CENTER FOR AUDIT QUALITY
Serving Investors, Public Company Auditors & the Markets

August 2, 2010

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. S7-08-10 Asset-Backed Securities

Dear Ms. Murphy:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA).

The CAQ appreciates the opportunity to respond to the Securities and Exchange Commission's (SEC or Commission) Proposed Rule *Asset-Backed Securities* (the Proposal or the Proposed Rule). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member. Given that a majority of the questions raised in the Proposal pertain to technical topics that are outside the expertise of our member firms, we have not responded to each question in the Proposal. Instead, we have focused on the following aspects of the Proposal that involve accounting, auditing, attestation or financial reporting matters:

- Third Party Opinion Provision in Transaction Agreements
- Accounting Issues Arising with Proposed 5% Risk Retention Mandate
- Servicer Assessment of Compliance with Servicing Criteria
- Financial Information Regarding Parties Obligated to Repurchase Assets

THIRD PARTY OPINION PROVISION IN TRANSACTION AGREEMENTS

The Proposal observes, consistent with our experience in practice, that "Transaction agreements typically have not included specific mechanisms to identify breaches of representations and warranties or to resolve a question as to whether a breach of the representations and warranties has occurred." As a condition for shelf eligibility, the Proposed Rule would require obligated parties to furnish a third party's opinion relating to any asset for which the trustee has asserted a breach of any representation and warranty and for which the asset was not repurchased or replaced by the obligated party. The third party opinion would be based on an assertion that the asset met the representations and warranties contained in the pooling and servicing or other agreement.

The Proposal questions whether a public accountant would be able to provide the proposed opinion under existing attestation standards. If the Commission adopts the third party opinion requirement as proposed, we believe that public accountants would not be precluded by professional standards from rendering the opinion called for, at least in some circumstances. The proposed third party opinion runs to compliance by the party making representations and warranties with the contractual requirements of the pooling and servicing agreement. AICPA Attestation Standards Section AT601, *Compliance Attestation*, provides professional standards for public accountants relative to engagements to examine and report on an entity's compliance with requirements of specified laws, regulations, rules, contracts or grants, and therefore would generally seem to be a suitable standard that could be applied by public accountants.[1] Among other things, these standards would require the public accountant to evaluate whether suitable evaluation criteria and sufficient evidence exist to provide a reasonable basis for conclusion about how specific representations and warranties apply to the assets in question. In our view, the interests of investors would be best served if the third party providing the proposed opinion adheres to recognized professional standards requiring independence, due care, sufficient evidential matter and relevant competence and training in performing the assessment and applying the requisite judgment.

However, we are concerned that the third party opinion requirement, as proposed, will not meet the stated objective to "enhance the protective nature of representations and warranties." It is unlikely that the proposed third party opinion provision would provide an effective or timely method for resolving individual breach claims because it would not bind the parties to accept the third party opinion. While it would require pooling and servicing agreements to call for such an opinion in certain circumstances, the Proposal would not require that those agreements incorporate any particular resolution mechanisms or related remedies. In our view, a better alternative would be to condition shelf eligibility on a requirement that pooling and servicing agreements specifically provide for arbitration or another non-judicial method for resolving disputes and claims. An alternative dispute resolution provision should be both timely and incorporate appropriate due process. Public accountants are not uniquely qualified to conduct arbitration proceedings, but they may be able to assist in valuable ways best left to the parties involved to determine.[2]

[1] Where necessary, the public accountant also may use the work of a legal specialist. See AT §601.43. See also AU §336, *Using the Work of Specialists*, and as an example, the related interpretation AU §9336.

[2] AT §601.03 says "A report issued in accordance with the provisions of this section does not provide a legal determination of an entity's compliance with specific requirements. However, such a report may be useful to legal

ACCOUNTING ISSUES ARISING FROM REQUIRED RISK RETENTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") mandates the adoption of regulations requiring a minimum 5% credit risk retention in all offerings of asset-backed securities. We believe the mandated risk retention could lead to an increase in financial reporting diversity and consequently a reduction in financial statement comparability.

We agree with the Proposal's assertion that "….satisfaction of the [SEC's proposed] risk retention condition would not, by itself, be determinative as to whether a sponsor's variable interests would be a controlling financial interest resulting in consolidation." Consequently, evaluating whether specific circumstances would result in consolidation will continue to require significant judgment. Appreciating this, we seek to understand whether the SEC would agree that an increase in financial reporting diversity is a reasonable and perhaps appropriate result of the Act's risk retention mandate.

In accordance with ASC 810, *Consolidation*, in order to consolidate a securitization vehicle, the sponsor must have both the right to receive benefits and the ability to direct its most significant activities. Currently, outside of multi-seller arrangements, the sponsor commonly retains the ability to direct the most significant activities through its servicing agreement. Further, the sponsor generally retains benefits in various forms, including certain required retained risks. These required retained risks, beyond standard representations and warranties, include but are not limited to:

- Retention of subordinated tranches of the issued beneficial interests, typically ranging from 5-100% of such tranche;
- Servicing arrangements that provide the sponsor market based fees for services, and in some circumstances, subordinated and/or incentive-based fees and other potentially non-market based fees;
- Arrangements to provide liquidity and/or credit backstops to enhance the quality of the issued beneficial interests; and
- Investments in issued beneficial interests by the sponsor's, its affiliates' or related parties' proprietary trading desk

We believe, the effects of the mandatory risk retention would not alter how registrants and auditors evaluate the quantitative aspect of the accounting consolidation evaluation under ASC 810. However, financial statement preparers and auditors could differ on the extent to which they emphasize the qualitative aspects of the risk retention condition. These differences may lead to an increase in financial reporting diversity. Specifically, some registrants and auditors may place relatively more or less weight on the legislative and regulatory motives underlying the retained risk condition. Consequently, when assessing whether such retained risk condition, when aggregated with other interests, represents significant benefits to the sponsor, registrants and auditors may reach differing conclusions in similar fact patterns.

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counsel or other in making such a determination." The report referred to in AT §601.03 could be either an opinion resulting from an examination or a report on agreed-upon procedures, depending upon the particular circumstances.

The accounting and financial reporting implications of the regulations implementing the Act could be better understood and applied more consistently if regulators as a group would conduct formal, and as permitted by law, informal outreach discussions with various originators, sponsors, auditors and financial statement users to identify and assess the various forms of risk commonly retained in asset-backed securitization arrangements. This outreach could help sponsors and other constituents better understand the statutory and regulatory intent of the mandatory risk retention percentages for purposes of influencing sponsor behavior, which might help registrants and auditors more consistently evaluate the significance of the risk retention percentages in consolidation assessments.

SERVICER ASSESSMENT OF COMPLIANCE WITH SERVICING CRITERIA

Expanded Disclosure

The Proposal would (1) expand the disclosures required in Form 10-K about whether there are any identified instances of noncompliance associated with the servicing of assets of the type backing the securities covered by that Form 10-K and (2) require Form 10-K to discuss any steps taken to remedy a material instance of noncompliance. The Commission asks whether these proposed requirements would provide incremental disclosure that would be helpful to investors.

In practice, SEC filings of ABS issuers often voluntarily disclose remedial measures taken to address identified material instances of noncompliance. It is important to note that such disclosures are not subject to any form of assurance in the independent auditor's attestation report. It is also important to note that the voluntary disclosures of remedial measures usually are limited to material instances of noncompliance identified at the servicing platform level. That is, specific instances of noncompliance involving the servicing of the specific assets backing the securities covered by a particular Form 10-K are not currently required to be disclosed, nor are they typically disclosed, unless they represent a material instance of noncompliance at the servicing platform level.

We recommend that the SEC maintain consistency among (1) the platform level at which servicing compliance is asserted by the servicer and attested to by the independent auditor, (2) the assessment of the materiality of instances of noncompliance with servicing criteria, and (3) any required disclosure of remedial actions with respect to identified instances of noncompliance with servicing criteria. That is, the SEC should not require disclosure of instances of noncompliance with servicing criteria unless material at the platform level, even if immaterial instances involve specific assets backing the securities covered by a particular Form 10-K. Moreover, any required disclosure of remedial actions should not extend beyond material instances of noncompliance with servicing criteria identified at the platform level. Accordingly, we recommend that the SEC clarify the scope of the proposed amendments to Item 1122 as discussed in the following paragraph.

The SEC is proposing to amend Item 1122 to require disclosure of “any steps taken to remedy a material instance of noncompliance previously identified by an asserting party for its activities with respect to asset-backed securities transactions taken as a whole involving such party and that are backed by the same asset type backing the asset-backed securities.” We recommend that any final rule make clear that such disclosures are not within the scope of the independent auditor’s attestation report. Further, we recommend that the final rule clarify whether the disclosure of remedial actions applies to (1) all material instances of noncompliance with servicing criteria identified at the platform level (as suggested in the proposing release), or (2) any material instances of noncompliance with servicing criteria identified at the platform level that also involve the same asset type as that backing the respective asset-backed securities (as suggested by the proposed statutory rule text). In any event, such disclosure, whether required or voluntary, would appear to provide potentially helpful information to investors.

Aggregation and Conveyance of Information

The Proposal also would codify an SEC staff interpretation by adding a new servicing criterion to Item 1122 that, "if information obtained in the course of duty is required by any party or parties in the transaction in order to complete their duties under the transaction agreements, the aggregation of such information, as applicable, is mathematically accurate and the information conveyed accurately reflects the information that was obtained." The Commission asked whether timeliness of conveyance of this information also should be included as part of the proposed servicing criterion.

There are likely many servicing practices that involve the aggregation and conveyance of information by one servicer to another who must use the information in the performance of its duties. Adding a separate criterion addressing the accurate aggregation and conveyance of information between servicers that is broadly related to all responsibilities under the transaction agreements may not be cost beneficial, because it may require significant effort to identify and evaluate each instance of aggregation and conveyance in planning and performing the assessment and attestation. For example, the proposal includes a requirement to provide the asset-level information listed in Schedule L in the prospectus at the time of offering and Schedule L-D would provide similar information in ongoing Exchange Act reports. Such information would need to be aggregated by the servicer and conveyed to the party responsible for filing the Schedule L information. We recommend that the Commission's final rule clarify that the independent auditor's report on servicing compliance does not provide assurance on the asset-level data set forth in Schedule L and Schedule L-D and instead, we believe it would be appropriate to focus on the importance of investor reporting and revise the existing criterion in Item 1122(d)(3)(i) as necessary to address aggregation and conveyance. If a new criterion is added, such as the proposed Item 1122(d)(1)(v), we believe the Commission should limit the scope of the proposed criterion to activities affecting investor reporting rather than all responsibilities under the transaction agreement. Under this more narrow focus of an aggregation and conveyance servicing criterion, we would support including the aspect of timeliness of conveyance, because timeliness could affect the accuracy and completeness of reports to investors.

Codification of Staff Interpretations

The Proposal also would codify SEC staff interpretations relating to the platform determination by adding an instruction to Item 1122. We agree that the proposed codification would provide clarity to servicers and independent auditors about platform determination. The Commission asks whether the proposed instruction reflects current servicer practices and whether servicers conduct servicing in any ways different than what is contemplated in the instruction. We are not aware of divergence between the proposed instruction and current servicer practices.

Unregistered offerings

The Commission has proposed, that as a condition of Rule 144A, transaction agreements require an issuer of structured finance products to provide to investors promptly, upon the investors' request, (1) information that would be required if the offering were registered on Forms S-1 or SF-1, and (2) any ongoing information regarding the securities that would be required if the issuer were required to file reports under Section 15(d) of the Exchange Act. The Commission should clarify whether such information would extend to the independent auditor's attestation report regarding servicing compliance required by Item 1122, and if so, how timely the reports must be provided following an investor's request. In other words, would an issuer need to engage an independent auditor to perform attestation services in contemplation of a request. We also note that the existing Item 1122 servicing criteria contemplate the types of assets underlying most registered offerings of asset-backed securities (e.g., mortgages, auto loans, credit cards) and may not apply in all cases to the types of assets underlying many unregistered offerings of asset-backed securities (which include CDOs, CLOs and Auction Rate Securities, among other asset types). Accordingly, it is reasonable to expect a variety of implementation questions to arise if the Item 1122 servicing criteria are applied to additional types of assets included in unregistered offerings of asset-backed securities.

Other Matters

In addition to the Commission's specific request for comment on servicer assessment of compliance with servicing criteria, we believe the Commission should clarify the existing servicing criterion in Item 1122(d)(4)(v), which states, "The servicer's records regarding the pool assets agree with the servicer's records with respect to an obligor's unpaid principal balance." The Commission should revise this criterion to clarify that the servicer's records should agree to the <u>obligor's</u> records, which would help achieve consistency in the assessment of compliance with this criterion. Such an update might consider USAP procedure, V.1, after which the Item 1122(d)(4)(v) criterion was modeled, which states, "The servicing entity's mortgage loan records shall agree with, or reconcile to, the records of mortgagors with respect to the unpaid principal balance on a monthly basis."

The Proposal would revise Item 1111 to require a description of any provisions in the transaction agreements governing the modification of the terms of any asset and disclosure regarding how such asset modifications might affect cash flows from the assets or to the securities. Historically, many transaction agreements have been unclear as to what types of modifications, if any, are permitted, and how asset modifications should be made, reviewed and approved. Often, the provisions in the transaction agreements governing loan modifications have been vague and open to interpretation, and in some cases simply defer to the servicer's internal policies and procedures. We support requiring clear and specific disclosure of the transaction agreement provisions governing asset modifications. In our view, such disclosure would promote more specificity within transaction agreements and provide greater clarity for auditors, servicers, and others responsible for assessing compliance with Item 1122(d)(4)(vi) loan modification criterion. In addition, the proposed revision would appear to provide potentially useful information for investors. For example, investors may feel differently about investing in a transaction that permits modifications under government sponsored programs such as Home Affordable Modification Program, as compared to a transaction that permits modifications under the servicer's own proprietary programs.

FINANCIAL INFORMATION REGARDING PARTIES OBLIGATED TO REPURCHASE ASSETS

As proposed, Item 1104 and Item 1110(b) would be amended to require, in certain circumstances, information on the "financial condition" of sponsors or 20% originators that are obligated to repurchase or replace any pool asset for a breach of a representation and warranty in the transaction agreements. Under the Proposal, information regarding the financial condition of a 20% originator would be required "to the extent there is a material risk that the financial condition could have a material impact on the originator's assets in the pool or on its ability to comply with provisions relating to the repurchase obligations for those assets." Similarly, information regarding the sponsor's financial condition would be required "to the extent that there is a material risk that the financial condition could have a material impact on its ability to comply with the provisions relating to the repurchase obligations for those assets or otherwise materially impact the pool."

As demonstrated by the recent high loss rates in many securitized asset pools, repurchase provisions are often very important to the overall performance of an asset-backed security. Accordingly, we support the SEC's overall objective of improving disclosure about material risks associated with repurchase obligations.

The Commission asked whether the definition of significant obligor in Item 1112 should be expanded to incorporate the obligated party that is required to repurchase assets for breach of a representation or warranty, rather than adding the proposed disclosure requirements to Item 1104 and Item 1110. Transaction documents may contain unique and complex repurchase terms and conditions that result in varying obligations among multiple parties, not just the sponsor and originator(s). To ensure that all repurchase obligors fall within the scope of enhanced disclosures about their financial wherewithal, we believe the definition of significant obligor in Item 1112 should be expanded. Alternatively, the scope of Item 1114 could be expanded to include repurchase and replacement obligations. In any event, the threshold and basis for disclosing financial information about repurchase obligors should be applied consistently and should be based on the existing provisions of Item 1112 with respect to significant obligors or Item 1114 with respect to significant credit enhancements. That is, by expanding the scope of Item 1112 or Item 1114 to include any party with a potential asset repurchase or replacement obligation, the required financial information would be (1) the selected financial data specified by Item 301 of Regulation S-K when the obligation exceeds 10% of the asset pool, and (2) audited financial statements that comply with Regulation S-X when the obligation exceeds 20% of the asset pool. Unlike the proposed amendments to Item 1104 and Item 1110(b) that would require a subjective evaluation of the materiality of the risk, expanding the scope of Item 1112 or Item 1114 to include repurchase obligors would provide an objective standard for determining when and how the requisite financial disclosure should be provided.

In many cases, the obligation to repurchase or replace assets rests with the originator, which may be a subsidiary that does not prepare separate financial statements or obtain an audit. In appropriate circumstances, we recommend that the Commission accept alternative methods of providing the requisite financial information. If the obligation to repurchase or replace assets is fully and unconditionally guaranteed by a parent, the audited financial statements of the consolidated parent should be accepted in lieu of those of the obligor. Otherwise, in lieu of the separate audited financial statements of a subsidiary obligor, the Commission should accept audited financial statements that include the obligor (and any affiliate guarantors) on a consolidated basis, provided those financial statements include condensed consolidating financial information that includes a separate column for the subsidiary obligor (and any subsidiary guarantor(s)).

The request for comment in the Proposed Rule also asks if there are other situations where financial information should be required (e.g., all servicers and all sponsors) and whether that information should be audited financial statements**.** We believe that the framework discussed above would provide investors with financial statements in those circumstances in which the investor's cash flows potentially depend, to a significant degree, on the financial wherewithal of underlying obligors (Item 1112), credit enhancers (Item 1114) and parties with an asset repurchase/replacement obligation (amended Item 1114, as we have suggested). In the absence of an indirect financial obligation regarding the securitized assets, there does not appear to be a need for additional financial information, in the form of audited financial statements or otherwise. That is, if a sponsor does not provide any credit enhancement and is not obligated to potentially repurchase or replace assets, there is no obvious utility to ABS investors from receiving financial information about the sponsor. Further, given that there are numerous parties in the marketplace that could assume servicing functions in the event of the incapacity of one or more servicers, it is unclear that providing additional financial information about servicers would be useful or cost beneficial.

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We appreciate the opportunity to comment on the Proposal and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,

Cynthia M. Fornelli

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

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