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

8th March 2005

Ladies and Gentlemen:

Re: Asset-Backed Securities, Releases Nos. 33-8518; 34-50905; File No. S7-21-04.

The International Swaps and Derivatives Association (**ISDA**) welcomes the opportunity to respond to the request for comments on the final rules set out in releases nos. 33-8518 and 34-50905 (the **Final Rules**) by the Securities and Exchange Commission (the **Commission**), in which the Commission has solicited comments on the registration, disclosure and reporting requirements for synthetic securities, currently excluded from the definition of asset-backed securities (**ABS**) under the Final Rules.

Summary

ISDA understands that the Commission has excluded synthetic securities from the Final Rules' definition of ABS on the basis that these transactions are generally effectuated through the use of derivative instruments such as credit default swaps or total return swaps and the assets on which the return is primarily based are referenced through derivatives rather than transferred into the asset pool. While the Commission does not currently apply Regulation AB to synthetic securities, this letter is being sent by ISDA in response to the Commission's request for comments as to whether a specifiable regulatory framework should be considered for synthetic securities. For these purposes, ISDA assumes "synthetic securities" to mean capital market instruments whose payment profile is linked, typically by virtue of a derivative instrument, to the credit or other performance of one or more entities or obligations, the issuer of which instruments is not required to own such underlying obligations. ISDA firmly believes that the Commission should provide for the same or a substantially similar regulatory framework to that set out in the Final Rules for synthetic securitizations structures, which are often closely analogous to existing types of asset-backed securities transactions. The reference entities (specified corporate names) and the reference obligations (debt obligations) in synthetic securitization structures have similar characteristics to many of the types of assets that may be securitized in traditional securitization structures. In this regulatory framework, appropriately tailored additional disclosure would allow investors to understand the nature of their investment based on available information about the reference entities, the reference obligations, the derivative instruments and the transaction structure.

Synthetic securities have now become an integral part of the financial markets. A decision not to address the regulatory treatment of synthetic securities now or in the near future would appear, for many products, to codify a regulatory distinction that does not exist in market practice. ISDA believes that synthetic securities should be treated under the Securities Act of 1933, as amended (**the Securities Act**), and the Securities Exchange Act of 1934, as amended (the **Exchange Act**), in the same (or substantially the same) manner and with access to the same (or substantially the same) benefits as ABS in order, among other benefits to investors, to respond to identified market trends and to avoid any lack of regulatory guidance to aid in the development of these products. ISDA is concerned that if the appropriate treatment of synthetic securities is not addressed through the rulemaking process now or in the near future, market participants will find it difficult to develop such products without substantial involvement from the Commission when, at the same time, ISDA believes that for a large number of synthetic transactions, the existing regulatory framework provided under the Final Rules is an excellent platform for developing this market without the need for significant new rule-making. ISDA strongly believes that putting in place a regulatory framework for synthetic securities similar to the Regulation AB regime for ABS is an adequate solution for many products.

Introduction

ISDA is the global trade association representing participants in the privately negotiated derivatives industry, a business covering swaps and options across all asset classes (interest rate, currency, commodity and energy, credit and equity). ISDA was chartered in 1985, and today numbers over 600 member institutions from 47 countries on six continents. Its members are the leading participants in the privately-negotiated or over-the-counter (**OTC**) derivatives industry. The OTC derivatives industry includes interest rate, currency, commodity, credit and equity swaps, options and forwards and related products such as caps, collars, floors and swaptions. The membership includes associated service providers and consultants.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements; securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives. ISDA is committed to promoting the development of sound risk management practices. Its work includes efforts to ensure adequate legal and regulatory treatment of OTC derivatives transactions, which are at the core of almost all synthetic securities. As part of its function, ISDA has developed a series of master definitions and other related documents for products that have become the base definitions adopted by the market in OTC and funded structured credit products. In particular, ISDA's documents are at the heart of nearly all synthetic securitizations. ISDA is also in the process of preparing a standardized credit default swap (**CDS**) confirmation template referencing asset-backed securities (expected to be published in June of this year), which is predicted to aid significantly in the development of the synthetic asset-backed market. Accordingly, ISDA believes that it has played and will continue to play an important role in the development of the synthetic securitization market and would like to ensure that its members' experiences with this market are taken into account by the Commission as it works to consider an appropriate regulatory regime.

In this letter, ISDA addresses the role synthetic securities currently play and are expected to play in the securitization and capital markets. In response to the Commission's request for comments in the Final Rules, ISDA discusses the advantages and disadvantages of establishing a regulatory framework for a definable category of synthetic securities (closely analogous to securities issued in traditional securitization transactions) in view of the state of advancement of the synthetic market and proposes minor modifications to the current definition of ABS to reflect the specific features of synthetic securities. ISDA also suggests in this letter several amendments to the regime currently set out in the Final Rules to appropriately address synthetic securities within a new regulatory framework that would be substantially similar to that set out in the Final Rules and discusses the disclosure standards that could be appropriate for this new regulatory framework with respect to the derivative counterparty, including the need for financial statements, the reference entity, the reference assets and, where relevant, the collateral. Lastly, ISDA comments on the treatment of synthetic securities under Rule 3a-7 of the Investment Company Act of 1940, as amended (the **Investment Company Act**). Specifically, ISDA answers the following requests for comments of the Commission:

- 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 securities matures such that establishing a separate regime is appropriate? Are there additional alternative that should be considered? How are these securities offered and sold today? Who offers and purchases these securities?

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

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

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

- 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 would be required regarding the derivative counterparty? Should financial statements for the derivative counterparty always be required?

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

A. Background information in the synthetic securities market

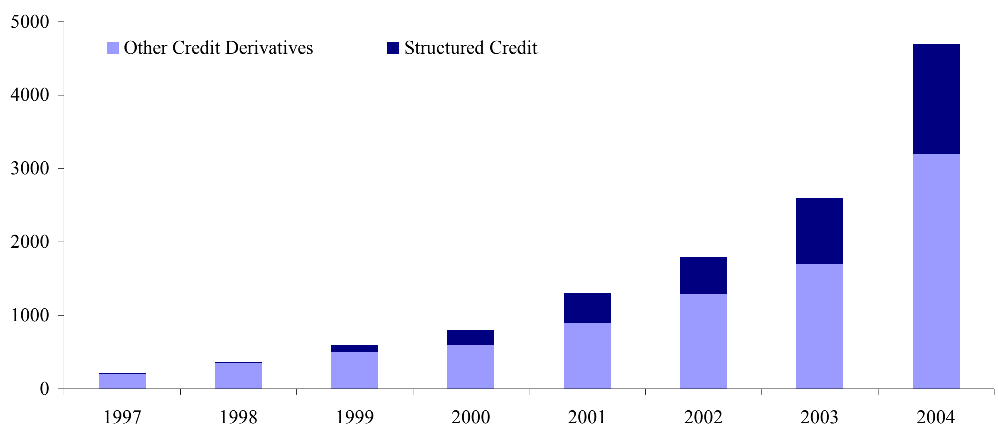
Market considerations

ISDA is concerned that public ABS transactions will not benefit from the ongoing developments in one of the most dynamic areas of finance today. Although ISDA understands that synthetic ABS transactions will be reviewed by the Commission on a case-by-case basis, it fears that the current interpretation of the definition of ABS will materially inhibit the growth of a public market for synthetic securitizations, effectively preventing public investors from accessing the benefits of such products.

As a general matter, derivative transactions play a large and ever-expanding role in the international financial system. The latest market statistics show a derivative and risk management market size of between U.S.$130 trillion and U.S.$200 trillion.[1] It is estimated that the ISDA Master Agreement is used as a basis for documenting over 90% of the trades in this sizeable market. In 2003, ISDA surveyed corporate usage for the first time and found that 92% of the top 500 companies globally use derivative instruments to manage and hedge their risks more effectively. The process of private negotiation under the ISDA Master Agreement allows market participants to develop transactions that are specifically tailored to provide the desired economic outcomes for all parties involved. Therefore, parties may employ OTC derivatives to reduce risk, to reduce financing costs or to generate capital with acceptable levels of risk depending on their unique financial requirements.

More specifically, the market for global structured credit products has grown considerably since the development of synthetic securitizations in 1997 and is expected to continue to grow in 2005 and beyond. In 1997, the global collateral debt obligations (**CDO**) market consisted overwhelmingly of securitization of cash assets. Of the estimated U.S.$250 billion CDO issuances in 2002, however, more than U.S.$187.5 billion were synthetic issuances. The market for global structured credit products increased to over U.S.$600 billion in outstanding private issues in 2004 (almost equally divided between the U.S. market and the European market) and is expected to reach U.S.$800 billion in 2005. In comparison, the global market for cash issuance is growing at a much slower pace with an anticipated U.S.$115 billion in cash issuances for 2005.[2]

Total Outstanding Global Credit Derivatives Volume ($bn)



Source: JPMS, CreditFlux, British Banker's Association, ISDA, McKinsey & Co., Bank for International Settlements.

The growth of the ABS market has been fueled by the positive benefits the securitization of financial and other assets brings to both originators and investors. In the same way, financial institutions structure synthetic securities using derivative instruments as a flexible and efficient tool to tailor the characteristics of an investment to the preferences of investors seeking exposure, including credit

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1 In June 2004, the Bank for International Settlements measured the total amount outstanding of OTC derivatives at U.S. $ 197 trillion worldwide.

2 "U.S. Fixed Income Markets 2005 Outlook", Fixed Income Research, J.P. Morgan Securities Inc., December 1, 2004.

exposure, to certain assets or groups of assets. The derivative instruments used in synthetic and other similar structured product transactions are versatile and customized financial contracts contemplating an exchange of payments in which at least one of the cash flows is linked to the performance of a specified underlying component, be it one or more obligors (reference entities), one or more obligations (reference obligations), and/or one or more external indices (such as the Consumer Price Index or foreign exchange rates).

The explosive and sustained growth of these synthetic securities (from 1997 onwards) reflects several clear market trends, including:

- An acknowledgment by regulators worldwide of the growth of the derivatives market and of the need to address its development. In the United States, both the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency have issued prescriptive guidelines for credit derivatives allowing financial institutions to benefit from regulatory capital relief assuming certain conditions are met.

- A shortage in the supply of primary securities (noticeably ABS) and an increasing appetite by investors for structured credit products as they become more familiar with them.

- The intent of financial institutions to offer investors the opportunity to take advantage of arbitrage opportunities arising from inefficiencies in the pricing of similar credit risks across different asset classes. Synthetic products allow investors to trade on specific credit profiles and take advantage of credit spreads available on the market by disaggregating credit exposure from yield.

- The increasing need for investors to manage their credit exposure: a credit derivative instrument allows a corporation to voluntarily assume or transfer all the economic risks and benefits of a bond, a loan or a portfolio of fixed-income instruments without having to actually purchase and hold the relevant asset.

- The intent of investors to get exposure to new, or a variety of existing, markets through the use of index-linked products in a liquid and highly transparent manner.

In addition, the variety of underlying assets and obligations being referenced in synthetic securities is continually expanding. By way of example, the market now references bank loans, corporate debt, trade receivables, emerging market debt, convertible securities, project finance loans, residential mortgages, leveraged loans, indexed products as well as credit exposure generated from other derivatives-linked activities. While ISDA is not suggesting that all such products are appropriate for public sales, these are indicative of the current state of the synthetic market.

ISDA would like to emphasize that although the traditional market participants are mostly large and sophisticated corporates, insurance companies, banks and hedge funds, our members see an increasing interest in these products from investors in the public market. Indeed, a significant size of the overall market for synthetic securities is composed of simple products that are of interest and benefit to investors in the public market. Many jurisdictions, including Benelux countries, certain Asian markets and Australia, have already extended the ABS and synthetic markets to provide access to investors in the public market.

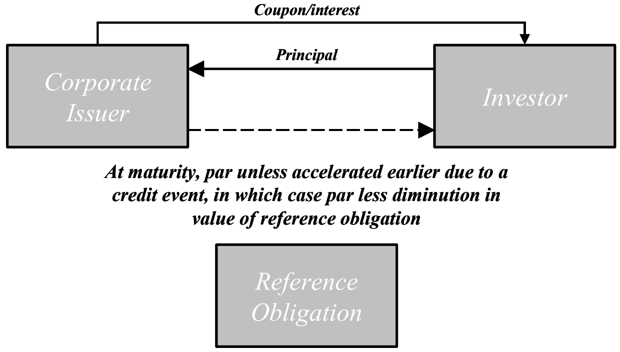
B. Because synthetic securitization products closely mirror the economic effects of traditional securitization, a regulatory framework similar to Regulation AB is appropriate for synthetic securitizations

The definition of ABS provided by the Commission is principles-based rather than specific in order to provide regulatory flexibility and to accommodate different asset types. As long as a security and the underlying asset meet the "core principles," the definition of ABS should apply. ISDA believes that synthetic securitizations do meet, or are capable of meeting, the core principles of the definition of ABS because synthetic securitizations have many structural features in common with traditional cash securitizations. In particular, both synthetic and cash securitizations achieve a transfer of risk through a structured financing that links payment on the securities offered by a special purpose entity to the performance of a definable set of assets. In addition, both synthetic and cash securitizations represent a fixed income investment for which the primary risks are those associated with default by obligors under debt instruments. Synthetic securities allow the seller of protection to assume the credit or other risks associated with a reference obligation or index without directly acquiring, or being required to hold, such obligation or the assets represented by the index. The Final Rules make it clear that a special purpose entity that holds a portfolio (such as loans or bonds) and issues pass-through certificates to investors will fall within the ambit of the Final Rules. The pool of assets (the loans or bonds) is transferred to the special purpose entity and the proceeds of the portfolio are passed through to the investors. However, several forms of synthetic transactions will achieve the same (or substantially the same) economic result without the need for an outright legal sale of the underlying assets. As a result, ISDA believes that a regulatory framework similar to the regime in Regulation AB is appropriate for credit derivative synthetic securitizations. The following are examples of some of the simpler forms of these synthetic transactions:

1. A credit-linked note puts an investor in substantially the same position as a bond without the need for an outright legal sale

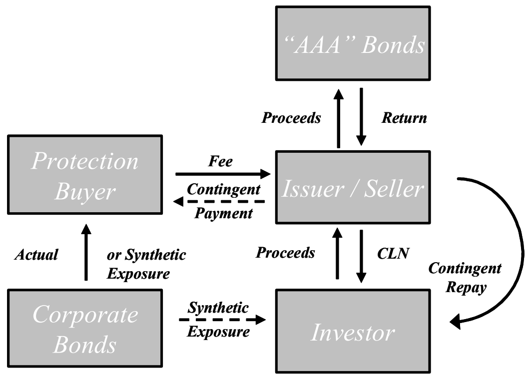
By way of illustration, consider a transaction in which a note is issued by a protection buyer (such as, but need not be, a large financial institution or a bank)(to an investor and the note is to be redeemed at par value on maturity only if a pre-defined credit event does not occur on a specific reference entity or asset (i.e., a debt obligation of a reporting company under the Exchange Act). A standard credit-linked note such as this contains an embedded default swap between the large corporate issuer as seller of credit protection and the protection buyer. The investor pays par to buy the note, which then pays LIBOR plus a spread equal to the default swap spread of the reference entity (plus a spread linked to the funding spread of the issuer, which compensates the investor for its credit exposure to the issuer). If the reference entity defaults, the credit-linked note accelerates.

Credit-Linked Note
(corporate structure)



Alternatively, the protection buyer may issue credit-linked notes through a special purpose entity. The special purpose entity will generally invest the purchase price paid by the investors in an asset in the form of treasuries, a guaranteed investment contract or "AAA"-rated asset-backed securities purchased in the secondary market. The exposure of the protection buyer to the credit of the reference entity is passed to the investors via the credit default swap entered into between the protection buyer and the special purpose entity.

Credit Linked Note
(special purpose entity structure)



These simple credit-linked note structures achieve an economic effect that is similar (or substantially similar) to buying a bond issued by the underlying reference entity (which could be any form of debt security, including, for example, ABS or corporate bonds). The investor takes exposure synthetically to the credit of a major corporate name and receives a spread over LIBOR for a term that is often unavailable in the cash market. An investor assumes the full credit risk of the reference bond and may lose all or part of the principal invested under the terms of the credit-linked note, just as would be the case if it owned the reference bond directly. In this way, however, an investor can use a credit-linked note to buy or sell credit protection on reference credits or to create synthetic credit exposure for a maturity and/or currency and/or interest profile not available in the bond/loan market. This product is almost identical to a simple repackaging transaction which, ISDA believes, falls within the requirements of the Final Rules.

Upon the occurrence of a credit event with respect to the reference entity, the investor in a credit-linked note ends up in a similar economic position as it would have been if it had bought the relevant debt obligation of the reference entity directly: if the credit-linked notes are cash-settled, the credit-linked notes are accelerated and the issuer delivers to the investor the principal amount of the credit-linked note less the diminution in value of the defaulted obligation following the relevant credit event.

Credit events, as provided for in the market-accepted documentation drafted by ISDA, are largely intended to put an investor in a synthetic product in the same position as an investor in a "cash" product. Credit events typically include bankruptcy (the reference entity becomes insolvent or is unable to pay its debt) and failure to pay (a failure by the reference entity to make due payment on one of its obligations (typically taking into account some grace period to prevent accidental triggering due to administrative error)).

These products can also involve simply referencing a highly public measurement such as the CPI rate, one or more foreign exchange rates or a commodity price (e.g., gold). ISDA believes that these types of products should fit within the Final Rules adopted by the Commission since they typically involve "derivative instruments, such as interest rate and currency swap agreements, that are used to alter the payment characteristics of the cashflow from the issuing entity and whose primary purpose is not to provide credit enhancement related to the pool assets or the asset-backed securities".

Investors in the public markets should be given access to the benefits of synthetic securitizations in order to diversify their investments and tailor their portfolios to their specific needs

There are many advantages for investors in the Commission providing for synthetic securitizations through a regulatory framework similar to the regime adopted by the Final Rules. For example:

- A credit-linked note allows a very flexible customization of investors' preferred exposure profile. For example, tranched synthetic products use structural subordination to divide the potential losses in an underlying portfolio of credits. An investor in tranched synthetic products can select a particular level of exposure at which to bear default risk according to its risk appetite and desired yield. This option is not available to an investor in the cash markets unless there is a full capital structure being offered. Likewise, a principal-protected credit-linked note will lower the credit exposure of a note investor by guaranteeing a minimum return equal to the investor's initial investment (the principal amount): the interest on a principal protected credit-linked note is linked to the credit of a reference entity but if a credit event occurs, the full principal is still returned to the note investor. These products (and variations) have become increasingly popular. In addition, the coupon of a credit-linked note can be tailored to the preference of an investor (fixed, floating, monthly, quarterly, semi-annually, etc.) and a credit-linked note may be issued in respect of any type of obligation.

- A credit-linked note and other synthetic instruments will allow an investor to gain exposure to the credit of a reference entity even if there is a shortage in the available supply of the securities of that issuer or if there is some other legal or regulatory reason why it may be inefficient or otherwise undesirable for an investor to buy the underlying obligation directly.

- A credit-linked note may be rated. The ratings assigned by the rating agencies to credit-linked notes address timely or final payment of principal and interest on the notes and, in respect of a credit default swap, the probability of a claim by the protection buyer under the credit default swap agreement. The ratings are based on the quality and diversification of the reference portfolio, the available credit enhancement, the protection buyer's underwriting practices and the transaction's financial and legal structure. With respect to the reference portfolio, the rating agencies consider the credit quality, characteristics and diversification of the initial portfolio and define strict eligibility criteria to which the initial reference obligations and the reference portfolio in general are subject, thereby increasing the level of protection offered to the synthetic investor. In this respect, the rating agencies have aided significantly in the development of the synthetic markets and, by developing appropriate models and structural safeguards, have ensured that the interests of investors are taken into account.

- A credit-linked note structure is inexpensive and easy to put in place, allowing investors to rapidly take advantage on short notice of windows of opportunities available in the market. It maintains bond features and convenience (e.g., DTC settlement, separate CUSIP, Bloomberg listing). In addition, a credit-linked note structure avoids certain internal, regulatory, legal and tax problems which come up with asset transfers. This structure enables the protection seller to find investors for portfolios of medium-sized and unrated companies, as well as blind pools, and can accommodate very large portfolio sizes.

- A credit-linked note structure is simple: ISDA has standardized the underlying swap documentation, which has had a significant effect on the growth of the market.

2. An index-linked synthetic certificate attempts to replicate the risk profile of a portfolio of underlying assets

An index-linked synthetic security allows investors to take exposure with respect to a well-defined, liquid and diversified portfolio of reference entities

Index-linked instruments have been a huge growth product since 2002 for the fixed income capital markets in Europe, the United States and Asia. Index-linked instruments are largely independent from market participants and benefit from an objective pricing based on individual prices provided by multiple contributors. By way of an actual example, consider the issuance by a trust of certificates linked to a portfolio of the reference entities in the Dow Jones CDX.NA.HY.3 index, which allows investors to take exposure to the 100 most actively traded names in the US high yield market. The effect of the certificates is that investors are able to take credit risk with respect to a well-defined, liquid and diversified portfolio of reference entities included in a specific index. This transaction alone, which closed in July 2004, involved the issuance of U.S.$4.25 billion of trust certificates. Such index-linked synthetic products are of great interest to all investors, including potentially investors in the public market.

An index-linked synthetic structure is transparent

There are several distinct advantages for investors attached to an index-linked product:

- The structure of an index-linked product is transparent because the portfolio of reference entities is specifically defined in reference to the linear basket of a specific index. Adjustment to the reference entities can usually be made every 6 months based on trading volumes but these adjustments are rule-based, rather than discretionary.

- An index-linked product allows diversification because protection sellers are exposed only to small losses on a large number of credits.

- An index-linked product is very liquid because investors are all trading on the same contracts.

- An index-linked product is very flexible because indices are offered in all formats that are of interest to investors (funded versus unfunded, tranched versus untranched, sub-sectors, regions or maturities).

C. An appropriate regulatory framework for synthetic securities would need to address specific features of synthetic securitizations not present in cash securitizations

While the Commission's request for comment refers to a range of possible synthetic structures (credit derivatives, total return swaps and commodity index-linked products), ISDA recognizes that an appropriate regulatory framework would sensibly begin with synthetic structures that are closely analogous to existing types of asset-backed securities transactions. These fall generally into the category of credit derivative synthetic transactions. However, ISDA acknowledges that such a regulatory framework for synthetic securities would be ill-suited to synthetic offerings that do not have some significant common characteristics with traditional cash securitizations (such as actively managed CDO transactions).

A credit event in the context of a synthetic securitization raises settlement issues

If a credit event occurs with respect to a reference entity in a synthetic securitization, the protection buyer will use a specific reference obligation (complying with pre-agreed criteria) in order to measure the loss. The protection buyer is responsible for obtaining bids from market makers in such debt obligation and for establishing its valuation price. If the credit-linked note is cash settled, the loss borne by the investor amounts to the difference between the par value and the market price as determined by a calculation agent in accordance with the terms of the derivative instrument and based on quotations by the bidders. ISDA notes that the rating agencies have modified their traditional cash CDO rating methodologies to accommodate the synthetic nature of CDOs. All of the agencies generally follow their standard quantitative methods with slight adjustments (haircut to default rates or recovery rates) due to the particular nature of the collateral, structure or documentation of the transaction. Rating agencies will closely examine the definition of credit events and will value credit events that match their definition of default as closely as possible. This approach allows rating agencies to use their historical default data to make assumptions on the probable performance of the CDS pool.

The mechanism of notification of the occurrence of a credit event in a synthetic securitization differs from the mechanism usually contemplated in a cash securitization

In a synthetic securitization, the determination of a credit event is made by the calculation agent on the basis of the availability of public information confirming the existence or occurrence of a credit event in relation to a reference entity. Notification is provided by the calculation agent to the paying agent for informational purposes only. As the information necessary to complete a credit event notice is publicly available, investors in these products should have access to it. In a traditional cash securitization, the servicer will usually inform the trustee acting on behalf of the investors of any default in the asset pool. ISDA believes that an alternative disclosure framework for synthetic securitization could capture this mechanism by requiring specific additional description of the notification process in the case of a credit event.

An investor in synthetic securities also takes exposure to the credit of the protection buyer

The cash flows in a synthetic securitization are partly dependent upon regular premium payments from the swap counterparty. Accordingly, the alternative regulatory framework would need to address disclosure relating to the credit protection buyer itself.

D. Existing disclosure rules can be adjusted to create a regulatory framework for credit derivative synthetic securitization that would accommodate a significant portion of the synthetic securitization market

1. The broad principles of Regulation AB can be applied to synthetic transactions

The Commission has defined an ABS as a "security that is primarily serviced by the cash flow 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 distribution of proceeds to the security holders" (Item 1101(c)). ISDA believes that the principles set forth in Regulation AB can accommodate a significant portion of the synthetic securities market to the extent that they clarify that the assets upon which a synthetic offering is based need not actually be in the "pool" of reference assets so long as they are sufficiently identifiable to allow for appropriate disclosure.

In establishing a new regulatory framework for synthetic securities, ISDA respectfully suggests to the Commission that the definition of ABS in Item 1101(c)(1) be amended to include securities whose payment is linked by virtue of a derivative instrument to the credit or other performance of one or more entities or obligations, the issuer of which instrument is not required to own such underlying obligations. The amendment to the definition of ABS (or the creation of an analogous definition that would be used in this new regulatory framework) should also clarify that (i) the settlement mechanics of synthetic instruments, and (ii) the replacement of collateral (such as a guaranteed investment contract) by the credit protection buyer in the event of downgrade, default or maturity in the context of credit-linked notes issued by a special purpose entity, will not constitute active management of the reference assets in contradiction with the principles of the Final Rules.

In the Final Rules release, "the existence of the “discrete” requirement is to prevent a level of portfolio management that is not contemplated by the definition of “asset-backed security” or consistent with this registration and reporting regime". ISDA also acknowledges that managed synthetic structures will not fit within the framework of the proposed regulatory framework. For many synthetic securities, however, the reference assets remain static throughout the term of the transaction, thus ensuring that the pool of reference assets remains discrete.

2. A separate regime requiring appropriate disclosure is an adequate solution

In synthetic transactions, ISDA appreciates that investors must be provided with adequate information to be able to understand the synthetic components of these products and to be in a position to fully assess the creditworthiness of the issuer and the swap counterparty (if different).

ISDA believes disclosure requirements for synthetic securities should be tailored to elicit the types of information that investors in the current credit derivative synthetics market may find most informative. Information on the triggers for payment under a credit default swap and details of how and when settlement amounts will be determined should be addressed in the new regulatory framework. Rating information and other data relevant to concentration limits (geographical and/or industrial) will also be important. However, historic pricing data and credit spreads on reference obligations, which can vary for a variety of reasons, would not seem pertinent. In addition, the Commission will want to consider to what extent disclosure will be required in respect of obligations which can trigger a credit event in contrast to information relating to the reference obligation which will be used to value post-default amounts for determining cash settlement amounts. Both are clearly material to investors and the nature and extent of appropriate disclosure is a matter on which the Commission may wish to reflect further.

Disclosure regarding the swap counterparty and the credit derivative instrument

The Commission has already provided specific guidance in the Final Rules concerning the disclosure necessary if the presence of an intermediating party is material to a purchase of ABS, as investors in credit derivative synthetic securitizations assume risk not only of the reference entities but also takes on credit exposure to the swap counterparty. ISDA believes that similar disclosure would be appropriate for credit protection purchasers in synthetic structures. Disclosure related to the swap counterparty and the derivative instrument in a synthetic securitization could be based on Items 1114 and 1115 and supplemented in the following way:

(i) The name of the counterparty, its organizational form and the general character of its business;

(ii) The material terms of the credit derivative instrument, including any limits on the timing or amount of payments or any conditions to payment as well as any termination provisions; and

(iii) Financial information depending on the measurement of the significance of the derivative. The measurement of the significance of the derivative in Item 1114 is to be determined based on whether an entity or group of affiliated entities is liable or contingently liable for at least 10% of the cash flows of any class of offered notes. An approach similar to the one adopted in Item 1114 could also be adapted to establish the levels of disclosure of financial information of a swap counterparty in a credit derivative synthetic securitization. For example, the amount of premium payments made by the swap counterparty compared to the cash flow supporting any offered class of securities could be used to evaluate the swap counterparty's significance to the issuer. Similar disclosure would be required if the counterparty were deemed to be a "significant obligor" within the meaning of Item 1112 under Regulation AB.

In addition, Item 1119 of Regulation AB addresses affiliations and relationships between entities in an asset-backed securitization. These disclosure requirements could be easily adapted to credit derivative synthetic securitizations in which a swap counterparty may play a variety of roles (sponsor, hedge provider or servicer).

A specific regulatory framework for synthetic securities should also require disclosure of the method selected for loss calculation. Some methods specify multiple valuation rounds and multiple bids, whereas others permit as little as one round and two bids, of which one could be provided by a party involved in the transaction. For example, the category of disclosure outlined in Item 1107(c) relating to any specific discretionary activity with regard to administration of the asset pool is highly relevant to a synthetic securitization. ISDA believes that a detailed description of the mechanics for valuation in cash settlement should be required.

Disclosure regarding the reference assets

In the case of the reference assets/reference entities, information about the composition and characteristics of the reference portfolio, including geographic distribution, industry classification, rating, concentration levels and historical default rates should be required components of disclosure for a synthetic obligation. In "cash" transactions, the actual disclosure to be provided must be tailored to the asset type to be securitized and a general description of the material terms of the assets/reference entities in the reference portfolio must be provided. The form and extent of disclosure on the reference assets in a synthetic transaction should be similar to that required for "cash" transactions. ISDA believes that the disclosure required by Item 1112 with respect to significant obligors of pool assets would be appropriate and sufficient to describe the reference entities included in the reference portfolio of a synthetic securitization.

In addition, investors in synthetic products that are not linked to asset-backed securities are primarily interested in the credit characteristics of the reference entities and not in the payment characteristics of their outstanding debt. Therefore, some of the information required under Regulation AB may be less relevant in a regime for synthetic securities. For example, the information required under Item 1105 relating to static pool information or information required under Item 1111 relating to payment characteristics of pool assets may not be of relevance to an investor in a synthetic product, which is not linked to ABS.

Disclosure regarding transaction structures

ISDA would suggest that the disclosure requirements in Item 1107(h) requiring the description of the sale or transfer of the asset pool to the special purpose entity be adjusted to credit derivative synthetic securitizations to require a description of the transfer of the economic risk relating to the reference entities pursuant to the relevant derivative agreements. Item 1113 should also need to be amended to address the specifics of credit derivative synthetic securitization structures.

Disclosure regarding the reference entities

To the extent that the reference entities are reporting entities under the Exchange Act, publicly available information on the reference entities should be referenced in the disclosure documents. Where reference entities are not reporting entities under the Exchange Act, appropriate disclosure should be required (perhaps consistent with current requirements for other products, such as warrants, exchangeable bonds or repackaging transactions), unless each entity accounts for less than a certain threshold of the notional amount of the synthetic transaction.

Disclosure regarding collateral

Information should be included about the collateral where the synthetic security is issued by a special purpose entity. The disclosure should presumably focus on the nature and the rating of the collateral, and any terms governing its payment or acceleration schedule. Collateral obligations in synthetic transactions are usually highly rated products and ISDA does not expect this disclosure to raise any specific issue for either the market or the SEC. However, it should be made clear that any investment by or on behalf of the special purpose entity of any income from the collateral in certain specified types of eligible investments or any action taken for the replacement of the collateral in the event of downgrade, default or maturity would not constitute the sort of active management that would disqualify the search for treatment under the proposed regulatory regime for synthetic securities.

Modification of the definition of "sponsor"

Item 1101(l) defines the sponsor as "the person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity". A credit derivative synthetic securitization does not contemplate the legal sale of reference assets to the special purpose entity, although there is a transfer of the credit risk of the assets through the use of a credit derivative instrument. Therefore, ISDA would suggest that this definition be amended to focus on the nature of the risk transfer through the purchase of credit protection pursuant to a credit derivative. The result would be that the credit protection purchaser (the swap counterparty) would generally end up in a role analogous to that of a "sponsor" under the Final Rules.

Consistency with Rule 3a-7 under the Investment Company Act

ISDA would also respectfully suggest that the Commission consider reconciling the definition of "asset-backed securities" in the proposed regulatory framework for synthetic securities with the definition of the term "eligible assets" in Rule 3a-7 under the Investment Company Act. ISDA believes that harmonization of the requirements under the Securities Act and the Investment Company Act is important to the maintenance of efficient financial markets in this area as under current law and practice, structured finance professionals still differ on the precise parameters of Rule 3a-7 under the Investment Company Act.

ISDA appreciates this opportunity to comment on the Final Rules and would be happy to discuss any questions the Commission may have about these comments, provide further information the Commission may find helpful in evaluating them and/or play an ongoing role in connection with any future rule-making or any statement by the Commission in regard to synthetic securities. Should you have any questions, please do not hesitate to contact Robert G. Pickel at (212) 901-6020 or Kimberly Summe at (212) 901-6030.

Yours sincerely,

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