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VIA E-MAIL RULE-COMMENTS@SEC.GOV

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Dechert LLP ("Dechert") Comments to Release No. IC-28327; IA-2751
File No.: S7-19-08 (the "Release 28327")

Ladies and Gentlemen:

Dechert submits this letter in response to the request for comments made by the Securities and Exchange Commission (the "Commission" or "SEC") in Release 28327, which proposes amendments to various rules under the Investment Company Act of 1940 (the "1940 Act") and the Investment Advisers Act of 1940 that incorporate ratings of nationally recognized statistical rating organizations ("NRSROs").[1] This comment letter addresses the Commission's proposal to eliminate references to NRSRO ratings in the Rules generally and, specifically, in Rule 3a-7 of the 1940 Act ("Rule 3a-7"). This letter expresses the views of Dechert and are not necessarily those of any client.

Removal of References to NRSRO Ratings Generally

With regard to the removal of references to NRSRO ratings in the Rules generally, Dechert joins in the views of the American Securitization Forum ("ASF") and the Securities Industry and Financial Markets Association ("SIFMA") and echoes the concerns expressed by the ASF and SIFMA in their comment letters submitted to the Commission.[2]

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[1] Release 28327 proposes amendments to Rules 2a-7, 3a-7, 5b-3, and 10f-3 under the 1940 Act and Rule 206(3)-3T under the Investment Advisers Act of 1940 (together, the "Rules").

[2] See Comment Letter of the ASF (September 5, 2008) on file at the Commission ("ASF Comment Letter"), at 2 and 3, and Comment Letter of SIFMA (September 4, 2008) on file at the Commission ("SIFMA Comment Letter"), at 2 through 5.

Dechert recognizes the concern of "undue reliance on NRSRO ratings" that the Commission is seeking to address through its proposed amendments and agrees with the Commission's emphasis on the importance of independent investment analysis by market participants.[3] However, Dechert does not agree with the Commission's contention that the incorporation of NRSRO ratings in the Rules causes such undue reliance by market participants and does not believe that the mere possibility of undue reliance supports the removal of references to, and use of, NRSRO ratings in the Rules. We agree with SIFMA's belief that "the appropriate degree of use by market participants of ratings is less a regulatory issue, and more one of best practices within the marketplace.[4]

We agree with the Commission that NRSRO ratings are not meant to, and should not, be relied upon by market participants in lieu of conducting their own independent risk analysis. Dechert believes, however, that the majority of market participants are also of this view and have not interpreted the use of NRSRO ratings in the Rules as an endorsement of the quality or accuracy of the NRSRO ratings. The use of NRSRO ratings, in many cases, provides an independent, objective, third party minimum threshold that acts as an important component in an investor's overall risk analysis. We agree with SIFMA that the removal of this objective minimum threshold would be a detriment to investors and hinder their investment making decisions since currently "[t]his objective check on the subjective deliberations of various investors creates a level of conformity among standards in the marketplace and has an overall stabilizing effect."[5]

Furthermore, we agree with the ASF and SIFMA that if the proposed amendments in Release 28327 are viewed in light of the previously proposed SEC initiatives relating directly to the NRSRO ratings process and the various reforms already initiated by the NRSROs themselves, then the need for the proposed amendments in Release 28327 is likely eliminated.[6] The proposals in the June 16 Release, when adopted, can be expected

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[3] Release 28327.

[4] SIFMA Comment Letter, at 2.

[5] *Id.*, at 3.

[6] *See* Statement on Proposal to Increase Investor Protection by Reducing Reliance on Credit Ratings (June 25, 2008); Press Release No. 2008-110 (June 11, 2008); Proposed Rules for Nationally Recognized Statistical Rating

to provide increased integrity and transparency to the ratings process, which would result in market participants incorporating, with a greater understanding, more transparent NRSRO ratings into their investment analysis. This can only be a benefit to the market.

As to Rule 3a-7 specifically, we look to the final 1992 Rule 3a-7 adopting release (the "Adopting Release") where the Commission recognized that the purpose of Rule 3a-7 was to remove "an unnecessary and unintended barrier to the use of structured financings in all sectors of the economy, including the small business sector" by permitting issuers of structured financings to publicly offer their securities without registering as an investment company under the 1940 Act.[7] The Adopting Release recognized that structured finance was one of the dominant means of capital formation in the United States which had been constrained to some degree by the 1940 Act which, prior to the adoption of Rule 3a-7, treated similar types of structured financings differently based on the type of asset securitized with "[s]ome sectors of the economy, including small business, generally unable to use structured financings as sources of capital...".[8] The final rule incorporated the rating requirement as a means of distinguishing structured financings from investment companies, emphasizing that "although ratings generally reflect evaluations of credit risk, the rating requirement is not intended to address investment risks associated with the credit quality of a financing. The involvement of rating agencies represents one of the most significant attributes of the structured finance market...rating agency evaluations tend to address most of the [1940] Act's concerns regarding abusive practices, such as self-dealing and overreaching by insiders, misvaluation of assets, and inadequate asset coverage. Rating agencies have been successful in analyzing the structural integrity of financings, without impeding the development of the structured finance market."[9] Ratings and the rating process continue to be relevant to investors since rating agencies have more historical data, research, knowledge of models, structures and assumptions used in structured financings across asset classes and issuers and ability to produce meaningful independent statistical

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Organizations, Securities Exchange Release No. 57967 (June 16, 2008)("June 16 Release"), 73 FR 36212 (June 25, 2008).

[7] Release No. IC-19105, 52 SEC Docket 2573, 1992 WL 346941 (November 19, 1992), at *1.

[8] *Id.* at *2.

[9] *Id.*, at *6.

analyses than do issuers, sponsors or investment banks involved in structured financings. Trustees do not have the expertise to perform these functions nor would they be willing to do so.

While recent market troubles have raised concerns about the NRSRO ratings process, as noted above, these concerns are being addressed by the previously proposed SEC initiatives relating directly to the NRSRO ratings process and the various reforms already initiated by the NRSROs themselves. We continue to believe that the NRSRO's provide a valuable independent analysis to the structured finance process in addition to the credit analysis performed by market participants and that the substantive NRSRO reforms referenced above will make the need for the proposed amendments to Rule 3a-7 unnecessary. Therefore, we favor retaining current Rule 3a-7.

Current Rule 3a-7

Rule 3a-7 was adopted to facilitate the issuance and development of structured finance products[10] by excepting from the definition of an "investment company" under the 1940 Act "issuers of asset-backed securities" (i.e., structured finance vehicles) that comply with the conditions set forth in Rule 3a-7.

Under current Rule 3a-7, a structured finance vehicle may sell fixed-income securities to the general public provided that such securities are rated by at least one NRSRO "in one of the four highest rating categories assigned long-term debt or in an equivalent short-term category."[11] Regardless of the rating, riskier (*i.e.*, junior) fixed-income securities may be sold to institutional accredited investors ("IAIs"), and any securities (fixed-income or equity) may be sold to "qualified institutional buyers" ("QIBs") and "persons . . . involved in the organization or operation" of the structured finance vehicle or such persons' affiliates.[12] A purchase or sale of securitized assets is

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[10] Release 28327 (and this comment letter) use the term "structured finance product" to refer "to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction (including but not limited to asset-backed securities ("ABS")) such as residential mortgage-backed securities ("RMBS") and to other types of structured debt instruments such as collateralized debt obligations ("CDOs"), including synthetic and hybrid CDOs." The term "structured finance vehicle," as used in this comment letter, refers to any issuer of a structured finance product.

[11] Rule 3a-7(a)(2).

[12] *See* Rule 3a-7(a)(2)(i) and (ii).

allowed only if, among other things, it would "not result in a downgrading in the rating" and cash flows from collateral must be "deposited periodically in a segregated account . . . consistent with the rating of the outstanding fixed-income securities."[13]

Amendment to Rule 3a-7(a)(2)

The Commission is proposing to eliminate the provision in current Rule 3a-7(a)(2) which permits an issuer of asset backed securities to issue investment grade fixed-income securities to the general public.

Dechert opposes this proposed amendment to Rule 3a-7(a)(2). First, as discussed above, we believe the rating requirement remains an appropriate method to distinguish structured financings from investment companies. In addition, the investment grade rating requirement in current Rule 3a-7(a)(2) continues to be a reasonable way to identify classes of fixed-income securities that are reasonably expected to be fully and timely paid from the cash flows from the issuer's underlying assets and there is no reason why, with other existing safeguards in place for retail investors under applicable law, they should not be permitted to invest in such asset backed securities. Furthermore, although some structured finance securities offerings are privately placed and, as a result, may rely on the exclusions from investment company status provided by Section 3(c)(1) or Section 3(c)(7) under the 1940 Act, as noted by the ASF, "Public ABS issuers do in fact rely on Rule 3a-7, or alternatively (for certain mortgage-backed securities) on Section 3(c)(5)(C) under the [1940] Act"[14] and, as noted in the Adopting Release, one of the purposes of Rule 3a-7 was to provide a level playing field for the public offering of structured finance securities which did not vary depending on the nature of the underlying assets.

Notwithstanding our view and that of the ASF and SIFMA that there is no need to remove references to NRSROs as proposed in the Release and that to do so likely will further impede capital markets liquidity, we agree with the relevant comments of the ASF that if Rule 3a-7(a)(2) is amended, it should be aligned with the conditions of the applicable provisions under the Securities Act of 1933 ("1933 Act") and the Securities

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[13] Rule 3a-7(a)(3)(ii) and (a)(4)(iii), respectively.

[14] ASF Comment Letter, at 13.

Exchange Act of 1934 ("1934 Act") (including, for example, Form S-1 and Form S-3 eligibility requirements) to avoid any resulting uncertainty about whether Rule 3a-7 can be relied upon for a structured finance securities offering that otherwise meets the relevant provisions under the 1933 Act and 1934 Act.[15] Furthermore, if the amendment to Rule 3a-7(a)(2) is adopted as proposed, we believe that (i) there should be an explicit allowance for offerings to non-U.S. investors consistent with Regulation S under the 1933 Act ("Regulation S")[16] and (ii) it will be necessary to include an appropriate grandfathering provision since many of the structured finance vehicles that currently rely on Rule 3a-7 have limited neither the initial sale nor resales of their "investment grade" fixed-income ABS to any particular type of investor.[17]

Amendment to Rule 3a-7(a)(3)(ii)

Dechert opposes the proposed amendment to Rule 3a-7(a)(3)(ii) that would cause the current requirement that an acquisition or disposition of securitized assets by an issuer "not result in a downgrading in the rating of the issuer's outstanding fixed-income securities" to be replaced with a requirement that "the issuer has procedures to ensure that the acquisition or disposition does not adversely affect the full and timely payment of the outstanding fixed-income securities".[18] While the proposed amendment appears to merely remove references to the rating while reflecting the original purpose behind including a rating requirement in Rule 3a-7 (*i.e.*, preservation of credit quality consistent with full and timely payment of the fixed-income securities), we believe that the proposed language is quite subjective and actually goes beyond the Commission's intention to reduce or eliminate reliance on NRSRO ratings. NRSRO ratings rate the likelihood of full and timely payment of principal and interest on fixed-income securities based on the structure of the transaction. It is not clear that the issuer having "procedures which ensure that acquisition or disposition of assets do not adversely affect full and

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[15] ASF Comment Letter, at 14.

[16] Regulation S investors are important participants in the ABS market, and the market is not currently set up to monitor the requirements that would result from the proposed amendments (*e.g.*, distinguishing which Regulation S investors are also "IAIs" or "QIBs").

[17] We note that no such grandfathering provision appears in Release 28327.

[18] *See* Rule 3a-7(a)(3)(ii) and Release 28327.

timely payment of the outstanding fixed-income securities" is the same standard and may be read to prohibit or restrict selling defaulted, credit impaired or other securitized assets at a loss even when that is the appropriate investment decision and is permitted by the structure of the transaction and transaction documents which are reasonably designed to permit the full and timely payment of the issuer's fixed-income securities.

Notwithstanding our view and the view of the ASF in favor of retaining the current Rule 3a-7, if the Commission determines that it is going to eliminate references to NRSRO ratings in Rule 3a-7(a)(3) then Dechert proposes as an alternative to combine the current Rule 3a-7(a)(3)(i) and the proposed Rule 3a-7(a)(3)(ii) resulting in a new Rule 3a-7(a)(3) that reads as follows:

> "(3) 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 [old (iii)])* the assets are not acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes".

As compared to the Commission's proposed amendment, we believe this proposed language is more in keeping with the Commission's intentions since it (i) removes reference to the NRSRO ratings, (ii) distinguishes structured finance vehicles from investment companies, (iii) accurately reflects how the securitization transactions are designed and (iv) removes a level of subjectivity and provides clarity for structured finance issuers who rely on Rule 3a-7 for an exclusion from the definition of "investment company" under the 1940 Act, which will improve liquidity in markets that are currently lacking it.

Amendment to Rule 3a-7(a)(4)(iii)

Consistent with our views on the other proposed amendments to Rule 3a-7, we also believe that Rule 3a-7(a)(4)(iii) should be not be amended to remove the reference to

NRSRO ratings. As with Rule 3a-7(a)(3), we believe the proposed language is too subjective of a standard.

We appreciate the opportunity to comment on the proposed amendments. If you have any questions about Dechert's comments or would like any additional information, please contact Cynthia J. Williams at 617-654-8604.

Respectfully yours,

Dechert LLP

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