VIA E-MAIL RULE-COMMENTS@SEC.GOV

November 7, 2011

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attn: Ms. Elizabeth M. Murphy, Secretary

RE: Treatment of Asset-Backed Issuers under the Investment Company Act
Release No. IC-29779; File No. S7-35-11

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comments regarding Release No. IC-29779; File No. S7-35-11, dated September 7, 2011 (the "ANPR")[2], relating to the treatment of asset-backed issuers under the Investment Company Act of 1940, as amended (the "Investment Company Act").

In the ANPR, among other things, the Commission asks whether any modifications should be made to Rule 3a-7 Investment Company Act-related investor protection conditions in light of market developments since 1992 when Rule 3a-7 was adopted, recent legislative developments including the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and recent proposed rulemaking regarding the asset-backed securities markets.

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[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues to promote further growth, innovation and efficiency in the U.S. securitization market. ASF institutions include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

[2] *Advance Notice of Proposed Rulemaking Treatment of Asset-Backed Issuers under the Investment Company Act*, Release No. 29779 (Aug. 31, 2011), 76 FR 55308 (Sept. 7, 2011).

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RULE 3a-7 HAS OPERATED EFFICIENTLY; CHANGE COULD BE DETRIMENTAL TO OUR ECONOMY

Rule 3a-7 was the result of significant advance consideration by the Commission and its Staff and the extensive review, comment and analysis associated with Commission rulemakings.[3] The history of Rule 3a-7 clearly ties Rule 3a-7 issuers closely to Section 3(c)(5) issuers and distinguishes both from investment companies. One of the recommendations in the Protecting Investors Report was to "develop a coherent approach to the treatment of structured financings" in order to close the gap between structured financings for which an exclusion under Section 3(c)(5) was available and those for which it was not.[4] At the time Rule 3a-7 was adopted, the Commission recognized that, although asset-backed issuers "typically meet the definition of investment company under the Investment Company Act," they "generally cannot operate under certain of the Act's requirements and restrictions."[5] The ANPR notes that Rule 3a-7 was adopted to exclude certain asset-backed issuers from the definition of investment company, and that Rule 3a-7 and its conditions were designed to "accommodate future innovations in the securitization market, consistent with investor protection."[6] Currently, Rule 3a-7 is used to securitize business loans and other types of eligible assets that are not within the scope of the exception provided by Section 3(c)(5) of the Investment Company Act. Asset-backed issuers under Rule 3a-7 differ from investment companies in many ways; the first and foremost of which is that asset-backed issuers are special purpose vehicles used to issue securitization transactions (*i.e.*, financings), not investment companies.

Since its adoption in 1992, Rule 3a-7 has worked well to distinguish asset-backed issuers from investment companies, address investor protection concerns under the Investment Company Act and permit the growth and innovation of the asset-backed securities markets that provide important capital and liquidity to financial institutions engaged in providing credit to consumers and businesses, including small and middle market businesses that drive job creation in the U.S.

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[3] *Protecting Investors: A Half Century of Investment Company Regulation*, The Treatment of Structured Finance under the Investment Company Act 1-101 (May 1992) ("Protecting Investors Report"), a report in which the Staff of the Division of Investment Management (the "Staff") surveyed the then fifty-year history of the Investment Company Act and made recommendations for potential improvements; *Exclusion from the Definition of Investment Company for Structured Financings*, Investment Company Act Release No. 18736 (May 29, 1992), 57 FR 23980 (June 5, 1992) (the "Proposing Release"); *Exclusion from the Definition of Investment Company for Structured Financings,* Investment Company Act Release No. 19105 (Nov. 19, 1992), 57 FR 56248 (Nov. 27, 1992) ("Adopting Release").

[4] Protecting Investors Report at 76. For example, in the Protecting Investors Report the Staff observed that, at that time, structured "[f]inancings that [did] not fit within Section 3(c)(5) . . . either must be privately placed in the United States or sold overseas." *Id*

[5] ANPR at 3; "Structured financings fall within the definition of investment company under section 3(a), but cannot operate under the Act's requirements." Adopting Release at 2.

[6] ANPR at n. 4.

economy. Investors, consumers and businesses have all benefitted from the growth, liquidity and diversity that asset-backed securities transactions provide.

For the reasons discussed in this letter, we believe that Rule 3a-7 continues to be well suited to serve the purposes for which it was adopted and that significant changes to Rule 3a-7 are unwarranted. Given the importance of asset-backed securities transactions to the capital markets, care should be taken to avoid making any changes to Rule 3a-7 under, or to Section 3(c)(5) of, the Investment Company Act that could diminish the availability of credit to consumers and businesses and exacerbate the current fragile economic environment. We are also concerned about potential "negative interactions" and other unintended consequences that might result from changing Rule 3a-7 or Section 3(c)(5) concurrent with the other Dodd-Frank Act related rule-makings (many of which have not yet been completed, adopted or implemented) that represent the most far-reaching suite of changes to the United States financial regulatory environment since the Great Depression.

Both Rule 3a-7 and Section 3(c)(5) have worked well for decades and do not need to be made more restrictive. We believe that Rule 3a-7 and Section 3(c)(5) are critical to those in the capital markets who provide credit to consumers and businesses, particularly small and middle market businesses that are primary engines of job growth for our economy. Asset-backed securities transactions provide capital that funds consumer and business transactions alike. Unnecessary changes to Rule 3a-7 or to Section 3(c)(5) would interfere with the regulatory and market certainty necessary for asset-backed securities transactions to perform this important function.

RULE 3a-7 SERVES ITS PURPOSES

It has been our experience that Rule 3a-7 adequately addresses the investor protection issues noted by the Commission (*e.g*., "self-dealing by insiders, misvaluation of assets and inadequate asset coverage as they relate to the structure and operation of the asset-backed issuer . . . and preservation and safekeeping of the asset-backed issuer's eligible assets and cash flow")[7] while providing sufficient flexibility to support much needed capital formation through asset-backed securities transactions.

The conditions currently in Rule 3a-7 do an excellent job in assuring that appropriate structural safeguards are present to mitigate potential abuses and to meet other investor protection concerns discussed in the ANPR. Certain of these safeguards are directly imposed by the rule, while others are imposed by the rating agencies in rated transactions and by investors in the asset-backed securities market in rated and unrated transactions.[8] In many cases, the goal and effect of these structural safeguards are to assure that cash flows from the pool of eligible assets are kept safe and available to repay the asset-backed securities issued in an asset-backed securities

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[7] ANPR at 18.

[8] "[A]lthough Rule 3a-7 generally states that fixed-income securities of an asset-backed issuer must be rated by at least one NRSRO in one of the four highest rating categories, the text of the rule does not require fixed income securities of a Rule 3a–7 issuer to be rated, provided that the securities are sold and resold only to certain sophisticated investors." ANPR at 17.

transaction. For example, an asset-backed issuer relying on Rule 3a-7 must: (i) issue securities that entitle their holders to receive payments that depend primarily on the cash flow from eligible assets;[9] (ii) restrict general public investment to fixed-income securities rated, at the time of initial sale, in one of the four highest categories assigned long-term debt or in an equivalent short-term category, with no rating requirement for securities to be sold to more sophisticated investors or persons involved in the organization or operation of the issuer or an affiliate thereof; (iii) cause an unaffiliated trustee meeting certain requirements to have a perfected security interest or ownership interest in the eligible assets that principally generate the cash flow needed to pay the securities; (iv) cause cash flows to be deposited periodically in a segregated account that is maintained or controlled by the trustee, consistent with the rating of the outstanding fixed-income securities and (v) assure that assets are acquired or disposed of in accordance with the transaction documents. Other conditions serve to distinguish an asset-backed issuer from an investment company by requiring an asset-backed issuer to: (a) generally limit its activities to acquiring and holding eligible assets and activities incidental thereto; (b) refrain from acquiring or disposing of the eligible assets on which repayment of securities depends if such acquisition or disposition is for the primary purpose of recognizing gains or decreasing losses resulting from market value changes and (c) not issue "redeemable securities" (as contrasted with "mutual funds" that issue securities redeemable at current net asset value). In further contrast, registered investment companies may invest in a far broader array of securities and other assets, returns to investors in registered investment companies are dependent on the market value of the portfolio assets and registered investment companies can engage in activities that would not be permitted by Rule 3a-7.

Concerns regarding self-dealing by insiders, dumping of assets, inadequate asset coverage, and safekeeping of eligible assets and the related cash flows therefrom, are sufficiently addressed by Rule 3a-7 and other applicable laws, rules and regulations. As noted above, Rule 3a-7 requires asset-backed issuers to issue securities that entitle holders to receive payments that depend primarily on the cash flow from eligible assets and that eligible assets only be acquired or disposed of in accordance with the transaction documents and not based on market value considerations. Applicable securities laws require the disclosure of the material terms of an asset-backed securities transaction, as well as risk factors and potential conflicts of interest associated therewith. The rating agencies, underwriter or placement agent and issuer and certain investors in a rated transaction, and the underwriter or placement agent, if any, sophisticated investors and issuer in an unrated transaction, typically review and analyze the terms set forth in the organizational, transaction and disclosure documentation associated with the asset-backed securities transactions to assure themselves that the asset-backed securities transaction is structured to avoid self-dealing, dumping of assets and similar concerns.[10] Rating agencies as well as participants in asset-backed securities transactions also review and analyze the

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[9] Rule 3a-7(b)(1) defines "eligible assets" as "financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders." 17 CFR 270.3a-7.

[10] In fact, many transactions include boards, review committees or other mechanisms for the independent review and approval of actions taken by the collateral manager or other "insiders" when such actions could result in a conflict of interest or otherwise disadvantage participants.

requirements and restrictions in the transaction documents regarding the eligibility of the assets that can be included in the transaction, acquisition and disposition restrictions and the likelihood that the cash flow from such assets will be sufficient to repay holders of asset-backed securities based on various models and assumptions.

Further protection is provided through ongoing oversight by the collateral manager or servicer. The collateral manager or servicer must perform its duties in accordance with the requirements of the transaction documents and in accordance with the applicable law. Following the implementation of the Dodd-Frank Act, we expect that most collateral managers will be required to register as investment advisers, if not already so registered, no later than March 30, 2012.[11] As registered advisers, collateral managers will be subject to the substantive and anti-fraud provisions of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), that impose significant protection against the types of potential abuses discussed in the ANPR. These include, among others, restrictions on principal and agency-cross transactions, requirements with respect to custody of funds and securities, Form ADV and other disclosure requirements and the general anti-fraud provisions.

Concerns regarding preservation and safekeeping of the assets and cash flow are also well mitigated by the requirements of Rule 3a-7 itself as (i) the independent trustee for the fixed-income security holders must have a perfected security interest or ownership interest in the asset-backed issuer's eligible assets and (ii) the cash flow therefrom must be deposited periodically into a segregated account maintained or controlled by the trustee. Finally, we believe that any concern about misvaluation of assets is not particularly relevant because asset-backed securities transactions that rely on Rule 3a-7 must be structured and sold based on the expected cash flows from the asset-backed issuer's assets, not their market value.

As a result, we do not believe there is any need for Rule 3a-7 to impose additional specific requirements or adopt a prescriptive principles based approach. Rule 3a-7 works well as it is. We do, however, suggest changes to Rule 3a-7, that we believe will assist in capital formation and the availability of credit to consumers and businesses without reducing investor protection. We propose: (i) including leases within the definition of "eligible asset"; (ii) accommodating the use of intermediate entities in securitizations structured in reliance on Rule 3a-7; (iii) ensuring that Rule 3a-7 is a viable exception for asset-backed commercial paper conduits by making only a limited change to Rule 3a-7 regarding the independent trustee requirement; and (iv) removing the trading restriction related to rating agency downgrades.

Leases Should be Included as Eligible Assets.

The definition of eligible assets under Rule 3a-7 effectively excludes most leases from its scope. The reason is that the definition covers only financial assets that "by their terms convert into cash within a finite time period," which excludes the portion of the proceeds of a lease that is realized through the sale of the leased property upon its return following termination of the lease.

[11] Servicers will likely not be required to register as investment advisers because unlike collateral managers, servicers generally do not provide the type of advisory services requiring registration.

Inasmuch as virtually all auto leases, and a significant portion of equipment leases, are closed end leases that permit the lessee to return the vehicle or leased equipment upon lease termination in lieu of purchasing it, the result is that securitizations of such leases cannot rely on Rule 3a-7.[12] The Commission addressed this issue when it adopted Regulation AB in 2004. We believe that the definition of "eligible assets" in Rule 3a-7 should be amended to include leases. In **Appendix A**, we set forth our rationale and proposed language to amend the definition. Such an amendment would facilitate lease securitizations, which would provide additional capital to consumers and businesses interested in leasing autos and equipment and would stimulate our economy.

The Use of Intermediate Entities Should be Facilitated by Rule 3a-7.

Certain securitization structures, including securitizations of auto leases, commonly use one or more intermediate entities to hold eligible assets. These intermediate entities, which are colloquially known as "titling trusts" in lease securitizations, issue a security representing an interest (an "intermediate security") in the underlying eligible assets that is transferred to the issuer of the asset-backed securities.

These intermediate entities often do not fit neatly into the regulatory regime for asset-backed securities, which tends to focus largely on the asset-backed issuer. They have been formed as a means of satisfying legal requirements, such as certificate of title statutes, or of facilitating the securitization in another manner; they are not formed as a means of avoiding the federal securities laws. Accordingly, we believe that the Commission should provide relief for intermediate entities under Rule 3a-7, so as to facilitate the use of Rule 3a-7 in transactions which utilize them. We have set forth in **Appendix B** the rationale for accommodating intermediate entities, along with a proposed amendment to Rule 3a-7 to achieve that goal.

Rule 3a-7 Should Remain a Viable Exemption from the Investment Company Act for Asset-Backed Commercial Paper Conduits.

In the ANPR, the Commission states its belief that asset-backed commercial paper ("ABCP") conduits often rely on Rule 3a-7. In practice, virtually all ABCP conduits rely on the exemptions provided by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Since Section 3(c)(1) and Section 3(c)(7) require issuers to offer and sell their securities without public offering, sales and resales of ABCP are typically made in reliance on the private placement exemptions in Section 4(2) and Rule 144A of the Securities Act of 1933 (the "Securities Act") rather than the commercial paper exemption in Section 3(a)(3).

We note that when Rule 3a-7 was adopted in 1992, the Adopting Release made clear that the Commission assumed that most ABCP conduits would be able to rely on Rule 3a-7. In evidence of that, the SEC made an exception for ABCP in the only condition of Rule 3a-7 that it believed ABCP conduits would be unable to satisfy, that is, the need for an independent trustee and for that trustee to be granted a perfected security interest in the eligible assets that generated

[12] Section 3(c)(5) is also unavailable for securitizations of closed end leases, as such leasing does not fit within the types of businesses contemplated therein.

repayments for the conduits' securities. The Commission, in recognition of prevailing market practice for ABCP conduits in 1992, chose to provide that exception to ABCP conduits by reference to the Securities Act exemption that the conduits regularly relied on at that time, namely, Section 3(a)(3). We believe that the reference to 3(a)(3) was intended as a "proxy" for ABCP conduits, not as a limitation of the types of conduits that could rely on Rule 3a-7. As discussed above, in the nearly 20 years since Rule 3a-7 was adopted, ABCP conduits have come to rely on the Section 4(2) and Rule 144A exemptions from the Securities Act, primarily for ease of execution reasons. However, the fundamental business of ABCP conduits is not very different today from what it was in 1992, and the underlying reasons for exempting ABCP conduits from the trustee and perfected security interest conditions of Rule 3a-7 are no less valid. For this reason, we believe that the independent trustee requirement should not apply to ABCP conduits that would qualify for Rule 3a-7, but for the fact that they issue their securities in reliance on the Section 4(2) exemption (and typically provide for resales in reliance on Rule 144A) rather than Section 3(a)(3).[13] We note that the policy reasons cited by the Commission in the 1992 Adopting Release for the independent trustee exception in (a)(4) of the Rule, particularly the roles of providers of credit and liquidity facilities to these conduits, are equally true with respect to conduits that rely on Section 4(2) and Rule 144A. Limiting the independent trustee exception to instances where the ABCP issuer only sells commercial paper with maturities not to exceed 397 days (the maximum maturity eligible for purchase by money market funds) to QIBs and accredited institutional investors would be both consistent with current market practice for 4(2)/Rule 144A ABCP programs and should in our view address any concerns the Commission may have in broadening the exception to these programs.[14]

It is extremely important that in making any changes to Rule 3a-7 the Commission ensure that Rule 3a-7 be made again a viable exemption from the Investment Company Act for ABCP conduits. We note in this respect that given the liquidity and credit support provided to ABCP conduits and the resulting substantial incentives that providers of this support have to ensure securitizations funded by these conduits are well structured, we are of the view that the investor protection issues raised in the ANPR are not implicated by these conduits and, other than the change requested above, no changes to Rule 3a-7 in its current form are necessary for ABCP conduits.

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[13] To effectuate this, we believe that the introductory language to Rule 3a-7(a)(4) should be amended as follows (additions are indicated in **bold/underline**):

> If the issuer issues any securities other than [asset-backed] **commercial paper having a maturity not to exceed 397 days, provided that such** securities **are** exempted from **registration under** the Securities Act by section 3(a)(3) **or section 4(2)** thereof**, or Rule 144A thereunder,** the issuer:

[14] The Commission could also consider limiting the exemption to commercial paper issued by ABCP conduits that meet the definition of "eligible ABCP conduit" as the ASF proposed to redefine that term in its June 10, 2011 comment letter to the proposed risk retention rules under Section 941 of Dodd-Frank. A copy of the ASF risk retention comment letter may be found at: http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCommentLetter8.2.10.pdf. The proposed definition of "eligible ABCP conduit" appears in Exhibit C to that letter.

The Trading Condition Related to Rating Agency Downgrades is Unnecessary and Should be Removed.

The trading restriction that "the acquisition or disposition of the assets does not result in a downgrading in the rating of the issuer's outstanding fixed-income securities" is unnecessary because: (i) rating agencies typically do not decide to downgrade based on acquisitions or dispositions (rather downgrades are usually the result of poor performance of the underlying assets), (ii) the transaction documents already significantly restrict acquisition and disposition of assets in a manner designed to reasonably assure that cash flow will be available from eligible assets in an amount necessary to pay the asset-backed issuer's fixed-income securities and (iii) some Rule 3a-7 transactions are unrated, making this requirement meaningless (and, potentially, confusing) for those transactions. Moreover, removing this condition is consistent with ASF's and the Commission's view that the rating provisions of Rule 3a-7 relate to structural and investor protection considerations, rather than credit quality. Accordingly, we ask the Commission to delete clause (ii) of Rule 3a-7(a)(3).

THE ROLE OF CREDIT RATING AGENCIES

ASF believes that credit rating agencies should continue to serve their current role with respect to asset-backed securities transactions in which fixed-income securities are offered to the public under Rule 3a-7. We recognize, as the Commission notes in the ANPR, that the conditions that refer to credit ratings were included in Rule 3a-7 principally because rating agencies typically require certain structural safeguards which address investor protection under the Investment Company Act when providing credit ratings for fixed-income securities issued in connection with asset-backed securities transactions.[15]

One of the primary reasons for promulgating Rule 3a-7 was to permit investment grade rated asset-backed securities to be sold to the public when the assets being securitized did not qualify for the exclusion provided by Section 3(c)(5).[16] The rating agency methodology and process was viewed as a proxy for addressing the Investment Company Act's investor protection goals, especially as they relate to public investors. This remains true today. Since the rating agency requirements in current Rule 3a-7 principally serve to assure that certain structural safeguards exist in asset-backed securities transactions to protect public investors with respect to Investment

[15] In footnote 38 of the ANPR the Commission notes that the Adopting Release for Rule 3a-7 emphasized that, "although ratings generally reflect evaluations of credit risk the rating requirement [was] not intended to address investment risks associated with the credit quality of a financing."

[16] Indeed, in proposing Rule 3a-7, the Commission recognized that "[t]he regulatory barriers presented by the [Investment Company] Act have broader economic implications. Many sectors of the economy are prevented from fully using structured finance to address capital needs." Proposing Release at 8.

Company Act related concerns, and do not relate to credit-worthiness,[17] we do not believe that Section 939A of the Dodd-Frank Act[18] requires the Commission to reconsider these requirements in the context of Rule 3a-7.

The structural requirements of Rule 3a-7, which are typically required in cash flow asset-backed securities transactions, whether rated or unrated, have provided and continue to provide an appropriate level of investor protection to address concerns that may arise under the Investment Company Act while allowing for the growth and innovation in the asset-backed securities market, with outstanding asset-backed securities having increased from $136 billion in 1992 to over $2 trillion in 2010. Applying additional requirements or limitations would not necessarily serve the goals of the Investment Company Act, as stated in the ANPR, and would likely diminish the flexibility afforded by Rule 3a-7 which has allowed for continued growth and innovation in the securitization markets.

Given the success of current Rule 3a-7, we believe that it would be a mistake to require additional review of asset-backed securities transactions by new or different independent reviewers (who would simply play the current role of the credit rating agency, albeit with a different name) or additional opinions or certifications. These changes would only add unnecessary costs to asset-backed securities transactions for no additional benefit, chilling the asset-backed securities market until new protocols for reviews, opinions or certifications are developed and companies are formed or repositioned to provide the reviews, opinions or certifications. We are also concerned that any review, opinion or certification requirement that creates "expert" liability under the securities laws could halt asset-backed securities transactions altogether.

COMMENT ON OTHER REGULATORY AND LEGISLATIVE INITATIVES

Rule 3a-7 works well and addresses Investment Company Act-related concerns in its current form. We have suggested some minor changes that we believe would make it work even better. We do not believe that it is necessary to explicitly include other recent proposed rulemakings under Dodd-Frank or other securities laws in Rule 3a-7. We are very concerned about conflating investor protection requirements under Rule 3a-7 with other legal requirements intended to cover other (even if related) concerns under other laws, particularly when there is not yet enough

[17] We believe that concerns, including those expressed in the ANPR, regarding rating agencies' methodologies and processes during the recent financial crisis are more related to predictions concerning credit worthiness of certain rated transactions involving particular asset classes rather than the efficacy of the rating agency requirements that the Commission built into Rule 3a-7 for investor protection purposes in 1992.

[18] "(a) Agency Review — Not later than 1 year after the date of the enactment of this subtitle, each Federal agency shall, to the extent applicable, review— (1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings. (b) Modifications Required — Each such agency shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." Public Law 111–203 §939A.

experience with the application of such new requirements to form a clear view of how they would impact asset-backed securities transactions. Rather, we believe that to the extent an asset-backed securities transaction is within the scope of such laws or rules, it must comply, and if not, it is likely that the particular law, rule or regulation is not particularly relevant to asset-backed securities transactions and would not be expected to help mitigate investor protection concerns. We would suggest that the Commission refrain from incorporating changes into Rule 3a-7 or Section 3(c)(5) from other proposed rules when the other proposed rules themselves are in flux and any changes to Rule 3a-7 or Section 3(c)(5) could create serious negative unintended consequences.

Because Rule 3a-7 and Section 3(c)(5) have significant interplay with a variety of other existing and proposed laws, rules and regulations, altering Rule 3a-7 or Section 3(c)(5) could have profoundly negative unintended consequences. For example, the proposed Volcker Rule,[19] intending to pick up hedge funds and private equity funds, defines a "covered fund" as an issuer relying on Section 3(c)(1) or Section 3(c)(7) to be excluded from investment company status under the Investment Company Act. For their own liquidity needs, banks often sponsor asset-backed securities transactions that rely on Rule 3a-7 or Section 3(c)(5) and the bank or an affiliate may act as collateral manager or servicer in such transactions. If asset-backed securities transactions could no longer rely on Rule 3a-7 or Section 3(c)(5) due to changes thereto, but instead were forced to rely on Section 3(c)(1) or Section 3(c)(7), they could become "covered funds" subject to the restrictions in the proposed Volcker Rule. Such a change to Rule 3a-7 or Section 3(c)(5) could result in unintended expansion of the proposed Volcker Rule to the detriment of the asset-backed securities marketplace, the availability of consumer and business credit, and liquidity available for banks and banking entities.[20]

COMMENTS REGARDING SECTION 3(c)(5)

With respect to Section 3(c)(5), we believe that the exclusions from investment company status provided thereunder to asset-backed issuers owning assets that fall within the purview thereof are appropriate because such asset-backed issuers are financing vehicles and not investment companies. The market and other applicable laws provide appropriate investor protection, as companies and issuers have relied on this exclusion for decades in markets that provide significant capital to consumers and businesses. In addition, any change to Section 3(c)(5) is a statutory change that should come from Congress.

COMMENTS REGARDING MAJORITY OWNERS OF RULE 3a-7 ISSUERS

Because Rule 3a-7 compliant asset-backed issuers engage in financing transactions, not transactions typical of investment companies, there is no reason to treat asset-backed securities

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[19] *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds,* Release No. 34-65545 (Oct. 12, 2011) (the "Volcker Rule").

[20] While we note that the proposed Volcker Rule includes a carve out for certain securitizations, the carve out does not reach all securitizations covered by Rule 3a-7.

issued by an asset-backed issuer to a majority owner thereof as "investment securities" for purposes of such owner's investment company status analysis. It is clear that the Commission and the Staff, at the time that the Protecting Investors Report was issued and Rule 3a-7 was adopted, understood that the exemptive rule would have the effect of treating interests in Rule 3a-7 subsidiaries in a manner equivalent to interests in Section 3(c)(5) subsidiaries for purposes of an owner's Investment Company Act status. Despite this knowledge, neither the Protecting Investors Report, nor the Proposing or Adopting Releases for Rule 3a-7 suggested that there was then any need for disparate treatment of interests in Rule 3a-7 subsidiaries, as opposed to Section 3(c)(5) subsidiaries. The lack of any such suggestion is, however, consistent with the views expressed by the Staff and the Commission as to the "fundamental[] differen[ce]" between structured financings and investment companies, and the intent of Rule 3a-7 to provide "a coherent approach to the treatment of structured financings" whether or not Section 3(c)(5) was available. We do not believe that a need for disparate treatment of these very similar vehicles for Investment Company Act status purposes has developed in the interim. In addition, although some asset-backed issuers also rely on these exemptions when available, asset-backed issuers are substantially different from private equity funds or hedge funds that rely on the private funds exemptions of Section 3(c)(1) or Section 3(c)(7).

GRANDFATHERING / TRANSITION

If changes are made to any existing Investment Company Act exclusions used by asset-backed issuers, or to any interpretive guidance for any such exclusions (any exclusion affected by a change being an "affected exclusion"), it will be necessary to provide both appropriate "grandfathering" arrangements and a reasonable transition period prior to effectiveness. Each will be crucial to these asset-backed issuers.

In making its recommendation in the Protecting Investors Report that led to Rule 3a-7, the Staff noted the "distinctions between structured financings and investment companies" and that "[a]s a practical matter, structured financings cannot register as investment companies because they cannot operate under the [Investment Company] Act's provisions." Moreover, in most asset-backed securitization transactions an early amortization event or event of default occurs automatically if the issuer ceases to be exempt from registration as an investment company. Such an occurrence would cause billions of dollars of asset-backed securities to be repaid earlier than expected. In connection with exercising remedies after an event of default, a forced liquidation of eligible assets at fire sale prices would negatively affect investors and reduce the availability of funding for consumers and businesses and could cause another credit crisis.

The appropriate grandfathering arrangements have several dimensions. First, we believe that any existing issuer formed or operated in reliance on an affected exclusion should be entitled to continue to rely on that exclusion. Otherwise an issuer would likely need to modify its transaction structure and documentation, to comply with any changes to Rule 3a-7. Few, if any, asset-backed transactions permit unilateral modifications of the operative documents by the issuer due to changes in the law. As a result, any amendment would be a multi-party process, in most cases requiring the consent of investors (which, as a practical matter, may be impossible to obtain) and confirmation by the rating agencies of their then current ratings. This would create

excessive and unnecessary expenses to modify transactions that already comply with Rule 3a-7, which we believe continues to work well.

Second, special attention must be paid in designing grandfathering arrangements for issuers using a master trust. These issuers make multiple issuances utilizing a common asset pool over a number of years or even decades. Master trust structures are used most prominently for the securitization of credit card receivables.[21] It is important that sponsors of master trusts are able to continue to issue from those same master trusts. Many, if not all, of the major sponsors of credit card master trusts are banks or other insured depository institutions that are subject to the insolvency regime under the Federal Deposit Insurance Act. These sponsors may be subject to the terms of the rule adopted by the Federal Deposit Insurance Corporation ("FDIC") that governs the FDIC's treatment of financial assets transferred by an insured depository institution in a securitization (the "FDIC Rule"). The FDIC Rule provides a transition period safe harbor to revolving trusts or master trusts that had issued obligations as of the date of adoption of the FDIC Rule. These grandfathered trusts do not need to comply with the conditions of the FDIC Rule, so long as they continue to meet the isolation standards that the FDIC had previously promulgated.

If Investment Company Act exclusions are changed in a way that conditions future issuance from master trusts upon compliance with the new provisions of an affected exclusion, the effect could be very problematic to these sponsors. Compliance with a revised exclusion that requires modifications of existing documentation might be impossible under the terms of the existing master trust, either because it would be impractical to obtain that consent from investors or because it would require changes that would eliminate the ability to rely on the transition period safe harbor under the FDIC Rule. In that case, the sponsor would be put in a no-win situation: it could not continue to issue asset-backed securities from its existing master trust, and only by enduring the considerable time and expense required to establish a new master trust (that would also have to comply with the FDIC Rule requirements for new master trusts) would it be able to access the securitization markets. If compliance were required quickly, such a sponsor could also lose access to securitization funding altogether before it could structure its new master trust and populate it with assets. Perhaps more importantly to investors, the accounts and receivables in the (now liquidating) old master trust would not be available for the new master trust, which could well be comprised of less desirable assets. As a result, it is critical to these sponsors to be able to continue to issue from their existing master trusts.

The grandfathering of any changes to Rule 3a-7 or Section 3(c)(5) of the Investment Company Act would also need to consider the effect thereof on banks, banking entities and their affiliates under the Volcker Rule as and when finally promulgated.

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[21] While firm numbers are not available, we think it is conservative to estimate that at least $340 billion of credit card receivables are held in existing master trusts that have outstanding ABS of at least $160 billion. The second largest asset class utilizing master trusts is dealer floorplan. This asset class is critical to the health of their automotive finance companies and associated manufacturers.

Accordingly, we recommend that any changes that affect existing exclusions upon which asset-backed issuers rely be made applicable only to those asset-backed issuers that affect their first bona fide offering of securities on or after the effective date of such changes. Such a provision will permit existing asset-backed issuers relying on Rule 3a-7 and Section 3(c)(5) to continue to rely thereon and will permit existing master trusts to continue to issue in reliance on the existing exclusions. In addition, we recommend that the Commission work with the industry and organizations such as ASF to develop a reasonable transition period during which asset-backed issuers and their counsel can determine how to implement any changes to affected exclusions.

SECTION 2(c) OF THE INVESTMENT COMPANY ACT

Section 2(c) of the Investment Company Act requires the Commission, in its rulemaking, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. Given the growth, innovation and resilience of the asset-backed securities markets since the introduction of Rule 3a-7 in 1992, the need for the asset-backed securities markets to provide credit and liquidity that is crucial to consumers and businesses in these difficult economic times, the fact that current Rule 3a-7 has provided and continues to provide protection for investors, and the fact that changing it in the current regulatory environment which is in flux could have significant negative unintended consequences, we respectfully suggest that the Commission not propose changes to Rule 3a-7 (except for minor changes such as those suggested in this letter) or Section 3(c)(5) or, should the Commission desire to propose changes, take care that any such proposed changes not jeopardize the existing efficiency, competition and capital formation in the asset-backed securities markets.

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ASF very much appreciates the opportunity to provide the foregoing comments in response to the Commission's ANPR. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me via telephone at 212.412.7107 or via email at tdeutsch@americansecuritization.com, Evan Siegert, ASF Managing Director, Senior Counsel, via telephone at 212.412.7109 or via email at esiegert@americansecuritization.com, or ASF's outside counsel on these matters, Cynthia J. Williams of Dechert LLP, via telephone at 617.654.8604 or via e-mail at cindy.williams@dechert.com.

Sincerely,

Tom Deutsch
Executive Director
American Securitization Forum

cc: Mary L. Schapiro, Chair
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Jr., Commissioner
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Why Leases Should be Included as Eligible Assets.

The Commission facilitated lease securitizations when it adopted Regulation AB in 2004. The definition of "asset backed security" was revised from the prior definition in Form S-3 to acknowledge that the realization of residual values constitutes a permissible source of cash flow:

> *Asset-backed security* means a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders; *provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases.*[22]

Regulation AB also includes substantive limits on the proportion of the securitized pool balance attributable to the residual value of the physical property underlying the leases.[23] However, we do not believe that these limits are appropriate in the context of Rule 3a-7, and they should not be included in a revised Rule 3a-7. These residual value limits will continue to apply to registered public offerings of lease-backed securities, so inclusion of similar limits in Rule 3a-7 would provide no incremental protection to investors in these transactions. Issuers that wish to securitize lease pools whose residual values exceed such limits may do so in unregistered private placements. Those offerings typically rely on Section 3(c)(7) to be exempt from registration under the Investment Company Act – but Section 3(c)(7) does not include the investor protections encompassed within Rule 3a-7. Permitting lease-backed issuers to rely on Rule 3a-7 would promote the investor protections that Rule 3a-7 provides.

Accordingly, we propose that the definition of "eligible assets" in Rule 3a-7 be reformulated as follows (indicating additions in bold and underscored text):

> *Eligible assets* means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely

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[22] 17 CFR §229.1101(c)(1) (emphasis added).

[23] Item 1101(c)(2) provides as follows:

> (v) With respect securities that are backed by leases, the portion of the securitized pool balance attributable to the residual value of the physical property underlying the leases, as determined in accordance with the transaction agreements for the securities, does not constitute:
>
> > (A) For motor vehicle leases, 65% or more, as measured by dollar volume, of the securitized pool balance as of the measurement date.
> >
> > (B) For all other leases, 50% or more, as measured by dollar volume, of the securitized pool balance as of the measurement date.

17 CFR §229.1101(c)(2)(v).

distributions of proceeds to security holders**; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases**.

Why the Use of Intermediate Entities Should be Facilitated by Rule 3a-7.

In certain securitizations, including securitizations of auto leases, it is commonplace to utilize one or more intermediate entities to hold eligible assets. These intermediate entities, which are colloquially known as "titling trusts" in lease securitizations, issue a security representing an interest (an "intermediate security") in the underlying eligible assets that is transferred to the issuer of the asset-backed securities.

These intermediate entities often do not fit neatly into the regulatory regime for asset-backed securities, which tends to focus largely on the asset-backed issuer. They have been formed as a means of satisfying legal requirements, such as certificate of title statutes, or of facilitating the securitization in another manner; they are not formed as a means of avoiding the reach of the federal securities laws.

The Commission has recognized the use of intermediate entities as part of the asset-backed securities process in several contexts and made accommodations for them. Leading examples are the disclosure requirements regarding an intermediate entity itself,[24] treatment of an intermediate security as a pool security,[25] and registration of an intermediate security as an underlying security.[26] In doing so, the Commission has adopted provisions that do not require full compliance by the intermediate entities on a stand-alone basis with the otherwise applicable regulations. Instead, these provisions have been tailored to permit use of the intermediate entities in circumstances where it is clear that the regulatory aims will be met. In the context of Rule 3a-7, intermediate entities cannot necessarily comply with each of the conditions specified in the proviso to paragraph (a) of Rule 3a-7. If, however, the asset-backed issuer can satisfy all of the

[24] Regulation AB does not include a separate item that prescribes precise disclosure rules for intermediate entities. Instead, Item 1100(d)(1) directs a registrant to "include information to the extent material regarding any such [intermediate entity] and its role, function and experience in relation to the asset-backed securities and the asset pool."

[25] Item 1100(d)(2) of Regulation AB similarly provides guidance for the treatment of interests issued by an intermediate entity to an ABS issuer. It permits the registrant to treat the underlying assets held by the intermediate entity as part of the pool assets so long as:

- the same sponsor and depositor established both the intermediate entity and the ABS issuer; and
- the intermediate security "was created solely to satisfy legal requirements or otherwise facilitate the structuring of" the ABS transaction.

[26] Rule 190(c) under the Securities Act of 1933 provides that a registrant does not have to treat an intermediate security as an "underlying security" for purposes of the registration requirements otherwise imposed by Rule 190, if:

- the same sponsor and depositor established both the intermediate entity and the ABS issuer;
- the intermediate security "was created solely to satisfy legal requirements or otherwise facilitate the structuring of" the ABS transaction;
- the intermediate security is not part of a scheme to avoid registration under the Securities Act of 1933; and
- the intermediate security is held by the ABS issuer and is part of the asset pool for the ABS offering.

Rule 3a-7 requirements, compliance by intermediate entities that facilitate the securitization by the asset-backed issuer should not be required.

Accordingly, we believe that the Commission should provide relief for intermediate entities under Rule 3a-7, so as to facilitate the use of Rule 3a-7 by asset-backed issuers which utilize them while preserving the protections of Rule 3a-7 for the benefit of investors.

We propose that the Commission insert a new paragraph (b) into Rule 3a-7 to permit intermediate entities and redesignate existing paragraph (b) as paragraph (c). This language draws heavily on the rules previously adopted by the Commission to accommodate intermediate entities. We have set forth below the text we propose, and we have annotated this text with several notes explaining the correspondence between those prior rules and this provision:

> **(b) Notwithstanding paragraph (a) of this section, if the eligible assets held by an issuer issuing asset-backed securities (the "issuing entity") includes a fixed-income or other security representing an interest in or the right to the payments of cash flows of eligible assets,[27] then the issuer of that security (the "intermediate entity") will not be deemed to be an investment company; *Provided, that:***
>
> **(i) both the intermediate entity and the issuing entity were established under the direction of the same sponsor or depositor;[28]**
>
> **(ii) the intermediate entity was created solely to satisfy legal requirements or otherwise facilitate the structuring of asset-backed securities transactions;[29]**
>
> **(iii) the intermediate entity has issued and, directly or through affiliates, transferred (A) securities representing an interest in or the right to the payments of cash flows of eligible assets solely to issuing entities that are affiliates of the sponsor and (B) any other securities solely to affiliates;[30] and**

[27] Explanatory note: The substance of clause (iv) of Rule 190(c), which specifies that the intermediate security must be held by the asset-backed issuer, is covered in this language, rather than in a separate clause in the proviso.

[28] Explanatory note: This clause (i) corresponds to provisions in both Rule 190(c) and Item 1100(d).

[29] Explanatory note: This clause (ii) corresponds to provisions in both Rule 190(c) and Item 1100(d).

[30] Explanatory note: This clause (iii) does not have a corollary in Item 1100(d) or Rule 190. This clause requires that the intermediate entity have issued securities in very limited circumstances – either intermediate securities that have been transferred to affiliated issuing entities or other securities that have been transferred to affiliates.

(iv) the issuing entity, if it effects its initial issuance of asset-backed securities on or after [insert effective date of revision], has issued asset-backed securities in compliance with paragraph (a) of this section.[31]

[31] Explanatory note: This clause (iv) provides that the issuing entity in the securitization must be issuing in reliance on Rule 3a-7, in order to assure the protections provided by Rule 3a-7 for the investors in the asset-backed securities. We believe that this requirement is an appropriate substitute for the condition in Rule 190(c)(3) that the transaction cannot be an attempt to avoid registration requirements (of the Securities Act, in that case). Such a concept would not be sensible in a provision that is, in fact, creating an exception from registration requirements (of the Investment Company Act, here).

Moreover, clause (iv) can be effective only with respect to issuing entities that effect their initial issuance on or after the effective date of the revisions to Rule 3a-7. We included this provision because a typical intermediate entity in a lease securitization program will already have issued securities to a number of existing issuing entities, and those issuing entities may well have used a basis for not registering as an investment company other than Rule 3a-7. It would be impractical, if not almost impossible, for those existing issuing entities to recast their transactions retroactively to rely on Rule 3a-7. Therefore, it is imperative that this condition apply prospectively only.