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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

November 15, 2010

VIA EMAIL (Rule-Comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: Asset-Backed Securities Repurchasing Disclosures and Enforcement of Representations and Warranties, File No. S7-24-10

Dear Ms. Murphy:

The purpose of this letter is to express support for the proposed rule to implement Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) addressing disclosure of repurchasing activity and enforcement of representations and warranties related to the sale of asset-backed securities (ABS). The proposed rule accurately implements the statutory requirements, and will contribute to increasing investor confidence in the ABS market. It would also, however, benefit from some strengthening measures as suggested below.

Background. The financial crisis has its roots in the collapse of the residential mortgage-backed securities (RMBS) market in 2007, and collateralized debt obligation (CDO) market in 2008. In both markets, the credit rating agencies instituted mass downgrades of the ratings assigned to thousands of RMBS and CDO securities, abruptly reducing them from AAA to junk status. Banks, broker-dealers, pension funds, and others were suddenly left with non-investment grade securities laced with poorly performing and defaulting loans. Two years later, the markets for these and other ABS securities remains weak, in large part due to a lack of investor confidence in ABS financial products. Section 943 of the Dodd-Frank Act seeks to restore investor confidence by enhancing disclosure of repurchasing activity and the enforceability of ABS representations and warranties.

Subcommittee Investigation. Over the last two years, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has conducted an extensive investigation and held a series of hearings delving into key causes of the financial crisis. Our first hearing, which featured Washington Mutual Bank (WaMu) as a case study, focused on that bank's origination, acquisition, and securitization of high-risk mortgages due to their relatively higher profit margins. The hearing exposed multiple loan quality and disclosure problems. For example, internal bank reports showed that two high-volume WaMu loan offices had been issuing loans

containing fraudulent borrower and appraisal information; that senior management had been informed that the two offices had loan fraud rates as high as 58% and 83%; that the fraudulent loans were being included in some securitized loan pools; and that investors had not been informed about the fraud problem affecting those loan pools. The hearing also showed that, in one instance, WaMu assembled a $2.3 billion RMBS called WMALT Series 2007-OA3, which included loans that had been selected on the basis of criteria designed to identify loans that were likely to become delinquent, without that selection process being disclosed to investors and despite a representation that no adverse selection process would be used to assemble the loan pool.

A later Subcommittee hearing, which used Goldman Sachs as a case history, focused on a completely different set of loan quality and non-disclosure problems. In that hearing, evidence showed that Goldman Sachs had assembled, underwrote, and marketed certain CDO securities, including Hudson Mezzanine 2006-1, Hudson Mezzanine 2006-2, and Anderson Mezzanine; filled those CDOs with assets that the firm thought were too risky to keep on its books; bet against those assets by taking a short position in the transaction; and then failed to tell the investors about its short position. In another instance, Goldman Sachs enabled a hedge fund seeking to take a short position against a CDO being assembled, Abacus 2007-AC1, to participate in the selection of the referenced assets, without other investors being informed of the hedge fund's role in asset selection.

In each of the loan pools described above, substantial numbers of poor quality loans were included in the securitized pools. When individual loans began defaulting, sometimes within months of a security's issuance, the securitizer sought to compel the loan pool originator to repurchase the defaulted loans. Our hearings released documents showing, for example, extensive efforts by Goldman Sachs to identify loans for repurchasing, submit repurchasing requests, and negotiate levels of cash compensation from WaMu. Those repurchasing efforts often included determining whether particular loans violated any representations or warranties. This type of repurchasing activity affects not only RMBS securities containing the questioned loans, but also CDOs that include or reference those RMBS securities. Repurchasing negotiations and litigation involving billions of dollars in 2006 and 2007 loan pools continue today.

The proposed rule attempts to strengthen both the disclosure of ABS repurchasing activity and the enforceability of ABS representations and warranties.

Repurchasing Disclosures. First, the proposed rule would require securitizers of all types of ABS securities -- not just those registered with the Commission -- to disclose data, both initially and on a monthly basis, regarding the repurchase history of the assets within the ABS pool. The proposed rule would require the data to be displayed in a table in a specified format, grouped according to the ABS issuer and asset originator, in a new Form ABS-15G. The proposed table is an effective tool to present complex repurchasing information in a clear, organized, and consistent format that can then be used, not only to evaluate individual securities, issuers, and originators, but also compare data across firms and the securitization industry. The table format also helps carry out the statutory intent of helping investors to identify ABS originators that use poor underwriting standards or issue poor quality assets.

The proposed rule also faithfully implements the statute by using broad definitions of securitizer and ABS securities, to ensure that the disclosure obligation applies in an even-handed manner to all types of asset classes, including unregistered ABS securities such as CDOs. If unregistered securities were instead exempted from the repurchasing requirement, that exemption would create an unwarranted incentive for issuers to favor unregistered securities.

Another important feature of the proposed rule is that it would require data on both filled and unfilled repurchase requests, whether initiated by trustees or investors. While repurchase requests occur for many reasons and are often unsuccessful, they serve as a useful benchmark by which investors can identify loan pools with potential problems. Those problems could include early payment defaults, incorrect loan information, fraud problems, impermissible adverse selection procedures, or paperwork deficiencies, all of which involve material information that a reasonable investor would want to know. Repurchasing data can also serve as a red flag for analysts, regulators, and policymakers seeking to identify problem areas and possible sources of financial risk. If investor confidence is to be restored and financial risk is to be identified and managed, it is critical for repurchasing information to be provided regarding all repurchase requests, no matter their outcome. In the case of repurchase requests that are unfounded, abandoned, or not approved, securitizers are explicitly permitted to provide additional explanatory information about those requests in footnotes to the table.

Still another key proposal is to include Form ABS-15G, with its repurchasing information, on the Commission's EDGAR database so that it is readily available to all investors and the public. This proposal would ensure that the data is maintained, easy to find, and cost free for investors as well as regulators and policymakers. The proposed rule raises the issue, however, of whether this filing requirement might discourage foreign securitizers from offering ABS securities to U.S. investors to avoid the filing requirement. Restoring investor confidence in the ABS market, however, requires more, not less transparency. Moreover, any exemption fashioned for foreign securitizers or foreign-offered ABS would immediately create a gaping loophole that would place pressure on U.S. securitizers to move their securitization operations offshore. The better course of action is to require foreign securitizers to follow the same rules as U.S. securitizers, to ensure a level playing field and that ABS securities sold in the United States contain key repurchasing information.

Enforcing Representations and Warranties. In addition to carrying out Section 943's requirements on repurchasing disclosures, the proposed rule would require Recognized Statistical Rating Organizations, the official term for credit rating agencies, to include in each rating report on a new ABS security information on the representations and warranties being made by the securitizer, how investors can enforce compliance with those representations and warranties, and how the representations and warranties proffered in the securitization differ from similar ABS securities. These provisions are intended to address the fact that it is currently very difficult to enforce RMBS and CDO representations and warranties and hold securitizers accountable.

While the proposed rule faithfully carries out the requirements of Section 943 on representations and warranties, it might benefit from the addition of clarifying language as to what constitutes "similar" securities, perhaps by articulating a guiding principle, such as enabling

investors, regulators, and policymakers to evaluate comparable securitizers, asset originators, and ABS securities. The rule might also consider establishing or referencing mechanisms to encourage the development and standardization of effective ABS representations and warranties, to increase the ability to make meaningful comparisons among ABS securities and to strengthen investor confidence that promises made to investors can be enforced. Still another improvement would be if the rule were to provide guidance on possible enforcement mechanisms, to encourage securitizers to adopt best practices. Since enforcing representations and warranties remains a weakness in the ABS market and an ongoing source of investor concern, the proposed rule would benefit from addressing the need to develop effective enforcement options.

Conflicts of Interest. Finally, the proposed rule should strengthen its coordination with Section 621's ban on ABS securitizers engaging in material conflicts of interest. For example, the proposed rule could require or encourage development of a new standard representation or warranty that the ABS securitizer has not and will not violate Section 621, and identify private enforcement mechanisms that could be used if a Rule 621 violation is suspected. In addition, the rule could reflect that the repurchasing data may be useful in efforts to detect potential or actual conflicts of interest prohibited by Section 621.

Thank you for the opportunity to comment on this proposed rule.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations