AFSA
American Financial Services Association

July 12, 2004

By e-mail: rule-comments@sec.gov

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609
Attn.: Jonathan G. Katz, Secretary

Re: File Number S7-21-04
Proposed Rule: Asset-Backed Securities

Ladies and Gentleman:

The American Financial Services Association ("AFSA") appreciates the opportunity to comment on this proposed rule regarding asset-backed securities. AFSA is the national trade association for consumer credit providers. The credit products offered by AFSA's members include personal loans, first and second mortgage loans, home equity lines of credit, credit card accounts, retail sales financing and credit insurance.

We commend the SEC for the immense amount of thought, time and effort invested in the Proposal. We wholeheartedly support the undertaking to address comprehensively the regulatory treatment of ABS under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"), and to codify and improve on existing SEC positions and ABS market practices by using a "principles-based" approach. We think the Proposal accomplishes those goals to a great degree (particularly with respect to the provisions addressing master trust structures), and that the Proposal will prove to be of tremendous benefit to ABS investors and all ABS market participants.

We endorse the comprehensive comment letters on the Proposal submitted by the American Securitization Forum and the Committee on Federal Regulation of Securities of the American Bar Association, except to the extent positions taken in those comment letters may be modified by what follows.

This comment letter addresses discrete parts of the Proposal that particularly concern us, or that we believe should be clarified, in the order in which they appear in the "Text of Proposed Amendments" section of the Proposal.

I. <u>Definitions</u>

A. Master Trusts. 1101(c)(3)(i)

We fully agree with the treatment of master trusts under the Proposal, but have one suggested refinement. Item 1101(c)(3)(i) states that the assets of master trusts satisfy the "discrete pools of assets" requirement under the definition of asset-backed securities if "[t]he offering relating to the securities contemplates adding additional assets to the pool that backs such securities *in connection with future issuances of asset-backed securities backed by such pool*" (emphasis ours). We believe the highlighted limitation on additions is not reflective of current master trust mechanics and that ABS investors neither desire nor would be better served by limiting additions to master trusts in this way.

Specifically, such a limitation would not allow for additions to pool assets that maintain the depositor's interest in the trust (*i.e.*, the portion of the trust's assets in excess of the aggregate outstanding principal balance of ABS backed by the trust's assets, which is usually referred to as the "transferor's interest") above a minimum level. Requiring additions to maintain the minimum transferor's interest is an essential means of assuring an adequate pool balance for master trusts with revolving assets. Furthermore, the process of making additions of assets to existing pools cannot always be coordinated closely with new ABS issuances.

For these reasons, we recommend Item 1100(c)(3)(i) be modified as follows:

> "(i) <u>Master trusts</u>. The offering related to the securities provides for the addition of assets to the pool that backs such securities in contemplation of future issuances of asset-backed securities backed by such pool and in connection with maintaining minimum pool balances."

B. Delinquent. 1101(d)

The Proposed Rule provides that for shelf registration eligibility, an asset pool with total delinquencies of up to 20% as of the cut-off date may still be considered an "asset-backed security." The Proposed Rule also provides that improper re-aging or recharacterization of delinquent accounts cannot be employed for purposes of satisfying delinquency concentration limits. The Proposed Rule clarifies the definition of "delinquent" as follows: "a pool asset that was more than one payment past due could not be characterized as not delinquent if only partial payment of the total past due amount had been made, unless the obligor had contractually agreed to restructure the obligation, such as part of a workout plan."

A receivable is defined as delinquent if "any portion of a contractually required payment" is 30 days or more past due. Our policy considers an obligor to be delinquent if less than 90% of a payment is received by the applicable due date. The new definition would require that we alter our delinquency recognition policy. There would be considerable time and effort required to convert our computer systems to recognize a contract as delinquent even when at least 90% of the scheduled payment had been made. In addition, this change could adversely affect our relationship with our obligors. Moreover, we have reviewed a number of prospectuses of other asset-backed issuers. Based upon this review, we believe that it is common practice in the prime retail auto receivable securitization market to report contracts as current when (1) for some issuers, at least a certain percentage of the scheduled payment has been made and (2) for other issuers, more than a certain dollar amount of a scheduled payment has been made. We request that the Staff modify the definition of "delinquent" to conform with the Staff's approach in defining when an asset is deemed to be "non-performing." The Staff notes that the point at which a financial asset is non-performing is often dependent on asset type, with some financial assets being considered non-performing before other asset types and concludes that an asset should be considered non-performing if it meets the requirements for being charged-off under either (1) the requirements in the relevant transaction agreements or (2) the policies of the sponsor. We believe that similar issues exist in defining when a financial asset should be deemed delinquent. For that reason, we propose that a receivable be determined to be delinquent in accordance with the provisions specified in the relevant transaction agreements or under the applicable sponsor's policies. The applicable terms and policies should be disclosed in the prospectus. We believe that market pressures will prevent issuers from adopting policies inconsistent with market practices. If the Staff is unwilling to make this change, we request that a 90% collection threshold be adopted for determining whether a receivable is current. If neither of these alternatives is adopted, we request clarification that for purposes of historical delinquency information, information may be presented as currently computed with a footnote indicating the applicable delinquency recognition policy.

Re-aging. We note under most securitization programs, the servicer has the power to grant the obligor certain extensions. When an extension is granted, the underlying documents are not typically contractually amended. We request that this practice not be affected and that these receivables not be considered delinquent as long as the practices are disclosed in the prospectus supplement.

II. <u>Sponsor Securitization Program Disclosure</u>

Item 1104 of proposed Regulation AB indicates that a prospectus should include basic identifying information about the sponsor and a description of the sponsor's securitization program. Item 1104(c) states that the latter description must include a description of (i) how long the sponsor has been engaged in the securitization of assets, (ii) the sponsor's experience in securitizing assets of any type and (iii) the sponsor's experience in and overall procedures for originating or acquiring and securitizing assets of the type included in the current transaction (which discussion must be a "more detailed discussion"). Additionally, the last sentence of Item 1104(c) indicates that information regarding the size, composition and growth of the sponsor's portfolio of assets of the type to be securitized, and information or factors related to the sponsor that may be material to an analysis of the origination or performance of the pool assets, should be included to the extent material.

We believe that Item 1104(c) is too broad. Even in light of the fact that the last sentence of Item 1104(c) is conditioned with "to the extent material," this item would encourage excessive information that goes beyond current disclosure practices and appropriate standards of materiality. The result of such a rule, therefore, may be the production of unnecessarily detailed disclosure regarding sponsors. In other words, given the explicit identification of such information in Item 1104(c), disclosure on this topic may become excessively robust out of a concern that such immaterial detail might be viewed as "presumptively material."

Additionally, we believe that requiring disclosure with respect to non-public securitization programs is inappropriate. The performance of the assets in those private structures has no material bearing on the performance of the assets in our public securitization structures. Moreover, certain information with respect to non-public programs is subject to confidentiality provisions limiting disclosure.

We believe, therefore, that Item 1104(c) should be modified to apply only to public securitization programs. Additionally, we recommend that the phrase ", to the extent material" be added to the end of the second sentence of Item 1104(c) and that the third sentence be eliminated.

III. Static Pool Data

Items 1104(e) and 1110(c) describe static pool data to be disclosed in ABS prospectuses, to the extent material. As a preliminary matter, we note that including static pool data creates a significant increase in the amount of pool data disclosed to investors in virtually all ABS prospectuses.[1] We acknowledge that, in some circumstances, static pool data may be material and should be disclosed. However, we are concerned that Items 1104(e) and 1110(c) will create an expectation that disclosure of static pool data is always required, even though it is clearly immaterial in many cases.

For example, unless there are negative trends with respect to a sponsor's generation of assets of the type being securitized, requiring disclosure of static pool data for prior securitized pools pursuant to Item 1104(e) will in most instances reveal little to ABS investors that is not already conveyed through current disclosure on the assets backing the ABS. Of course, should negative trends exist that are not revealed in current data about the assets backing the ABS, then disclosure with respect to those trends, which may include static pool data, should be included.

Additionally, for large, well-seasoned master trusts, the relevance of static pool data from prior securitizations of similar assets is even more limited. Because "prior data" is effectively contained in the data on the seasoned pool, any long-term trends with respect to pool performance should already be apparent. Similarly, the delinquency and loss static pool data required by Item 1110(c) is of limited value in understanding portfolio performance for well-seasoned master trusts. One of the principal instances where negative trends in delinquency and loss data for a pool as a whole might be obscured is if there is a significant amount of "unseasoned" assets in such pool. (Charge-offs for many types of loans tend to be minimal initially, and then increase and eventually level off as they mature.) Because there are generally either an immaterial amount of unseasoned assets in large, seasoned master trusts, or, more likely, a relatively constant amount of unseasoned assets in such master trusts over time, there is a decreased likelihood that the lower loss rates for such unseasoned assets are materially affecting losses for a pool as whole, or that such unseasoned assets are affecting losses in a

[1] Issuers do not currently disclose static pool data of the kind described in Items 1104(e) or 1110(c) in their registered ABS prospectuses[, nor do they prepare and provide such data to rating agencies evaluating their ABS].

manner distinct from the pool assets as a whole. To require static pool data on delinquencies and losses in this context would result in more, but not necessarily material, disclosure.

These same principles should apply with respect to any materiality consideration for static pool data, whether it is broken down for additions, portfolio purchases, originations, or any of the other categories set forth in the Proposal. If there are no material insights on portfolio performance trends to be gained by disclosing it, then this information should not be required in a prospectus. In fact, if there are no material insights to be gained by including such information, then including it may be confusing to investors.

Our member companies are committed to always providing material data to their ABS investors, and we appreciate that the SEC's objective in Items 1104(e) and 1110(c) is the same. We believe, however, that if Items 1104(e) and 1110(b) are promulgated without strong guidance from the SEC with respect to the immateriality of static pool data in certain circumstances, issuers may begin to disclose the data described therein, regardless of its materiality, either because of market pressure to standardize disclosure or a market presumption that such disclosure is material. We believe such a result would place an unnecessary and costly burden on sponsors without benefiting investors, who would have to sort through enormous amounts of static pool data of dubious relevance.[2] Moreover, the regulatory implication that disclosure of more data is always better, even where providing less data would constitute full material disclosure, is inconsistent with the SEC's stated goals of reducing boilerplate and unnecessary recitations. We therefore request that the SEC clarify that static pool data is not material in all instances, and certainly is not presumptively material.

In addition, whatever final rules are promulgated with respect to proposed Items 1104(e) and 1110(c), we request that the obligation to disclose such information be prospective only (*i.e.*, static pool data will only be required for periods from and after the effective date of the ABS rules). Most issuers have likely not kept records of static pool data in such a way that would allow for retroactive compliance with Items 1104(e) and 1110(c).

IV. <u>Pool Characteristics</u>

Similar to our concerns with the static pool data provisions, we feel that some of these categories of pool data are immaterial in light of other data that, in many instances, is already being provided by ABS sponsors, and we are concerned that specifying such categories of data in Item 1110(b) will create a standard of presumptive materiality. Item 1110(b) requires the description of material characteristics of a pool, and sets forth numerous categories of data "that may be common for many asset types."

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[2] In defining the standard of materiality under Rule 14a-9 of the Exchange Act, the Supreme Court voiced similar policy concerns:

> "...[I]f the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it to simply bury the shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decisionmaking."

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 448-449 (1976).

To illustrate our point, below are certain categories of data set forth in Item 1110(b), the disclosure of which would be immaterial given what issuers already disclose in their registered ABS prospectuses:

- The “interest rate” of an asset pool (Item 1110(b)(3)) is not only difficult to calculate,[3] it reveals little more than what an investor can learn about portfolio performance from examining yield data.

- Gross and net purchases and returns granted (Item 1110(b)(8)(vii)) are less indicative of portfolio performance than information on actual account balances.

- The percentage of full-balance and minimum payments made (Item 1110(b)(8)(viii)) is of collateral relevance when compared to yield data.

- Ranges of standardized credit scores of obligors and other information regarding obligor credit quality (Item 1110(b)(11)) also are of secondary relevance when compared with the actual performance of the assets in the pool – yield on the assets, delinquencies and losses, and our disclosure regarding underwriting criteria and origination.

- Pool data breakdowns by geographic region where 10% or more of the pools assets are located (Item 1110(b)(14)(ii)), absent any evidence of material pool characteristics unique to assets in such regions, are unlikely to place investors in a better decision-making position than they would be by viewing data from the overall pool.

As is the case with respect to the static pool data provisions, though we acknowledge that the data described in Item 1110(b) may be relevant for some ABS issuances, we are concerned that the provision will operate to require the disclosure of a great deal of additional data that will not add appreciably to investors’ understanding of portfolio performance and risk. Our member companies are committed in all circumstances to provide investors with material data in ABS prospectuses, but we are concerned about having to disclose data for data’s sake. [We therefore respectfully recommend that Item 1110(b) be deleted, as issuers are already required to disclose all material information to investors.]

V. <u>Credit Enhancement and Other Support</u>

We generally support the comments regarding Item 1113 expressed in the comment letter submitted by the American Securitization Forum. However, we wish to place additional emphasis on the potential impact of certain aspects of Item 1113. Item 1113(a) of proposed Regulation AB would require a description of any material external or internal sources of credit enhancement and other support features intended to affect or ensure the timely payment of asset-

[3] For credit card master trusts, calculating an interest rate for the pool as a whole would require tracking interest rates for millions of individual accounts. Rates on individual accounts are continuously changing due to, among other things, the expiration of introductory rate offers, the implementation of workout rates for distressed obligors, and changes in general economic conditions. To the extent rates for individual accounts change in the middle of the calculation periods being disclosed, a weighted average for each account would be required to determine how such changes affect the interest rate for the pool as a whole. Simply put, the sheer magnitude of the calculations required to arrive at such a figure is staggering.

backed securities. Item 1113(b) of proposed Regulation AB would require information about an enhancement provider in cases where such provider is liable or *contingently liable* to provide payments representing 10% or more of the cash flow supporting any offered class of ABS. In such an instance, descriptive and financial information, including selected financial data meeting the requirements of Item 301 of Regulation S-K, would be required. Where the provider is liable or contingently liable to provide at least 20% of the cash flow, audited financial statements meeting the requirements of Regulation S-X would be required.

We believe that the proposed rules with respect to credit enhancement and other support require modification to provide material information while not creating too large a burden for sponsors and credit enhancement providers. With respect to most swaps and other derivative products (other than insurance and similar derivative products), prospectuses historically have (i) provided the identity and credit ratings of the provider of the enhancement along with a very brief description of their business, (ii) included a brief summary of the material terms of the applicable enhancement agreement and (iii) presented a description of the events that terminate the enhancement agreement.

Rather than electing to provide more sweeping disclosure than listed above, it has been our experience that most swap counterparties prefer to provide investors with a mailing address to contact should the investor desire detailed financial information related to such counterparty. Further, to our knowledge investors have not requested the inclusion of additional disclosure in a prospectus beyond the items listed in the previous paragraph. At bottom, then, it has been our experience that investors rely mostly on the applicable credit ratings of the swap counterparty when making investment decisions.

Given this background, we are concerned that the SEC is electing to deviate from long-standing industry practice, particularly in a manner that would increase costs for ABS transaction parties or in ways that make compliance impossible. Additionally, we are concerned that the proposed rules would result in delays in marketing and pricing transactions, due to increasing the amount of required financial disclosure. This holds particularly true with respect to foreign and other credit enhancement providers that do not report under the Exchange Act.[4]

We respectfully request, therefore, that Item 1113 be changed to codify the current practice in the ABS market. Item 1113 could be modified to require a description of: (i) the general character of the enhancement provider's business, along with such provider's credit ratings, if any; (2) a description of the material terms of the agreement governing the enhancement, to the extent material; and (3) a description of events that would terminate such agreement, to the extent material.

Additionally, we echo the comments of the American Securitization Forum regarding the SEC's proposed measure for assessing whether the 10% and 20% thresholds have been triggered for

[4] With respect to companies that are not subject to the Exchange Act, and which do not prepare GAAP financial statements, we believe that financial statements prepared under such entity's regulatory accounting principles should be accepted as a substitute (provided that a statement is included regarding the fact that the financial statements are not prepared in accordance with GAAP). To determine otherwise could (i) result in a movement toward private placements instead of public transactions, (ii) force certain credit enhancement providers out of the market and (iii) increase costs for all parties to the transaction.

contingently liable enhancement providers. Not only is such a rule a departure from long-standing SEC staff and industry practice, it is inconsistent with the guidance of the Supreme Court.[5] Instead, as submitted in the comment letter by the American Securitization Forum, we believe that a central component of any materiality assessment for a contingently liable party is the probability of the contingency occurring.[6] Unless such a change is made to Item 1113, the contingent liability component of the SEC's proposal would impose new and very burdensome requirements on our organization. These costs would be shouldered by our organization with little appreciable benefit to investors.[7]

VI. <u>Prefunding Limits for Shelf Registration</u>

A set of interpretations in the Proposal codifies certain exceptions to the requirement in the definition of "asset-backed security" that the asset pool be "discrete." One exception to the "discrete" asset pool requirement permits the use of prefunding accounts, assuming that (i) the prefunding account does not exceed 50% of the proceeds of the offering and (ii) the duration of the prefunding period does not extend for more than one year from the initial date of issuance of the related securities. In addition, for purposes of Form S-3, the threshold for the prefunded amount would be reduced from 50% to 25%. In the Proposal, the SEC stated that these limits are designed to establish parameters for the types of securities that should be subject to the ABS regulatory regime. The SEC's express goal in these provisions is to expand access to the ABS regulatory regime for these structures.

The proposed limit on prefunding for purposes of Form S-3 is consistent with the existing no-action letters on this subject.[8] However, in informal communications with the SEC staff, at least one issuer has been advised that it would be permitted to use Form S-3 for transactions with prefunding in amounts up to 40% of the proceeds of the offering. Further, the issuer has been informed by other ABS market participants that the SEC staff has previously permitted use of Form S-3 for transactions with prefunding in amounts up to, and even in excess of, 50%.

We urge the SEC to revise the proposed definition of "asset-backed security" to accommodate larger prefunded amounts. We believe that not only would such a revision serve to accommodate existing market practice, but it would promote the SEC's goal to expand the eligibility of prefunded structures to the ABS regime. Therefore, we respectfully request that the SEC adjust the limitations in the context of Form S-3 to allow for a prefunded amount of up to 50% of the proceeds of the offering.

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[5] *See Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (quoting *SEC v. Texas Gulf Sulfur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (holding that an evaluation of the materiality of a contingent or speculative event depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event" in light of the totality of the circumstances).
[6] *See id*.
[7] To those ends, we believe that the valuation method proposed by the American Securitization Forum in its comment letter is preferable and superior to the rule in the Proposal.
[8] *See* Letters re Rule 15c2-8(b) No-Action Position from The Bond Market Association (Dec. 15, 2000) (position extended indefinitely); The Bond Market Association (Nov. 20, 1998) (position extended through Dec. 15, 1999); The Bond Market Association (Nov. 14, 1997) (position extended through Dec. 15, 1998); and the Public Securities Association (Dec. 18, 1995) (initial position expiring on Dec. 15, 1997).

VII. Transition Period

The Proposal states that the transition period for effectiveness initially will be (i) three months after the effective date for new registration statements or takedowns off of shelf registration statements (which date includes both the Securities Act and Exchange Act proposals with respect to such newly offered ABS) and (ii) fiscal years ending six months after the effective date for outstanding ABS (regarding Exchange Act proposals).

We believe that the SEC has underestimated the effort that would be required to implement the changes under the proposed rules. As a result of these rule proposals, a host of new internal programs and procedures will need to be created, evaluated and monitored both internally and externally. Additionally, many of the disclosure and ongoing reporting rules require issuers to obtain information from unaffiliated third parties that have not furnished such information in the past. The process of obtaining and ensuring future delivery of such information will take time, particularly for large issuers that deal with a wide array of unaffiliated third parties.

In light of those factors, and given the importance to our institution of access to the public capital markets, we request that the SEC provide that the date for compliance will not occur until, at the minimum, (i) nine months after the effective date for new registration statements or takedowns off of shelf registration statements (regarding both the Securities Act and Exchange Act proposals) and (ii) fiscal years ending nine months after the effective date for outstanding ABS (regarding the Exchange Act proposals).

VIII. Other Comments

Item 1120(d)(2)(i). This provision seems to impose a substantive requirement that moneys be deposited to a custodial or bank clearing account within two business days. Many transactions allow the servicer to commingle collections until they are required to be distributed provided that certain conditions are satisfied such as maintenance of a satisfactory rating. These conditions are subject to rating agency approval and are acceptable market practice for creditworthy servicers. Preventing commingling in these circumstances could adversely affect efficiency and would prevent a business practice that has not resulted in harm to investors.

Item 1120(d)(3)(i)(D). This provision requires the servicer to ascertain whether its records agree with the records of the trustee and investors. The servicer is not in a position to control this. Accordingly, we believe that the item should be deleted.

Item 1120(d)(3)(iii). The servicer does not maintain the records for investors. Accordingly, we believe that the item should be deleted.

Item 1120(d)(4)(iv). We believe that this provision should be clarified to make clear that it relates to the servicer's records relating to the obligor. The servicer cannot control the posting to the records of an obligor.

Item 1120(d)(4)(v). This provision requires the servicer to ascertain whether its records agree with the records of the obligors. The servicer is not in a position to control this. Accordingly, we believe that the item should be deleted.

<u>Conclusion</u>

We appreciate the opportunity to comment on the Proposal and again thank the SEC for their efforts. Should you have any questions about this letter, please do not hesitate to contact the undersigned at (202) 466-8606.

Respectfully submitted,

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