JONES DAY

July 12, 2004

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

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609
U.S.A.

Re: File Number S7-21-04

Dear Sir:

On behalf of Jones Day, we are submitting comments relating to the Securities and Exchange Commission's proposed new and amended rules and forms, as set forth in Release Nos. 33-8419; 34-49644 (the "Proposal"). Jones Day is an international law firm with over 2,200 lawyers practicing in 29 offices worldwide. The firm advises a variety of participants in securitization transactions globally, including cross-border offerings into the United States.

We support the Proposal's recognition of the fundamental differences between operating company securities and asset-backed securities ("ABS") and the Commission's initiative in proposing a comprehensive set of registration, disclosure and reporting rules tailored to ABS. Our comments below address select issues of particular concern in response to the Proposal.

Credit Default Swaps

The Proposal excludes synthetic securitizations from the definition of "asset-backed security" under the rationale that, in a credit derivative such as a credit default swap ("CDS"), the "assets" are not themselves included in the ABS issuer's asset pool but are "merely referenced."[1] We think the Proposal unfairly discriminates against derivative exposures and we see no reason why a pool of financial assets could not include synthetic exposures created by CDSs. Moreover, the Proposal's rationale fails to recognize that CDSs are themselves assets which by their terms convert into cash within a finite time period. A CDS involves the payment by a "protection buyer" of periodic fixed payments to a "protection seller" (the ABS issuer), in return for the protection seller's promise to pay an agreed amount upon the occurrence of a credit event with respect to a reference entity or obligation.[2] For a protection seller such as an ABS issuer, a cash-settled credit default swap behaves essentially as a financial asset, with a fixed scheduled return (unless a credit event occurs, or the

[1] Proposal, Section III.A.2.a.

[2] The Proposal fails to distinguish a completely synthetic transaction (where a single "master" swap arrangement references a pool of assets or names) from transactions involving discrete pools of cash-generating assets including single-name credit default swaps. The financial asset nature of CDSs obtains for both types of transactions. We would like the Commission to consider at least including "hybrid" securitizations involving both cash and synthetic assets.

swap counterparty defaults). Credit risk to the swap counterparty could be handled as with any other enhancement provider and to the reference entities as with any other obligor on financial assets. Furthermore, if the CDS is physically settled, then the CDS would involve delivery of a reference obligation (or its equivalent) to the protection seller, and thus synthetic securitization would in such cases involve the acquisition by the ABS issuer of the reference obligation to which it was synthetically exposed (or its equivalent). For these reasons, the Commission is requested to consider including CDSs as eligible assets for purposes of the definition of "asset-backed security."

Transition Period and Safe Harbors

The Proposal requests comment as to whether a transition period should be provided for compliance with new Regulation AB.[3] We support the concept of a transition period whereby a reasonable amount of time would be provided before take-downs off of an existing shelf registration statement would need to comply. We also support some sort of grandfathering for outstanding transactions, even if done under an outstanding shelf registration statement where subsequent take-downs would need to comply. We also believe that for grandfathering to have any real meaning in terms of potential liabilities, it might be prudent to consider safe harbors for grandfathered transactions from claims based upon the new rules and regulations. Moreover, we believe that the mere presence of the Proposal has created legal uncertainty with respect to appropriate disclosures under transactions closed prior to the effective date of any final rules. Therefore, consideration should be given to evidentiary rules prohibiting the use of the Proposal or any final rules as evidence as to material misstatements or omissions in respect of disclosures for grandfathered transactions.

Foreign ABS

The Proposal does not contemplate a different registration, disclosure or reporting system for foreign ABS, but sets forth a single regime for both U.S.-issued and foreign-issued ABS.[4] We are in general agreement with this approach. We also believe that the specific additional disclosures proposed for foreign ABS as outlined in Item 1100(e) of Regulation AB is generally adequate in terms of what most investors in cross-border securitizations consider to be material and also reflects current international standards of disclosure in the private market for cross-border ABS deals. Furthermore, we think that the Commission's proposed conditions on publicly-offered foreign ABS, such as initial registered offerings on a non-shelf basis (for a particular issuer, asset class or foreign jurisdiction), the opportunity for full review by the staff and pre-filing conferences, are sensible, and in these situations we would also request that the Commission consider granting confidential review.

There are, however, points which may require further clarification, development or relief as a result of the uniform application of the proposed rules to foreign ABS. The Commission is requested to consider the following points:

- Compared with the U.S., securitization is a relatively recent phenomenon in many foreign countries. As a result, many sponsors (often also originators and depositors as well as initial servicers) do not currently prepare and have not historically prepared static pool data on the performance of their asset portfolios. Despite the lack of this analysis regarding pool performance, arrangers, credit enhancement providers, rating agencies and other deal participants have all engaged in, and continue to engage in, large-scale cross-border ABS deals. We agree that static pool data is relevant and material to ABS investors and should be provided where available, and we thus agree that requiring static pool data is a positive regulatory trend. However, given the historical absence of such data in many foreign markets and the difficulties in producing the same, the Commission is requested to consider providing relief from the proposed requirement of three years' static pool data in the case of foreign ABS, either in the form of an initial exemption for foreign sponsors or a specified phase-in period (e.g., five years) after final promulgation of the proposed rules.
- The Proposal requires certain information to be disclosed in respect of transaction parties (e.g., sponsors, depositors, issuing entities, servicers, trustees, originators and enhancement providers).[5] In this regard,

[3] Proposal, Section III.F.

[4] Proposal, Section III.A.4.

[5] Proposal, Section III.B.3.

the proposed rules permit incorporation by reference of information contained in reports filed under the Securities Exchange Act of 1934 ("Exchange Act Reports"). In addition, the Proposal allows information regarding "significant obligors" to be referenced in an ABS registration statement from their Exchange Act Reports.[6] These conveniences would not, however, be generally available with respect to non-U.S. transaction parties or non-U.S. obligors that are not reporting companies or are not otherwise required to file Exchange Act Reports. The Commission is requested to consider whether, in respect of foreign ABS involving transaction parties or significant obligors that are not U.S.-based or U.S.-regulated, similar information filed with foreign regulatory authorities and/or foreign stock exchanges or otherwise publicly available could be referenced, in lieu of restating the same in the ABS registration statement and prospectus, so long as the such information is in the English language and accessible on the internet. We believe that extending this convenience would facilitate foreign ABS transactions and would not adversely affect the interests of investors so long as the information referenced meets the requirements that the Commission prescribes.

Financial Information

The Proposal requires certain financial information to be disclosed in the registration statement and prospectus in respect of "enhancement providers," i.e., selected financial data if the enhancement supports 10% or more, and audited financial statements if the enhancement supports 20% or more, of the pool payments.[7] Similar financial information is required in respect of "significant obligors," i.e., selected financial data if a particular obligor or group of related obligors accounts for 10% or more, and audited financial statements if a particular obligor or group of related obligors accounts for 20% or more, of the asset pool.[8]

- For purposes of the financial information requirements, the Proposal does not distinguish between credit enhancement and other types of non-credit support or enhancement, but simply refers to them collectively as "enhancement providers."[9] We believe, however, that market practice does make this distinction when it comes to the provision of financial information in offering documents. Thus, full audited financial statements are typically provided in respect of entities providing credit enhancement (such as financial guarantors), but such financial statements are not provided in respect of entities providing other types of non-credit support or enhancement (such as liquidity providers and interest rate swap providers). Please also note that servicers in respect of many ABS transactions provide liquidity in the form of servicing advances and that under the Proposal this would necessitate full audited financials, even though such liquidity advances do not guarantee recoveries upon defaults of the underlying assets. While we agree that some disclosure is necessary in order to allow investors to understand the identity of these non-credit enhancement providers, we believe the requirement of audited financials is onerous and unnecessary. We believe that the Proposal's current requirements in this regard may also discourage non-U.S. participants from acting in U.S. public offerings of ABS, which in turn would limit competition on price and quality for those important types of support in ABS transactions.

- The Proposal does not discuss the application of its financial statement requirements on non-U.S. entities (e.g., transaction parties, enhancement providers and significant obligors). Although we believe that U.S. GAAP reconciled and Regulation S-X compliant financial statements should be filed by sponsors and entities providing credit enhancement (such as financial guarantors), we believe that these requirements should be relaxed in respect of any financial information provided by transaction parties not providing credit enhancement and by significant obligors. We do not believe that it would be practical to assume that a non-U.S. entity performing roles other than sponsor or credit enhancer would prepare financial statements other than those already required in its home country. Accordingly, we request the Commission to consider allowing home country financial statements to be filed or referenced (see above) by these entities so long as such financial statements are audited in accordance with such country's generally accepted accounting principles and comply with home country law and regulations.

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[6] Proposal, Section III.B.9.

[7] Proposal, Section III.B.7.

[8] Proposal, Section III.B.6.

[9] Proposal, Section III.B.7.

Non-Performing Assets

To date, the great majority of securitization transactions have related to performing assets of all types. However, non-performing assets ("NPAs") also comprise a substantial source of the assets that may be securitized. For example, there have recently been numerous Italian securitization transactions backed by non-performing loans ("NPLs").[10] The number of Asian NPL-backed securitizations are also expected to increase substantially in the near future.[11]

In line with staff interpretations to date, the Proposal currently excludes NPAs from the alternative regulatory regime for ABS on the basis that this asset class does not fall within the proposed definition of "asset-backed security." Specifically, it is proposed that NPAs would not "by their terms convert into cash within a finite time period," but rather require more active management in order to resolve them into cash.[12]

Responding to the Commission's specific query as to whether there should still be an absolute bar on NPAs,[13] we respectfully submit that the Commission's definition of "asset-backed security" should be interpreted to include NPAs for the following reasons:

- Contractually, NPAs are financial assets and fall within the literal terms of the current (and proposed) definition of "asset-backed security,"[14] i.e., NPAs do in fact "by their terms convert into cash within a finite time period." The fact that the obligors on NPAs are either unable or unwilling to pay on a current basis does not change the fact that their written terms provide for conversion into cash by a particular time. The definition provides further flexibility in this regard by the qualifier "primarily" and by the phrase "plus other rights or other assets designed to assure the servicing or timely distribution of proceeds."

- Including NPAs in the definition of "asset-backed security" would be consistent with the Proposal's revised definition of that term by addition of the proviso "provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of physical property underlying such leases."[15] The proposed addition recognizes the principle that the value of hard assets (such as leased property or other collateral) is often a critical component in assuring sufficient payments to securitization investors. For example, RMBS servicers often are required to make liquidity advances in respect of residential mortgages so long as the advances can be repaid from the proceeds of foreclosing on the mortgaged properties. Accordingly, we respectfully submit that the proviso should be expanded to include any financial asset (i.e., evidencing a monetary obligation) that, when considered in conjunction with the value of any collateral securing such monetary obligation, can reasonably be expected to convert into cash.

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[10] See "*Italian NPL: Market Update and Performance Comparison – 2004*" dated May 24, 2004 published by Fitch, referring to 28 rated Italian NPL securitizations.

[11] A recent example of an NPL-backed ABS transaction is the US$367 million securitization of restructured non-performing loans by Korea Asset Management Corporation (KAMCO) in 2000. Source: *"Korea Asset Funding 2000-1 Limited*" dated August 11, 2000 published by Fitch IBCA, Duff & Phelps and "*Korea Asset Funding 2000-1 Limited Asset Backed Secured Floating Rate Notes Due 2009*" dated August 10, 2000 published by Moody's Investor Service. In addition, many Asian governments have over the past several years put into place new economic reform legislation to resolve the NPL problem in their countries' financial sectors – for example, the Chinese legislation on asset management companies was enacted in 1987 and the Taiwan legislation supporting NPL acquisition by asset management companies was enacted in 2000. As a result, vast pools of NPLs have come to market, both on a public auction and a negotiated sale basis. Virtually all of these NPL pools have to date been purchased by international investment banks and distressed debt funds. As yet, most of these transactions have been warehoused and serviced by the purchasers, but it is foreseen that at some point in the near future (given the large amounts of Asian NPLs in existence), purchasers of NPLs will wish to utilize securitization to sell their exposures to other investors.

[12] Proposal, Section III.A.2.c.

[13] Proposal, Section III.A.2.c.

[14] Proposal, Section III.A.2.a.

[15] Proposal, Section III.A.2.a.

- The Commission's proposed definition of "servicing" supports the above interpretation insofar as "servicing" is proposed to mean not only the mere collection and distribution of cash from the underlying assets, but the entire spectrum of activity typically required of servicers in ABS transactions, including asset maintenance and management.[16] Furthermore, the Commission recognizes that servicing includes functions performed by "special servicers," such as borrower work-outs and foreclosures.[17] Moreover, the special treatment of lease residual values recognizes that a core servicing function may include liquidation of underlying assets. That is, if it is recognized that the residual value of leases must be managed in order to convert into cash, then it would be consistent to also permit management of NPAs for purposes of the definition.

- By excluding NPA-backed ABS from the definition of "asset-backed security," the Proposal neglects the structural features inherent in most ABS transactions. For example, most ABS transactions (including NPA-backed ABS transactions) are structured so as to build in subordination, over-collateralization, liquidity facilities, reserves, external credit enhancement by third parties and other forms of structural enhancement. The existence of such structural enhancements is a key reason for the ability of the transaction parties to statistically analyze and model the payment structure of the ABS, despite the contingent nature of the underlying NPA cash flows.[18] In this manner, the senior tranched ABS (including NPA-backed ABS), after taking into account such structural enhancements as well as the capabilities of the servicer, are expected to yield consistent cash flow. The size of the U.S. distressed loans CDO market also demonstrates that industry participants have reached a level of comfort with respect to the structure of NPA-backed ABS transactions.[19] It is entirely possible, and even likely in many NPA-based securitizations, that senior tranched NPA-backed ABS can obtain an investment grade rating.[20] As stated above, the definition of "asset-backed security" expressly contemplates such structural considerations by the phrase "plus any rights or other assets designed to assure the servicing or timely distribution of proceeds."

The exclusion of NPAs from the definition of "asset-backed security" would formally disqualify NPA-backed ABS from public offerings in the United States. This could also, we believe, adversely affect the private placement of NPA-backed ABS in a number of ways, such as:

- a possible chilling effect on private placements of NPA-backed ABS to investors (including qualified institutional investors) in the United States;

- higher pricing of NPA-backed ABS in U.S. markets compared to non-U.S. markets (which would also, for better or worse, create arbitrage situations);

- the application by default of the traditional disclosure regime for operating companies to NPA-backed ABS, creating the same disclosure dissonance that the Commission's releases, interpretations and "no action" letters have sought to remedy over the past twelve years, when NPA-backed ABS exhibit the same basic characteristics as other ABS and thus the same basic differences from operating company securities;

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[16] Proposal, Section III.B.3.d.

[17] Proposal, Section III.B.3.d.

[18] Each of Moody's, Standard & Poor's and Fitch has published their respective rating methodology relating to NPA-backed ABS transactions. See "*NPL Securitisation and Moody's Rating Methodology – Italian Technology for Export*" dated September 9, 2003 published by Moody's Investors Service; "*Distressed Debt CDOs: Spinning Straw Into Gold*" dated May 7, 2001 published by Standard & Poor's and "*Securitisation of Italian Non-Performing Loans*" dated July 12, 1999 published by Fitch IBCA.

[19] According to Standard & Poor's, New York, the aggregate original closing amounts for all U.S. outstanding rated distressed corporate secured/unsecured loans CDOs as of June 28, 2004 was $4,017,311,711.

[20] For example, in the recent NPA-backed securitization involving Resolution & Collection Corp., Standard & Poor's assigned an "AAA" rating to the ¥9.1 billion class 1 trust certificates. Source: "*Ratings Assigned to ¥14.8 Billion NPL Securitization Involving Resolution & Collection Corp.*" dated June 2, 2004 published by Standard & Poor's.

- the possibility or even likelihood that disclosures for NPA-based ABS will in practice become inconsistent with the disclosure provided in ABS transactions under proposed Regulation AB;

- the disclosure anomalies that would inevitably occur in some ABS transactions when some portion of the originally performing assets become non-performing.

We shall be grateful if the Commission could consider the comments and views expressed above. Should you require any additional information, please do not hesitate to contact Glenn S. Arden in our New York office at (212) 326-7852 or Jeffrey H. Chen in our Hong Kong office at 011 852 3189 7206.

Very truly yours,

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