INVESTMENT COMPANY INSTITUTE

July 12, 2004

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

Re: Asset-Backed Securities (File No. S7-21-04)

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposed rules governing asset-backed securities ("ABS").[2] The proposed rules address the registration, disclosure and reporting requirements for ABS under both the Securities Act of 1933 and the Securities Exchange Act of 1934. Mutual funds are significant purchasers of ABS and devote substantial time and resources to analyzing offerings of these securities. As such, our members have a significant interest in this initiative.

I. Introduction and Summary of Institute Recommendations

As the Release notes, the proposed rules follow years of significant growth in the ABS market.[3] This growth has been attributed to a number of factors, including an increased supply of new financial products, innovations in the pooling of financial assets, the availability of technology and computers, and a hospitable regulatory environment. While the informal regulatory framework governing ABS generally has worked well, the expansion of the ABS market underscores the need for a disclosure, registration and reporting framework that is more specifically tailored to ABS. Most significantly, the Institute has long believed that more rigorous disclosure standards are needed for offerings of ABS in order to ensure that investors are able to make informed investment decisions at the time of initial purchases and on an

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,643 open-end investment companies ("mutual funds"), 629 closed-end investment companies, 126 exchange-traded funds and 5 sponsors of unit investment trusts. Its mutual fund members manage assets of about $7.425 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

[2] SEC Release Nos. 33-8419; 34-49644 (May 3, 2004), 69 FR 26650 (May 13, 2004) ("Release").

[3] According to the Release, one source estimates that the U.S. public ABS issuance grew from $46.8 billion in 1990 to $416 billion in 2003. Release at n. 25.

ongoing basis.[4] At the same time, we believe that any new regulatory framework must continue to foster innovation in the ABS market.

We commend the Commission for issuing the proposals and strongly support their adoption. We have several recommended changes, however, that we believe will further the goals of providing better and more timely information to investors, both at the time of an initial investment and on an ongoing basis.

The most significant aspects of our recommendations are summarized below:

- We support the proposed requirements for more ABS-tailored disclosure in prospectuses. We believe, however, that certain other items should be added to the required prospectus disclosure in order to ensure that investors are provided with the information they need to make informed investment decisions. We recognize that these informational needs may vary based on the type of ABS offering and therefore support the principles-based approach of the proposed disclosure requirements.

- We generally support the proposed rules' approach to ongoing reporting. We are concerned, however, with the practice of ABS issuers ceasing to report under the Exchange Act once they qualify for the automatic suspension under Section 15(d) of that Act. We therefore believe the benefits of shelf registration afforded issuers should be conditioned upon issuers agreeing to waive their right to suspend reporting under Section 15(d).

- We strongly oppose the proposal to codify existing staff positions under Rule 15c2-8(b) under the Exchange Act that exclude broker-dealers, in connection with offerings of ABS eligible for registration on Form S-3, from the requirement to deliver preliminary prospectuses at least 48 hours prior to the sending of a confirmation. We also recommend requiring the delivery of ABS informational and computational materials ("term sheets") that include additional information (as described below) in a reasonable time frame, such as two business days but not less than one business day, prior to effecting sales. We believe that both these recommendations, taken together, would address the current problems surrounding the absence of material information at the time investment decisions are made.

Our recommendations are discussed in greater detail below.

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[4] *See* Letter from Alexander C. Gavis, Assistant Counsel, Investment Company Institute, to Michael M. Mitchell, Special Counsel, Division of Corporation Finance, Securities and Exchange Commission, dated October 29, 1996 ("1996 Letter"). (The letter can be found on the SEC's website at http://www.sec.gov/rules/proposed/s72104.shtml.) *See also* letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 29, 1999.

II. Discussion

A. Disclosure in ABS Prospectuses

Proposed Regulation AB, which is a "principles-based" set of disclosure items that would form the basis for disclosure in Securities Act registration statements and Exchange Act reports for ABS, represents a major step in improving the disclosures provided to investors in ABS. The proposal includes many of the items that the Institute has previously recommended be included in ABS prospectuses.[5] Such information is critical to an investor's ability to analyze the performance, risks and potential returns of an ABS offering. While we support the proposed disclosure requirements, we believe that the Commission's proposal could be strengthened to provide investors with additional information necessary to make an investment decision.

Specifically, the Institute recommends that proposed Item 1104, which would require information about the sponsors of an ABS offering, require disclosure of the extent to which the sponsor relies on securitization as a funding source. Such disclosure would provide investors with information that would facilitate the evaluation of asset quality, as well as the underwriting and documentation standards used by the sponsor in originating or acquiring and securitizing assets.

As proposed, Item 1107(a)(2) would require a "detailed description of the servicer's experience in, and procedures for, servicing assets of the type included in the current transaction." The Institute recommends that proposed Item 1107 set forth the specific disclosures that will be required about servicers. In particular, the Institute recommends that this Item require disclosure of a historical breakdown of loss, delinquency and prepayment rates by year of origination experienced by the servicer with respect to the existing pool or on a comparable pool of assets. This "vintage analysis" is critical to enable investors to understand changes in underwriting standards – and therefore loss and prepayment rates – over time.

Proposed Item 1110 would require data about pool assets; however, as proposed, this Item would not provide significant guidance about how that data should be presented. To make this information more useful to investors, we recommend that this data be required to be presented in a matrix format. Other information, such as credit rating score distributions, should be graphically displayed and not just disclosed as a weighted average. Such presentation is important as the "shape" of the distribution (*e.g.*, normal vs. "barbelled") can have a significant impact on a pool's performance.

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[5] These include, among other things: (1) a transaction summary (proposed Item 1103); (2) a description of each class of securities and key financial information about each class (proposed Item 1103(a)(3)), the effect of prefunding on each class (proposed Item 1112(g)) and allocation of voting rights within the classes (proposed Item 1112(a)(12)); (3) identification of the participants (proposed Items 1104 – 1109); (4) the sponsor's securitization program and any growth rate in the sponsor's portfolio (proposed Item 1104(c)); (5) static data on the sponsor's loss and delinquency information presented in a graphical format (proposed Item 1104(e)); and (6) a description of the assets being securitized and the criteria that assets must satisfy before purchase (proposed Item 1110).

Finally, proposed Item 1118 would require disclosure of whether the issuance of the ABS is conditioned upon the assignment of a rating, the identity of the rating agency and what any minimum rating must be. The Institute believes that, in addition to these items, ABS prospectuses should be required to disclose any expected ratings for the securities, even if the issuance of the ABS is not conditional upon the assignment of a certain rating. Disclosure about expected ratings, which is frequently provided today, provides important information to prospective investors, especially when such investors must make their investment decisions under very compressed time periods.

B. Ongoing Disclosure

1. *Ongoing Disclosure.* As the Release notes, most ABS are not listed on an exchange and are held by less than three hundred record holders. Consequently, most publicly offered ABS cease reporting with the Commission after filing one annual report because they qualify for the automatic suspension under Section 15(d) of the Exchange Act. The proposed rules do not specifically address this issue. Consequently, if the proposals are adopted without modification, most investors in ABS would remain dependent on commitments from ABS sponsors to voluntarily provide ongoing disclosures regarding the performance of the underlying assets and payment data. While many ABS issuers agree to provide such ongoing disclosure, Institute members report that some ABS issuers refuse to issue these ongoing disclosures because of liability concerns. We therefore recommend that the Commission make the availability of shelf registration conditioned upon an issuer agreeing either to continue filing reports under Section 15(d) of the Exchange Act for each publicly offered ABS or to make publicly available on their web sites copies of reports that contain the information required by proposed Form 10-D.

2. *Proposed Form 10-D.* The Institute supports the proposed creation of Form 10-D, which would take the place of using Form 8-K for ABS in the current modified reporting system. Most significantly, we support the proposal's inclusion of repayment information. This information is extremely important to investors in evaluating performance of the underlying pool assets and payment surveillance, as well as in determining whether payments should be characterized as interest or principal. The Institute also supports the other proposed disclosure requirements of Form 10-D. In particular, requiring the registrant to provide the information required by proposed Item 1119 of Regulation AB, which would require information about distribution and pool performance, would ensure that investors receive timely information about this material.[6]

C. Delivery of Information Prior to Sale

The Institute believes that purchasers of ABS should receive information about an offering early enough in the offering process to enable them to make an informed investment

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[6] Other important disclosures that would be required by Form 10-D include: delinquency, loss and prepayment rates; amounts drawn on and changes to credit enhancements and other supports; and breaches of material pool asset representations and transaction covenants.

decision.[7] Investment decisions are informed when investors are provided with material information a reasonable time before making an investment decision. Unfortunately, an unintended consequence of the proposed rules may be to further prevent the ability of potential investors to get information on a timely basis as they may increase the already-predominant use of shelf registration.[8]

The Commission has proposed to codify no-action letters issued under Rule 15c2-8(b) under the Exchange Act that exclude broker-dealers, in connection with offering of ABS eligible for registration on Form S-3, from the requirement to provide a preliminary prospectus to potential investors at least 48 hours prior to sending a confirmation of sale as required by the Rule.[9] We oppose the codification of these letters and, in fact, recommend that the Commission rescind them. In order for investors to receive the full benefits of the proposals' new disclosure requirements, it is critical that they receive such disclosure prior to making their investment decision.

The Institute also recommends that the Commission require either the delivery of or access to term sheets a reasonable time (*e.g.*, two business days but not less than one business day) prior to sales being effected as a condition to issuer eligibility for use of the delayed shelf registration rule for ABS offerings.[10] As the Release notes, the Commission, through a series of no-action letters, merely permits delivery of term sheets to prospective investors prior to the delivery of a prospectus.[11] The proposed rules would codify this practice by permitting distribution "informational and computational materials" after an offering becomes effective but before the availability and delivery of a final Section 10(a) prospectus. Requiring such

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[7] In the Institute's 1996 Letter, we noted that several Institute members had received telephone calls in the morning from a broker-dealer asking for a commitment to purchase securities in an ABS offering that would be priced by the end of the trading day. Our members have confirmed that this type of situation still exists. Members have also indicated that they often have only a couple of hours to decide whether to purchase an ABS in a publicly registered ABS offering, whereas ABS offerings conducted under Rule 144A under the Securities Act typically give investors greater time to decide and often with more information.

[8] For example, any expansion of the definition of "asset-backed securities" for Form S-3 purposes would have the unintended consequence of potential investors having to make more investment decisions under extremely compressed time periods and with access to less information for those additional ABS. This results from issuers being able to "take down" ABS from an already effective Form S-3 shelf registration statement and quickly selling the ABS, often with incomplete or no disclosure documents. Today, ABS offerings that do not meet the ABS definition must be offered and sold immediately after the Form S-1 registration statement is declared effective by Commission staff and includes a prospectus specific to the transaction. Although the prospectus is not necessarily delivered to potential investors, such investors can access them through EDGAR.

[9] *See e.g., Bond Market Ass'n* (Dec. 15, 2000); *Bond Market Ass'n* (Dec. 15, 1999); *Bond Market Ass'n* (Nov. 20, 1998); *PSA The Bond Market Ass'n* (Sep. 26, 1997); and *Public Securities Ass'n* (Dec. 15, 1995). The Release states that without these no-action letters, most broker-dealers would be required to deliver a preliminary prospectus in ABS offerings because Rule 15c2-8(b) requires delivery if the issuer has not previously been required to file reports with the Commission pursuant to Section 13(a) or 15(d) of the Exchange Act, which most ABS issuers at the time of the ABS offering are not required to do.

[10] If the materials are made available by access, potential investors should be provided with the location of the materials a reasonable time before sales are effected.

[11] Release, Section III(C)(1).

information in a reasonable time prior to sales being effected would ensure that investors are provided with material information about an offering in a timely fashion.

Finally, we recommend that the Commission require that certain additional disclosures be included in term sheets. This would help ensure that investors receive the information they need to effectively analyze the terms of an ABS offering. Among the required disclosures that we recommend be included in term sheets are the following: (1) information in a matrix-style or graphical format about the pool of assets, such as the weighted average coupon, the annual percentage rate, the loan-to-value ratio, and credit scores; (2) the extent to which the sponsor relies on securitization as a funding source; (3) the size, growth and composition of the servicer's portfolio; (4) the ratings or if not known, the expected ratings, of the servicer's portfolio (*e.g.*, investment grade vs. unrated); (5) any material changes to the servicer's policies and procedures in servicing assets of the same type in the past three years; (6) a list of the significant investment risks associated with the particular ABS offering; and (7) a description of the total credit enhancement (qualified as a percentage of the amount of each of the tranches to be credit enhanced) and a summary of the different attributes of the credit enhancement.

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The Institute appreciates the opportunity to comment on the proposed rules. Any questions regarding our comments may be directed to the undersigned at 202-326-5824, Ari Burstein at 202-371-5408 or Jane G. Heinrichs at 202-371-5410.

Sincerely,

Amy B.R. Lancellotta
Senior Counsel

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
The Honorable Harvey J. Goldschmid, Commissioner

Alan L. Beller
Director, Division of Corporation Finance

Paul F. Roye
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Securities and Exchange Commission