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THE BOND MARKET ASSOCIATION

March 8, 2005

Mr. Jonathan G. Katz
Secretary
United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: File Number S7-21-04
Request for Comment in Asset-Backed Securities Adopting Release

Dear Mr. Katz:

The Bond Market Association[1] (the "Association") is pleased to submit this comment letter to the Securities and Exchange Commission (the "SEC" or the "Commission") in response to the SEC's request for comments in Section III.A.2.a. of the release (Release Nos. 33-8518, 34-50905 (the "ABS Release")) adopting new Regulation AB on asset-backed securities ("ABS") and related rules and amendments (collectively, the "ABS Rules").

We appreciate very much the SEC staff's openness in discussing these questions with us and with other market participants. In this letter we will first outline the general approach we urge the staff to take on synthetic securitizations. We then address the specific questions posed by the staff in the ABS Release. We next provide two examples of the type of transactions that we believe should be able to proceed as public offerings. Finally, we request the staff's assistance in clarifying the closely related question of issuances of indexed securities that do not qualify as ABS.

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[1] The Association is an international trade association representing approximately 200 securities firms and banks that underwrite, distribute and trade in fixed income securities internationally. More information about the Association and its members and activities is available on its website www.bondmarkets.com. This comment letter was prepared in consultation with the Association's MBS and Securitized Products Division.

A. Outline of the Proposed Approach

1. Defining Synthetic Securities

As the Commission has indicated, one threshold question is how to define the transactions at issue. While it is not necessarily difficult for industry participants and observers to agree whether a particular security is a "synthetic security" or not, it is extremely difficult to craft a definition of "synthetic security" that predictably draws the line between synthetics and other ABS in the right place. For example, the staff notes in the ABS Release that "Payments on the securities in a synthetic securitization can primarily or entirely comprise or include payments based on the value of a reference asset which is unrelated to the value of or payments on any actual assets in the pool." Yet publicly issued, non-synthetic asset-backed securities may provide returns that are entirely dependent on factors unrelated to the pool assets. For example, securitizations of fixed-rate mortgage assets may include publicly-offered interest-only securities whose payments vary inversely with the level of LIBOR, reducing to zero if LIBOR increases sufficiently from its level at pricing. This security is often paid at an extremely senior level in the cash-flow structure so that for all practical purposes it is not exposed to the credit risk of the asset pool – its repayment will depend solely on the level of the external index. In terms of the risk profile it presents to investors and the type of information necessary for investors to evaluate it, such an instrument is not meaningfully different than some securities that would clearly be considered synthetic.

We are concerned that it may be impossible to draw distinctions between synthetic securitizations and other ABS that are sufficiently clear and that hinge on differences that are meaningful for purposes of prescribing disclosure requirements. We are also concerned that any definition drafted to categorize synthetics today may not appropriately accommodate securities that may become common in the future. However, we recognize that the ABS Rules were drafted to address particular types of transactions that generally do not include transactions utilizing synthetic assets. Accordingly, either an extension of the regime established by the ABS Rules, or a new set of rules specifically for synthetic transactions, will be necessary.

We strongly urge the staff to undertake that rulemaking effort rather than addressing synthetic transactions as they arise, on an ad hoc basis. The market for synthetic securitizations would greatly benefit from the type of clear and transparent rules that the Commission has now adopted for other asset-backed securities. For purposes of defining the scope of these new rules it may be necessary to define the transactions involved even if that definition is imperfect. As experience develops under the new regime, its reach can be expanded. One way to define synthetic transactions in the first instance may be as transactions that meet the definition of "asset-backed security" in the ABS Rules but in which a material portion of the return to investors is determined by reference to a measure that (a) is not based primarily on the cash flows from any asset owned by the issuer except the derivative contract itself and (b) does not merely transform payments on assets owned by the issuer by applying an alternative measure of the time value of those payments (e.g. an interest rate derivative or one that affects only the timing of payments) or their value in a given currency (e.g. a cross-currency swap). This would exclude from the synthetic category transactions whose only synthetic component is an interest rate swap, for example.

2. Disclosure in Synthetic Securitizations

Although we acknowledge that it may be necessary as a matter of rulemaking practicality to define synthetic transactions, we believe that appropriate disclosure for synthetics should utilize the same principles that now apply to other ABS under the ABS Rules, although the way in which these principles are applied may vary somewhat.

Synthetic security disclosure must be analyzed in three different areas: disclosure concerning the issuer of the security being registered, disclosure concerning the source of payments to investors, and disclosure concerning the measure of payments to investors.

Disclosure Concerning the Issuer. Synthetic securities are issued by exactly the same types of limited-purpose securitization vehicles as other ABS.[2] As with other ABS, there will typically be little to disclose about the issuer apart from the details of the particular transaction because its only activities will be those required by the securitization being described. As described in greater detail below, we do not believe that requiring GAAP disclosures, such as those called for by FIN 46R or FAS 133, or MD&A disclosures, would provide meaningful information to investors in synthetic securitization transactions any more than it would in other ABS transactions.

Disclosure Concerning the Source of Payments. As in other ABS transactions, the source of payments to investors in a synthetic securitization transaction is the assets held by the securitization vehicle. A transaction is generally referred to as "synthetic" if it is structured to replicate the cash flows of an asset (such as a security or commodity) through the use of a derivative of some type. In a synthetic transaction, the issuer will often also hold other assets—typically highly-rated securities purchased in the secondary market—that serve as collateral to secure the issuer's obligations under the derivative contract, and so the synthetic and non-synthetic assets in a synthetic securitization are

[2] We believe that the current definition, including in particular the requirement added to the definition of "Asset-Backed Security" by Item 1101(c)(2)(ii), is appropriate to distinguish a special-purpose issuer from a traditional registrant. As it does for other ABS, this distinction marks the line between issuers that should be required to provide GAAP financial information and those for whom a different approach is both necessary and appropriate.

often integrally related. However, they may be of widely differing relative importance in different transactions, and the relationship between them and their relative importance to investors will determine the focus of the disclosure in a particular instance.

Disclosure concerning the non-derivative assets held by an issuer should follow the principles already embodied in the ABS Rules if holders of the securities are exposed to material credit risk from those assets. In particular, new Rule 190 (or a similar rule based on the same criteria) would often be the most appropriate disclosure requirement to apply to non-derivative assets included in a synthetic securitization. However, if the terms of the derivative contract effectively shift the credit risk of the assets to the derivative counterparty, a much reduced level of disclosure concerning these assets should be required (but of course, a heightened level of derivative counterparty disclosure may be appropriate). The rules for synthetic transactions should take into account the different disclosures necessitated by differently structured transactions.

Disclosure concerning the derivative counterparty in a synthetic securitization should follow the principles already prescribed in Items 1114 and 1115 of Regulation AB , which mandate financial information that must be provided with respect to derivative counterparties whose credit is material to investors. In many cases, sponsors will conclude that the full information that would be required by Regulation S-X is necessary. In other cases, security holders may be effectively insulated from the counterparty's credit and performance risk by collateral arrangements (in which case the disclosure will need to describe fully those arrangements and the relevant collateral but may not need to include full financial information of the derivative counterparty). Again, the goal should be for the rule to permit (and require) the disclosure to focus on the source of payments on which investors depend in a particular transaction, which may be non-derivative assets held by the issuer, the derivative counterparty, or both.

Disclosure Concerning the Measure of Payments. The need for disclosure concerning the measure of payments, as distinct from their source or from the assets held by the issuer, appears at first to be unique to synthetic securitizations. However, this aspect of synthetic securitizations is also found in other issuances of both ABS and non-ABS securities. The most common example is floating-rate securities, all of which involve a measure of payment that may well be independent from both the source of the payments and the performance of any assets held by the issuer. Some floating-rate indices, such as LIBOR, are now so common as to seem unremarkable, but it has not been so long since LIBOR-based interest was uncommon for U.S. publicly-issued debt securities. Other indices that have been used are still perceived as unusual, just as LIBOR was in the past – for example the 11th district cost of funds or a gold index. Nonetheless, in each of those cases the fundamental requirement of adequate disclosure that is inherent in any public security issuance led issuers to address on a specific basis the disclosure called for by each particular measure of payment. That same basic disclosure imperative will apply to publicly issued synthetic securitizations, and will provide a stronger and more flexible mandate than detailed disclosure rules intended to cover each different transaction structure. Accordingly, we urge the staff to formulate general rules that will be applied to specific structures or indices by the sponsor and its counsel.

External measures are not limited in the current market to those that affect only interest payments to investors. For example, issuers have publicly offered bonds denominated in one currency whose principal payments are to be made in a different currency at maturity. If holders of those bonds were to convert their principal payment back into U.S. dollars at that time, they may suffer negative returns if the foreign currency has depreciated against the U.S. dollar. Those negative returns would be determined by a measure of payment external to the issuer or its assets. As with the exposure to a specified credit or index in a synthetic transaction, the currency exposure in these transactions is not a side effect that raises external risks to investors; it is inherent in the instrument and is the reason an investor would choose to purchase such an instrument. As with most unusual features in public securities, the question of appropriate disclosure for this type of instrument has been addressed primarily by the issuers and underwriters and their counsel, without the need for detailed regulatory requirements.

The disclosure principles that have been articulated in the ABS Rules and followed in other areas apply just as well to disclosure concerning the measure of payments in a synthetic securitization, even when that measure is independent of the source of those payments. For example in the case of instruments on which payments are determined by reference to an external index, information about how the constituents of the index are chosen and what they are as of the relevant date, as well as historical information concerning the index, is necessary for investors to make an informed investment decision. Market practice has been to vary the level of disclosure provided in the prospectus depending on the level of information already available to investors from public sources. Even for less common indices such as those for gold and oil prices, there is a significant amount of information available to the general public, and in order to ensure that investors have adequate ability to follow their investments' performance, it may be appropriate to limit indices used in public synthetic securitizations to those for which meaningful and timely information is available to the public from third parties.

In prescribing how much disclosure to require concerning the measure of payments, the staff may wish to consider distinguishing between transactions in which the repayment of the investor's initial investment is not affected by the external measure (so-called "principal protected" structures) and those in which the investor's initial investment is also at risk from this measure. A more lenient standard of disclosure concerning the measure of payments would be appropriate in principal protected transactions.

B. Responses to Specific Questions in the ABS Release

- *Apart from the traditional approach of addressing hybrid securities as they arise, are there definable categories of securities where neither the existing regime nor regulation AB would be appropriate, but a specifiable alternative regime would be? What would be the advantages and disadvantages of such an approach? Is the existing approach of addressing these securities more practical if and until a market for that particular type of security matures such that establishing a separate regime is appropriate? Are there additional alternatives that should be considered? How are these securities offered and sold today? Who offers and purchases these securities?*

  As noted above, we believe that there would be great benefits from specifying the requirements for synthetic securitizations that may be executed as public transactions. A transparent and principled approach to these transactions by the SEC, even if it did not initially include all possible types of transactions, would enhance the development of this market and benefit investors, market intermediaries and sponsors alike. We do not believe it is realistic to wait for a public market for synthetic securities to develop before adopting clear standards, simply because no such market will develop under the current conditions. On the other hand, if the staff wishes to look to the disclosure standards applied in the Rule 144A market, there is already a very large market for synthetic securities with well-developed disclosure standards for most common products.

  Because it is not currently possible to issue synthetic securities publicly, these securities are offered and sold today primarily to institutional investors under Rule 144A. However, as the market has evolved, it has also become common for some dealers to sell various types of synthetic securities to high-net-worth individuals. In some jurisdictions outside of the United States (Canada, Australia and New Zealand, for example), synthetic securities are already offered and sold publicly to retail investors. It is primarily professional market intermediaries—principally investment banks—that structure and sell synthetic securities. Professional asset managers (both registered under the Investment Advisers Act and unregistered) and insurance companies are also involved in some types of synthetic securitizations.

- *If an alternative regime should be established, how would these securities be defined? Why should they be treated differently?*

  As described above, we believe the need to define synthetic securities arises more from the practicalities of rulemaking than from a fundamental qualitative difference between synthetic securitizations and other ABS transactions.

However, we have suggested above one possible starting point to distinguish between transactions subject to the ABS Rules and those that would be subject to the new regime.

- *What would be appropriate for this alternative regime with respect to registration, disclosure and ongoing reporting? What flexibility should be permitted under the existing regime and what additional or alternate requirements should be imposed?*

  We believe that the requirements for registration, disclosure and ongoing reporting that have been adopted under the ABS Rules are fundamentally appropriate for synthetic securitizations as well. However, they will need to be expanded somewhat and adapted to recognize the need to analyze separately the roles of the issuer, the source of payments to investors (whether synthetic or non-synthetic assets held by the issuer) and the manner in which the measure of those payments is determined.

- *While the Investment Company Act considerations are beyond the scope of this release for ABS, we also would seek comment as to the treatment of such securities, including synthetic securitizations, under Rule 3a-7 under that Act or other exemptive provisions of that Act or rules thereunder.*

  Of the possible exemptions from Investment Company Act registration that are consistent with a public securities offering, most synthetic securitizations will qualify only for Rule 3a-7. However, there have been varying views since Rule 3a-7 was adopted as to whether synthetic securitizations fall within Rule 3a-7's requirements. Any registration and disclosure regime that contemplates public issuance of synthetic securities will have no practical effect unless Rule 3a-7 under the Investment Company Act is interpreted to permit synthetic transactions to rely on that Rule.

- *Regarding synthetic securitizations where the return on the securities is not primarily dependent on the performance of the pool, what additional disclosures would be appropriate? For example, for other entities that offer securities and have derivatives or contingent obligations, there is required disclosure of financial intricacies, such as disclosure under FIN No. 45, Fin No. 46, SFAS No. 5 and SFAS No. 133, and off-balance sheet and MD&A disclosure. Would some or all of these disclosures be appropriate in synthetic securitizations? If not, why not? Please note these are non-exclusive examples.*

  These disclosures are intended to serve two purposes. First, they are intended to identify to users of a company's GAAP financial statements particular risks to which that company is exposed, and to quantify those risks, so that the remainder of a public company's GAAP financial statements can be evaluated in light of its contingent liabilities and exposure to volatile changes in interest or currency exchange rates, for example, which may in any future period have a material effect on the company's reported results of operations or assets and liabilities. Second, they are intended to place all companies that report under U.S. GAAP on an equal footing so that investors may evaluate different companies (in the same industry or not) in relation to each other. A securitization vehicle that meets the requirements in the definition of "asset-backed security" has no need for GAAP financial statements, as all of its assets and liabilities (including contingent liabilities) will be adequately disclosed by disclosing the details of the particular securitization transaction. There is no need to apply this type of accounting guidance to enable investors to evaluate possible future effects on the issuer's reported results because the only results meaningful to ABS investors involve the cash repayments of the securities issued in the transaction, and the contingencies affecting those results will be adequately disclosed by the disclosure described above in this letter.

- *Would financial statements be necessary to fully understand the risks and potential performance of these securities? Should some form of off-balance sheet disclosure be required when performance is tied to such instruments? Should market valuations of assets and liabilities be required?*

  For the reasons noted in response to the preceding question, we do not believe that GAAP financial statements are necessary to explain to investors the risks and potential performance of synthetic securities. The performance of these securities is evaluated on a cash-flow basis, not on the basis of reported GAAP financial measures. Accordingly, the risks of these securities are those that reduce or threaten cash payments to investors, not those that (as with an operating company) threaten its reported GAAP financial results. Although some synthetic structures may have exposure to fluctuations in market values of assets (just as non-synthetic ABS transactions may), in the great majority of synthetic securitizations, regular mark-to-market valuations bear no relationship to an investor's risk or return because the transaction is designed around cash flow rather than sale prices of assets. Although credit default transactions often measure the economic consequence of default on a reference obligation by determining the obligation's market value, this is a measure typically taken at the time a credit event has occurred, and regular mark-to-market valuations before that time may not be very useful to investors.

- *Where performance of the security is primarily tied to the performance of a derivative rather than the performance of the pool assets, what additional disclosure should be required regarding the derivative counterparty? Should financial statements for the derivative counterparty always be required?*

  As noted above, we do not believe that financial statements of the derivative counterparty should always be required. It will be necessary to assess how much an investor depends for payment on the derivative counterparty and how much on other sources of payment such as the assets held by the issuer.

- *Where performance is by reference to an unrelated entity or assets, what information should be required about the referenced entity or assets?*

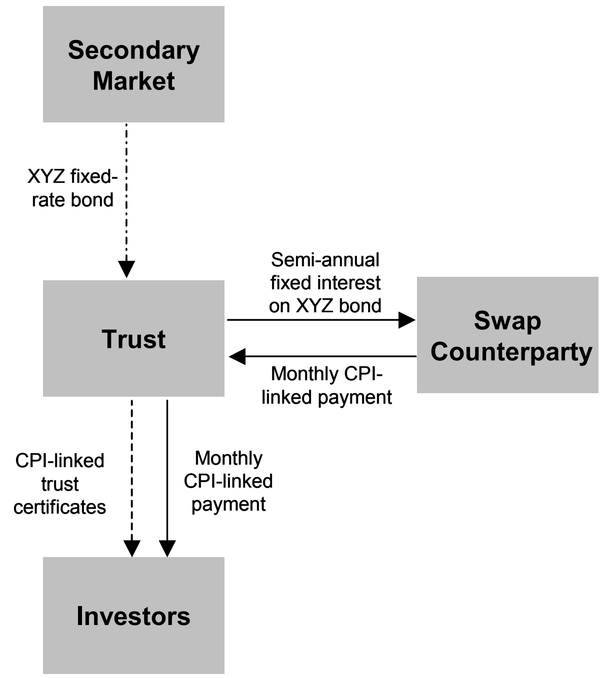
  In the case of an unrelated entity, information should be required that is similar to what would have to be provided under the ABS Rules with respect to the issuer of a debt security that is purchased in the secondary market and deposited in a securitization vehicle. The level of disclosure required should vary depending on the materiality of that reference entity to the investors in the securitization, and the permitted means of providing that information to investors should include reference to the reference entity's public disclosure documents. In the case of assets held by the issuer, the rule should similarly require disclosure analogous to what would be required if those same assets were to be securitized directly under the ABS Rules rather than through a derivative contract.

C. <u>Application of Suggested Approach to Specific Examples</u>

1. <u>CPI-Linked Repackaging Transaction</u>

One example of a transaction that we believe should be permitted is a repackaging of an interest-bearing asset together with an interest rate swap that converts interest on that asset into payments that are indexed to the consumer price index. We believe that this type of transaction fits within the ABS Rules as adopted, since this type of swap is a "derivative instrument . . . used to alter the payment characteristics of the cash flows from the issuing entity and whose primary purpose is not to provide credit enhancement" as described in Item 1115 of Regulation AB. However, if the staff disagrees with this conclusion, we ask that the guidance provided on synthetic securitizations address this case and similar ones.

A CPI-linked repackaging transaction can be summarized by the following diagram:



Disclosure Concerning the Issuer. Disclosure concerning the issuer in a CPI-indexed repackaging should be the same as that required under the ABS Rules for any other repackaging transaction. There is no difference in the role played by a securitization vehicle in a CPI-indexed transaction than in one using a LIBOR interest rate swap (or, for that matter, a gold-indexed swap).

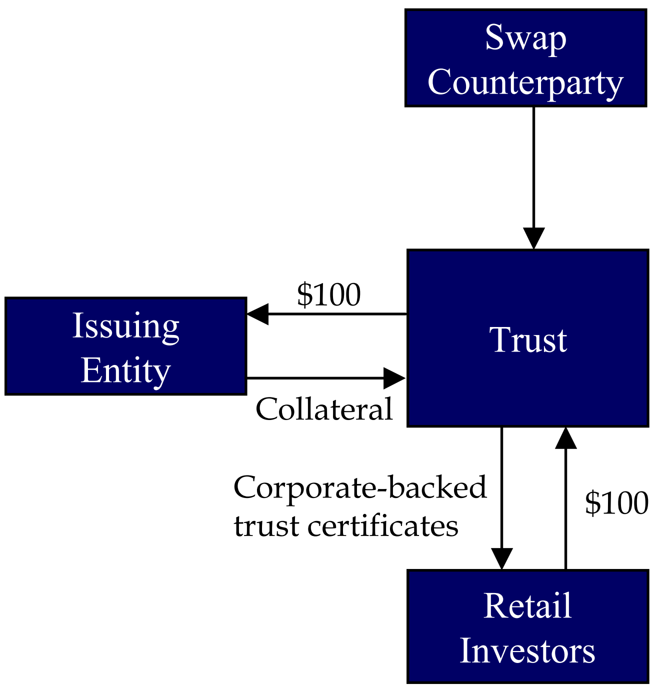
Disclosure Concerning the Source of Payments. The decision of what disclosure should be required of the source of payments in a CPI-indexed repackaging will be no different than it would be in any other repackaging. The requirements of Item 1112 of Regulation AB (or similar requirements) should apply to disclosure concerning the interest-bearing asset held by the issuer, as should the related rules permitting those requirements to be satisfied through incorporation by reference or by referring (without incorporation) to an unrelated significant obligor's Exchange Act reports.

The disclosures concerning the CPI swap counterparty as a source of payments should depend on the same factors that are used in Item 1115 under Regulation AB.

Disclosure Concerning the Measure of Payments. The exact manner in which the Consumer Price Index is applied to determine payments on the issued securities must be described in the offering document. Because the Consumer Price Index is a publicly reported statistic and information concerning how the index is calculated and its historical levels is widely available to the public from both governmental and private sources, a sponsor could reasonably conclude that little or no information of this sort should be required in the disclosure, although it will still be appropriate to highlight for investors any risks that may be unique to a CPI-indexed instrument. Also, because of the dependable availability of CPI information, the issuer of a CPI-indexed instrument should have no obligation to provide CPI-related information on an ongoing basis after issuance.

2. Single-Name Credit Default Securitization

Perhaps the paradigm synthetic securitization transaction at this point in the market's development is the single-name credit default securitization. Fitch Ratings has estimated that as of the end of 2003, 67% of the credit derivative market consisted of single-name credit default swaps. A typical collateralized CDS securitization can be depicted as follows:



Disclosure Concerning the Issuer. Again, the relevant issuer disclosure in a CDS securitization will not be different than in any other ABS transaction.

Disclosure Concerning the Source of Payments. In this transaction, the most significant source of payments of principal and interest to investors will generally be the collateral purchased with the proceeds of the investors' purchases of securities. In addition, the swap counterparty will typically pay a spread over the interest on the collateral, which will be passed through to investors as well. Depending on the structure and economics of a particular transaction, investors may not be exposed to the credit of the derivative counterparty to any material degree, in which case counterparty disclosure would be more limited than in other cases. Full information concerning the assets held by the issuer would be required, but should be permitted to be provided by reference.

Disclosure Concerning the Measure of Payments. In a CDS securitization, there are two factors that will determine the measure of payments by the swap counterparty to the issuer (and therefore to the investors): the terms of the swap agreement and the credit performance of the reference entity.

The detailed terms of the swap agreement will need to be disclosed as part of the description of the transaction structure. This will include the definitions of what events constitute "credit events" under the credit default swap and how the amount of loss is to be measured if a credit event occurs.

Of course, the likelihood of a credit event occurring with respect to the reference entity will depend on the financial condition of that entity. The reference entity is typically not involved in the creation of a CDS, and so this information should be permitted to be supplied by reference to the entity's Exchange Act reports.

D. Permissibility of Non-ABS Issuances of Indexed Securities

Because there has been considerable uncertainty as to the types of indexed transactions that may be offered on Form S-3 by traditional issuers (i.e., registrants that do not depend for S-3 eligibility on meeting the definition of "asset-backed security), we request that at the same time it considers how to treat synthetic securitizations, the staff considers providing guidance on the disclosure requirements for at least the more straightforward types of indexed issuances by traditional companies as well as the scope of synthetic and indexed transactions that may be registered as ABS transactions and the concomitant disclosure requirements for those transactions.

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The Association appreciates this opportunity to provide its views to the Commission in connection with this important project. If it would be helpful to the Commission and its staff, we would be happy to make Association staff and member firm personnel available to meet and discuss any of the points raised in this letter. Please address any questions or requests for additional information to Nadine Cancell of the Association at 646-637-9228 or Raymond Check of Cleary Gottlieb Steen & Hamilton LLP, the Association's special outside counsel in connection with this project, at 212-225-2122.

Very truly yours,

THE BOND MARKET ASSOCIATION

By: Nadine Cancell

Nadine Cancell,
Vice President and Assistant General Counsel, The Bond Market Association

cc: The Honorable William H. Donaldson, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
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