



July 25, 2008

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

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attn: Nancy M. Morris, Secretary

**Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations
Release No. 34-57967 (File No. S7-13-08)**

Ladies and Gentlemen:

This letter is submitted on behalf of the Structured Products Association in response to the request of the Securities and Exchange Commission (the "Commission" or the "SEC") for comments on Release No. 34-57967 (the "Release"). The Release sets forth proposed rules that aim to increase transparency and avoid conflicts of interest in the credit rating process. We note that at or about the same time that the Commission published the Release, the Commission also published several other proposed revisions to the Commission's rules and regulations that refer to and rely upon credit ratings. We are not commenting on those additional rule proposals.

The comments presented in this letter represent the views of the Structured Products Association (the "SPA" or the "Association"). The Structured Products Association is a New York-based trade group. The Association's mission includes positioning structured products as a distinct asset class; promoting financial innovation among member firms; developing model "best practices" for members and their firms; and identifying legal, tax, compliance and regulatory challenges to the structured products industry. The Association was the first trade organization for structured products in the United States and now has more than 2,000 members, including members from securities exchanges, self-regulatory

organizations, law firms, compliance professionals, investor networks, family offices, and buy-side and sell-side structured products firms. The Association counts among its members some of the largest and most active investment banks and distributors in the U.S. structured products market.

The Association is committed to promoting the development and growth of the structured products market in the United States, and to ensuring that investors in structured products understand the terms and risks of their investments. To our dismay, there has been a great deal of confusion in the popular business press regarding the nature of “structured products.” For example, in articles and commentaries on the current credit crisis, “structured products” have been frequently confused with products issued by securitization vehicles, including mortgage-backed and asset-backed securities, such as CDOs and CLOs.

Please note that, unlike the securities at the heart of the current credit crisis, the holders of these structured securities are subject only to the creditworthiness of the *issuer* of these securities. The issuer of structured products does not typically pass along (and therefore depend upon) the payments from the underlying assets, as would occur in the case of a securitization transaction.

Structured Products

Structured products represent a distinct asset class and should not be confused with securitization vehicles. Unfortunately, there is no uniform or consistently embraced definition of “structured products.” The Association and its members generally regard a “structured product” as a security or other instrument (*e.g.*, a bank deposit, commercial paper, senior or subordinated debt security or note, warrant, etc.), the return on which is based on the performance of one or more reference assets, which may include stocks, indices, funds, commodities, exchange rates, etc.¹ A structured product may be custom-

¹Some examples of “structured products” include those described in the following filings with the Commission:

- Barclays -- commodity linked exchange traded notes:
<http://www.sec.gov/Archives/edgar/data/312070/000119312508139235/d424b2.htm>;
- Deutsche Bank – notes linked to a basket of equity securities:
<http://www.sec.gov/Archives/edgar/data/1159508/000119312508127284/dfwp.htm>;
- Goldman equity index linked notes:
<http://www.sec.gov/Archives/edgar/data/886982/000119312508148776/d424b2.htm>;
- JP Morgan commodity index linked notes:
http://www.sec.gov/Archives/edgar/data/19617/000089109208003587/e32299_424b2.htm; and
- Lehman Brothers currency-linked notes:
<http://www.sec.gov/Archives/edgar/data/806085/000119312507230816/d424b2.htm>

tailored in order to offer investors exposure to particular risk/return profiles that are otherwise unavailable or that would be difficult to access for the investor. Structured products may be issued as registered securities, or may be offered pursuant to an exemption from the registration requirements of Section 5 of the Securities Act of 1933, as amended (the “Securities Act”). Prior to the securities offering reforms in 2005,² the Securities Act contained a definition of a “structured product” in Rule 434 relating to prospectus delivery requirements.³

Specific structured products are typically not assigned a credit rating. Instead, the structured product is typically evaluated by investors based on the applicable short-term or long-term credit rating of its issuer. However, in some cases, issuers of, and investors in, structured products may require that a structured product be rated by a credit ratings agency. A rating may be required in order for certain classes of investors to be permitted to purchase a product or in order to comply with FINRA Rule 2720. In those cases where a rating is required or deemed desirable, issuers of structured products or the financial intermediaries that create and design these products work closely with ratings agencies in order to obtain a rating for the products.

As we discuss further below, we believe that the Commission’s principal focus in the Release and related rule proposals is to promote greater transparency and reliability in the ratings of mortgage-backed and asset-backed securities, including residential mortgage-backed securities, that are at the root of the current credit crisis. We do not believe that the Commission intended to address in the Release and related rule proposals the ratings process for other securities, nor do we believe that the proposed rules set forth in the Release are appropriate for structured products, in light of their different structure, economics and risks. In order to avoid any ambiguity and in order to prevent any chilling effect on a growing segment of the market, the Association recommends that the Commission clarify the intended scope of the Release in its final rules.

² SEC Release Nos. 33-8591; 34-52056; IC-26993; FR-75.

³ Former Rule 434(g) provided as follows: “For purposes of this section, *structured securities* shall mean securities whose cash flow characteristics depend upon one or more indices or that have embedded forwards or options or securities where an investor’s investment return and the issuer’s payment obligations are contingent on, or highly sensitive to, changes in the value of underlying assets, indices, interest rates or cash flows.”

The Structured Products Market

The structured products market in the United States has been growing at an impressive rate. In 2007, the volume of issuances rose to \$114 billion in new products, up from the \$64 billion in 2006. The number of structured products listed on securities exchanges also increased in 2007 compared to the prior year, with 114 new issues listed on the American Stock Exchange in 2006. The number of issuers of structured products also continues to increase.

The structured products market is quite different from the CDO or asset-backed securities market in a number of important respects. Structured products are very frequently offered by issuers, which qualify as WKSIs and include the largest financial institutions in the United States. Structured products also may be sold pursuant to an issuer's medium-term note program. By and large, structured products are direct obligations (in the case of notes) or securities (in the case, for example, of warrants) of the issuer—not instruments issued by a pass-through vehicle that itself is not a reporting entity. In the case of structured products that are certificates of deposit or bank notes, there is still significant public disclosure available to investors about the issuers of the instruments. These instruments are typically offered using a detailed offering memorandum, which includes or incorporates by reference the bank issuer's publicly-available periodic financial statements.

A holder of a structured product generally is a holder of a senior debt obligation of the issuer of the product. The holder, then, is exposed to the credit of the issuer of the structured product. Although the return on a structured product will reference an underlying asset or underlying security, the structured product remains a "recourse" obligation of the issuer—unlike asset-backed securities, the holders of which generally have recourse only to the particular assets of the special purpose-entity issuer.

Structured products frequently are listed and traded on a securities exchange and subject to the rules and regulations of the exchange. A holder of a listed structured product can sell its structured product at any time during market hours. For example, a holder of an exchange-traded note (an increasingly popular structured product) may sell its ETN during market hours or purchase a new ETN during market hours.

Many classes of structured products are marketed and sold to retail investors, subject, of course, to suitability determinations. Unlike the CDO market, which is largely an institutional market, the market for structured products includes a significant retail component. In fact, structured products provide an important vehicle enabling retail investors, family offices, etc. to access investment classes that might not otherwise be readily available. Through a structured product, an investor may gain access to individual commodities and commodity indices, individual currencies and currency indices,

international equity markets, particular macroeconomic investment strategies, etc. In this respect, structured products are a valuable portfolio management tool.

There are many other important differences between asset-backed securities and structured products, which suggest that it is important that any new rules and regulations make a distinction between them.

Overview

As a general matter, the Association supports the Commission's efforts to bolster the regulation and oversight of nationally recognized statistical rating agencies, or NSROs. The Association understands that, in part, concerns regarding the quality and accuracy of NSROs' initial ratings of mortgage-backed and asset-backed securities have led to a lack of confidence on the part of investors in such ratings. The Association also understands that critics have pointed to potential or actual conflicts of interest that may have existed on the part of NSROs that were rating mortgage-backed and asset-backed securities. Given the reliance placed by investors and financial intermediaries on ratings, we believe that it is essential that confidence be restored in the ratings process. However, we also believe that it is essential that the Commission and other regulators acknowledge that continued capital markets activity and continued financial innovation cannot take place without involving or including rating agencies in the structuring and product development. There is no *per se* conflict of interest that arises as a result of discussing product structuring with rating agencies, especially where these discussions lead to better-informed ratings decisions.

In any event, we begin by noting that, while the Release includes a lengthy discussion of residential mortgage-backed securities and subprime mortgage related securities, the Release also includes a number of different references to "structured finance products" and "structured products." We note that footnote 15 of the Release states that "[t]he term 'structured finance product' as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction." Proposed Rule 17g-5(b)(9) adopts a similar definition. We believe this is an overbroad definition and will result in a great deal of confusion in the market. The same footnote acknowledges that the term "structured products" is a "broad category of financial instrument" and "includes, but is not limited to, asset-backed securities ("ABS") such as RMBS and to other types of structured debt instruments such as CDOs, including synthetic and hybrid CDOs."

We urge the Commission to adopt a more specific definition for the term "structured finance product" in order to avoid ambiguity. Based on the Release, it is clear that the Commission intends to address the ratings issues that arose in connection with asset-backed and mortgage-backed securities. As such, we suggest that the Commission

consider using an already existing definition, such as the definition set forth in Item 1101 of Regulation AB for “asset-backed security.” Given that Regulation AB became effective relatively recently and was passed following significant dialogue with, and comment from, industry participants, we believe that it is sensible to rely on the well-understood definition included therein. To the extent that the Commission believes it is necessary, for purposes of the regulation of rating agencies, to implement a new definition, we request that the Commission specifically exclude from the definition of “structured finance product” the class of products referred to as “structured products.” Toward that end, we suggest that the Commission, in defining “structured products” as an excluded category, consider the definition of “structured product” that was previously contained in the Securities Act. Consistent with our goal of seeking additional clarity, we ask that the Commission use the defined term “asset-backed security” (or its new defined term) throughout the final rules—rather than using several terms interchangeably as it does in the Release.⁴

As we noted above, the Association is dedicated to promoting the growth of the structured products market in the United States. Product structurers, financial intermediaries, issuers of structured products and investors all rely on the integrity of credit ratings. Furthermore, all parties involved in product development find that it is essential to include rating agencies in the process of bringing new products to market. If the Commission were to determine not to specifically exclude “structured products” from the application of these proposed rules, the Association is concerned about the chilling effect of the proposed rules on the market. It is in this context that the Association offers additional detailed comments on the regulations proposed in the Release.

Detailed Comments

Prohibiting NSRO Recommendations on Structure

The Release proposes amending Rule 17g-5c to prohibit an NSRO from issuing a rating in circumstances where the NSRO made recommendations to the obligor or issuer. As we noted above, the Association does not understand why participation by rating agency personnel in discussions with issuers, underwriters, other financial intermediaries and advisers regarding the potential structuring of a security or a transaction should be deemed a conflict of interest. The Association believes that such discussions actually enhance the interests of investors by facilitating the creation of financial products that are consistent with the investment preferences of different types of investors, in conformity with the NSROs’ standards.

⁴ Compare, for example, proposed Rule 17g-5(b)(9), proposed Rule 17g-7(a) and Proposed Item 9, Exhibit 1 to Form NRSRO.

The Association also points out that the major NSROs often make publicly available statements as to their policies and procedures for assigning ratings to different types of products. These releases, which are usually widely available to issuers, underwriters and the investing public, facilitate the exchange of information among the parties to a transaction, on the one hand, and the NSROs, on the other hand, without creating a conflict of interest. In order to remove any doubt as to their permissibility, we would recommend that any rules that the Commission adopt exclude from their coverage such publicly-available, widely disseminated, indications of NSRO standards.

Enhanced Disclosure of Information

In the Release, the Commission requires the public disclosure of information provided to an NSRO by an issuer, underwriter, sponsor, depositor or trustee. The Commission suggests in its release that making additional information provided to the NSROs available to the public will promote transparency in the initial ratings process, as well as encourage the issuance of ratings by NSROs not hired by the arranger of a transaction.

The proposed rule would require that all information provided to the NSROs by the issuer, underwriter, sponsor, depositor or trustee that is used in determining the initial credit rating and performing credit rating surveillance on the security would be subject to the disclosure requirement. This would include information concerning the characteristics of the assets underlying or referenced by the security, and the security's legal structure. For example, in the case of a structured product that references hedge fund returns or fund of fund returns, the proposed rule would require detailed disclosure relating to the underlying fund(s).

In certain cases, there are legal prohibitions regarding disclosure of information regarding referenced assets. For example, in the case of a structured product that references hedge fund returns or fund of fund returns, would these regulations require that the offering memorandum for the hedge fund be made public? Publication of an offering memorandum for an underlying security that is itself a restricted security that is not the subject of a registration statement would seem to be inconsistent with existing securities regulations. In the case of a structured product that provides an investor with a return that is linked to a customized index, it would seem that the proposed rule change would require disclosure of detailed information regarding the customized index. Much of this information would be regarded as highly proprietary by the index provider or financial institution that sponsors the index. If the index meets all of the requirements of the Exchange Act and any securities exchange (if applicable), it is difficult to see what, if any, additional regulatory objective is met by requiring additional disclosure.

In the Proposing Release, the Commission suggests that publication of all of this extraneous information will encourage other NSROs to provide unsolicited ratings.

Particularly in the case of structured products, it is difficult to understand the nexus between making additional information available and a greater number of unsolicited ratings. Financial intermediaries and issuers may collaborate to structure a product for a particular investor or group of investors and then seek to have the product rated by a NSRO. In the case of tailor-made structured products that are intended for a limited number of investors, it is unlikely that NSROs will devote the time and attention to providing an unsolicited rating. In the Commission's report on NSROs and in recent media accounts, it has become clear that, at least, some of the errors made in rating ABS structures and transactions arose because there were not enough trained ratings analysts.

Special Reporting Symbols

The proposed rules would mandate that a symbol or identifier or other means be used in order to distinguish the ratings that relate to structured finance products from those attributed to other types of bonds. The Commission states that its intent in requiring an identifier for structured finance products is to alert potential investors that the instrument may be subject to risks that are different from, or in addition to, those relating to bonds and in so doing avoid an over reliance by investors on ratings. Apart from all of the practical issues that would arise in connection with implementing a ratings system that includes an extra symbol or identifier, it is difficult to understand how the Commission's policy objective is met by the mere addition of another symbol.

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Any questions about the SPA Comment Letter should be directed to one or both of the Co-Chairs of the SPA's Legal, Regulatory and Compliance Committee, Lloyd Harmetz or Anna Pinedo of Morrison & Foerster LLP (lharmetz@mofo.com or apinedo@mofo.com, 212-468-8000) or Joe Inzerillo of BNP Paribas (joseph.inzerillo@us.bnpparibas.com, or 212-841-3354), or Keith Styracula, Chairman of the Association (keith.styracula@structuredproducts.org, or 917-612-1896).

Sincerely,

Keith Styracula

cc: Lloyd Harmetz
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