities based solely on the subjective standard that existing Rule 2a-7 currently applies. Should any such increased risk appetite result in losses, such an event in and of itself, though isolated to one or a few funds, would likely result in a negative liquidity impact on the broader ABCP markets. Although money market funds would still be required to make an independent minimal credit risk determination, we nonetheless believe that there is value, particularly in terms of the perception of potential investors in ABCP going forward, in retaining the additional independent assessment that credit ratings provide, and that such retention would increase, rather than reduce, investor confidence in the ABCP market.

Lastly, we note that the Commission’s final rules in response to the June 16 Release, on which the ASF has commented,¹⁴ should address the Commission’s concerns regarding the quality, accuracy and integrity of credit ratings and the credit ratings process. When promulgated, these final rules, as informed by commenters, should lessen any perceived need to expunge references to credit ratings in the Commission’s existing rules under the 1933 Act, the 1934 Act, the Investment Company Act and the Advisers Act.

Rule 3a-7

Rule 3a-7 under the Investment Company Act excludes structured finance vehicles from the Act’s definition of “investment company” subject to certain conditions. Under the current rule,

¹³ We note that Rule 2a-7 money market funds are the largest group of investors in ABCP.

¹⁴ *Supra* note 2.

ABS fixed income securities that are rated investment grade by at least one NRSRO may be sold to the general public; ABS fixed income securities may be sold to institutional “accredited investors” regardless of rating; ABS may be sold to QIBs regardless of rating; ABS issuers may acquire or dispose of eligible assets so long as the actions do not cause a downgrade in the rating of the issuer’s fixed income securities; and cash flows from the asset pool must be deposited periodically into a segregated account “consistent with the rating of the outstanding fixed income securities”.

In the proposed rule (“Proposed Rule 3a-7”), the Commission has proposed to eliminate the provision in the current rules allowing any “investment grade” security to be sold to non-IAs and non-QIBs. Under the Commission’s proposal as set forth in the IC/IA Release, only issuers that sell solely to IAs and QIBs will be able to avail themselves of the exemption from registration as an investment company afforded by Rule 3a-7,¹⁵ and references to credit ratings will be eliminated and replaced with a requirement that the issuer have procedures to ensure that the acquisition or disposition of eligible assets does not adversely affect the full and timely payment of the issuer’s outstanding fixed income securities, and that cash flows be deposited in a segregated account consistent with the full and timely payment of the outstanding fixed income securities.

The ASF believes that sales of investment grade ABS fixed income securities under Rule 3a-7 should not be limited to QIBs and IAs, particularly if the Form S-3 requirements as set forth in the final rules allow sales to investors without regard to their qualifications as the ASF is requesting herein. We note in this regard that the IC/IA Release states that “[w]e understand that today most asset-backed securities are issued by special purpose vehicles that do not rely on rule 3a-7 to exclude them from application of the Investment Company Act. Instead, they rely on section 3(c)(7)...”. Public ABS issuers do in fact rely on Rule 3a-7,¹⁶ or alternatively (for certain mortgage-backed securities) on Section 3(c)(5)(C) under the Investment Company Act, because these provisions permit use by ABS issuers who are making a public offering.¹⁷

Further, the element of Proposed Rule 3a-7 requiring the issuer to take “actions necessary for the cash flows derived from eligible assets for the benefit of the holders of fixed-income securities to be deposited periodically in a segregated account *consistent with the full and timely payment of the outstanding fixed-income securities*”¹⁸ introduces a subjective standard, which reduces legal certainty (and thus available comfort on the ability to rely on Rule 3a-7) for market

¹⁵ We note that the Commission has observed in the IC/IA Release that retail investors may incur opportunity costs under Rule 3a-7 as proposed to be revised, as such retail investors would not be eligible to purchase the securities of structured finance vehicles that rely on Rule 3a-7. Although ABS are generally not offered retail, as noted elsewhere in this letter, there are exceptions. *See supra* n. 9. Similar to the concerns echoed elsewhere in this letter, the ASF believes that this result would negatively impact existing liquidity in the already distressed ABS markets.

¹⁶ We also note that non-U.S. investors are generally unable to certify as to QIB or IAI status. Thus, the imposition of a QIB and/or IAI investor qualification requirement would effectively eliminate an entire investor base (non-U.S. investors) for such securities.

¹⁷ We note that Section 3(c)(1) and Section 3(c)(7) by their terms are only available to an issuer that is not making a public offering of the related securities.

¹⁸ Emphasis added.

participants.¹⁹ We do not believe that security ratings are fundamentally inappropriate for an exemption analysis, and favor retaining current Rule 3a-7.²⁰

Finally, we note as a technical matter that (subject to our views on the other aspects of the Proposed Rules as set forth above) the requirements of Rule 3a-7, if and as amended by the final rules, should be aligned with the requirements of the relevant provisions under the 1933 and 1934 Acts (including, for example, Form S-1²¹ and Form S-3 eligibility requirements), to avoid any resulting basis for uncertainty as to whether Rule 3a-7 can be relied upon for an ABS offering that otherwise meets the relevant provisions under the 1933 and 1934 Acts (for example, Form S-3 eligibility requirements). We also note that while the proposed changes to Form S-3 and Rule 415 only require that initial sales be made to QIBs, Rule 3a-7 requires issuers and underwriters to exercise reasonable care to ensure that secondary market sales are limited to the same categories of investors as the initial sales (QIBs and, for fixed income securities, IAIs). If Proposed Rule 3a-7 is adopted as proposed, it would be helpful if Rule 3a-7 were to be conformed to Form S-3 and Rule 415 on this point, at least as to sales to QIBs.²²

Conclusion

The ASF believes that credit ratings are, and should continue to be, an important element of the regulatory regime that applies to structured finance products. The Final June 16 Rules will benefit investors both by improving disclosure about the meaning and limitations of ratings and by improving the credit ratings process itself. Establishing eligibility for use of Form S-3 based on the qualifications of the investors to whom offers and sales are to be made would create unduly disparate treatment as compared to the treatment afforded non-ABS issuers under Form S-3, and would also be inconsistent with the Commission's past practice of maintaining registration and disclosure criteria that treat all investors equally, regardless of their characteristics. We also believe that the removal of credit ratings from Rule 2a-7 will cause

¹⁹ We also note that the requirement for "procedures to ensure that the acquisition or disposition does not adversely affect the full and timely payment of the outstanding fixed income securities" does not provide guidance on whether credit-impaired or defaulted securities could be sold.

²⁰ One approach the Commission could consider as an alternative would be for Rule 3a-7(a)(3) to read as follows: "The issuer acquires additional eligible assets, or disposes of eligible assets, only if: (i) the assets are acquired or disposed of in accordance with the terms and conditions set forth in the agreements, indentures, or other instruments pursuant to which the issuer's securities are issued, which include provisions the issuer reasonably believes are designed to permit the full and timely payment of the issuer's outstanding fixed-income securities and (ii) the assets are not acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes." This approach would also be consistent with the view expressed by the Commission on page 31 of the IC/IA Release that "Commission staff believe that almost all issuers currently have these procedures in place", and would meaningfully distinguish an asset-backed securitization from an investment company that should be registered under the Investment Company Act.

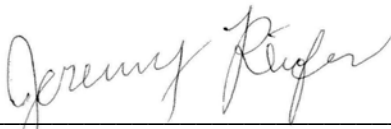
²¹ We note that, while this letter focuses primarily on Form S-3 in response to the Commission's request for comments thereon, ABS issuers offering and selling under an effective Form S-1 registration statement must also avail themselves of an applicable exemption from the Investment Company Act; if adopted as proposed, Proposed Rule 3a-7 would effectively impose an IAI/QIB standard on Form S-1 registrants as well.

²² We note that if, notwithstanding the comments herein, Proposed Rule 3a-7 is adopted as proposed, it will be necessary to include appropriate grandfathering and transition provisions, as many pre-existing ABS issuers that rely on Rule 3a-7 have limited neither the initial sales nor resales of investment grade fixed income securities to any particular type of investor. No such transitional guidance appears in the IC/IA Release.

more harm than benefit. The reforms effected by the Final June 16 Rules will substantively address any issue of undue or inappropriate reliance by investors on ratings, thereby reducing or eliminating any perceived need to remove references to credit ratings in the Commission's rules under the 1933 Act, the 1934 Act, the Investment Company Act or the Advisers Act as set forth in the Proposed Rules.

The ASF very much appreciates the opportunity to provide the foregoing comments in response to the Commission's Proposing Release. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please contact one of the undersigned or George Miller, Executive Director of ASF, at 212.313.1116.

Sincerely,



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Co-Chair, ASF Credit Rating Agency
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