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

Re: **Request for Public Comments on SEC Regulatory Initiatives Under the Dodd-Frank Act**

Title VI - Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions
Section 621 Conflicts of Interest

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities and the Committee on Securitization and Structured Finance (the "Committees") of the Section of Business Law of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission (the "Commission") in connection with the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") that permit or require the Commission to undertake various initiatives, including rulemaking and studies touching on many areas of financial regulation.

The comments expressed in this letter represent the view of the Committees only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law.

The Committees thank the Commission for this opportunity to comment on the initiatives the Commission is required or permitted to undertake in connection with the Dodd-Frank Act. In accordance with the Commission's efforts to organize the submission of comments relating to each major initiative under the Dodd-Frank Act, the Committees will be submitting a number of comment letters, each addressing one of the major initiatives as identified by the Commission. This letter will comment on certain provisions relating to Conflicts of Interest set forth in Section 621 of Title VI of the Dodd-Frank Act.

Background

Section 621 of the Dodd-Frank Act requires the Commission, within 270 days of enactment (i.e., by April 17, 2011), to issue rules implementing new Section 27B of the Securities Act of 1933, entitled Conflicts of Interest Relating to Certain Securitizations. Section 27B provides that an underwriter, placement agent, initial purchaser[1], or sponsor, or any affiliate of any such entity, of an asset-backed security ("ABS") shall not, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the ABS, engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity.

The legislative history of Section 621 (156 Cong Rec S 5899-5901) states clearly that the intent of the Section was to address "blatant conflicts of interest" in which an underwriter or sponsor creates an ABS that is "designed to fail" and then profits by betting against it, by means of short sales or otherwise. In their joint letter dated August 3, 2010 to the Commission and other regulatory agencies, Senators Merkley and Levin, the two Senators principally responsible for the drafting of Section 621 of the Dodd-Frank Act, confirm this intent. The legislative history further provides that changes in market conditions "may lead an underwriter to wish to sell the securities it holds. That is also not likely to pose a conflict." Although the legislative history indicates a focused intent, the language of Section 621 is significantly broader. We believe rules implementing this provision should give appropriate weight to Congressional intent while permitting a broad range of common activities that are essential to the functioning of the securitization markets.

In our view, in connection with the rulemaking required by Section 621, the Commission should consider the following:

1. Ordinary course business transactions do not involve the types of material conflicts contemplated by Congress and should be permitted under the rules.

In reviewing both the statutory language and the legislative history, we believe the focus of the rulemaking should be on the following types of conflicts:

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[1] For ease of reference, the underwriter, placement agent and initial purchaser of an ABS transaction are referred to collectively in this letter as "identified parties."

a. ABS transactions in which the adverse performance of the pool assets would directly benefit an identified party or sponsor (or any affiliate of any such entity) of the applicable ABS transaction;

b. ABS transactions in which a loss of principal, monetary default or early amortization event on the ABS would directly benefit an identified party or sponsor (or any affiliate); and

c. ABS transactions in which an insolvency event related to the issuing entity of the ABS would directly benefit an identified party or sponsor (or any affiliate).

The implied conflicts in most ordinary course transactions involving underwriters, placement agents, initial purchasers and sponsors of ABS (and their affiliates) do not have these characteristics, and indeed, these transaction parties generally have a strong interest in the positive performance of the assets and the transaction.

The relationship between an ABS sponsor and ABS investors is inherently conflicted, in that the ABS sponsor is seeking funding and the ABS investors are providing that funding on negotiated terms. Pool selection also may involve conflicts, as has been discussed in connection with new risk retention requirements, and as discussed below, risk retention itself may create conflicts with some classes of investors. We believe that conflicts of this type, relating to the terms and nature of the security, exist in any ABS transaction and cannot be eliminated.

Similarly, many potential conflicts of interest are an unavoidable byproduct of the securitization process or arise from transaction features that on the whole are beneficial to investors. For example, subordinate tranches act as credit enhancement for the more senior tranches and are frequently required by the rating agencies and/or investors. The sponsor may not be able to sell these tranches to third-party investors because of the high interest rate that would be demanded by investors and its adverse effect on the transaction economics. Therefore, subordinate tranches are often retained by the sponsor or one of its affiliates.[2] In a default situation, senior holders may be willing to accept any sale of assets that repays them in full without regard to the effect on subordinate tranches, and subordinate holders facing a potential shortfall may resist sales that could realize losses, creating significant conflicts—but these conflicts arise only at the time a deal has started to fail, and will arise without regard to the identities of the senior and subordinate holders.

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[2] Moreover, Section 941 of the Dodd-Frank Act requires sponsors to retain a portion of the credit risk of the ABS they create in order to better align the interests of ABS sponsors and investors. Likewise, the recently issued FDIC Securitization Rule (12 C.F.R. §360.6) and the proposed amendment of Regulation AB issued by the Commission impose risk retention on certain types of securitizations. We appreciate that the appropriate form of such risk retention has not yet been determined and that the form of retention may attempt to mitigate these potential conflicts.

Another example is servicing. For many classes of ABS, the sponsor or one of its affiliates acts as servicer of the underlying assets. Indeed, the strength of the affiliated servicer may be one of the aspects of the transaction that makes it most attractive to investors. For many types of assets (and particularly for revolving assets), it is advantageous for servicing to be performed by the originator (or an affiliate) because the originator has continuing relationships with the obligors of the securitized assets, the originator has an established track record with regard to its servicing capabilities, and implementing a change in servicer would be both expensive and disruptive to the customer base and the collection process. Nonetheless, although the servicer is obligated to service the assets in accordance with standards set forth in the servicing contract, there are discretionary elements in dealing with delinquent assets (e.g., whether and to what extent to modify an obligation or to foreclose on underlying collateral) that may result in conflicts between the servicer and investors.

A conflict may also exist where the sponsor or its affiliates originate or acquire second lien loans on mortgaged properties included in a prior first lien securitization. Restricting the sponsor from arranging such loans, however, may eliminate an important source of credit for the homeowner. Moreover, the holder of the second lien asset has a strong interest in the performance of the first lien asset.

Other examples include: (a) loans by an identified party to an ABS sponsor or issuer (including a warehouse loan to be repaid in whole or in part from the proceeds of an ABS issuance), (b) loans by an identified party to servicers or credit enhancers of an ABS, (c) loans by an identified party to an investor secured by ABS (e.g., an investor margin account or repo facility), or (d) sales by an identified party of ABS which it originally placed or sales of other debt or equity securities of an ABS issuer or of debt of an entity included in a CDO or CLO. In the case of loans included in the foregoing examples, the exercise of remedies upon a default could trigger cross-defaults with other credit facilities or could financially weaken the sponsor, servicer or credit enhancer in a way that would impact ABS investors. A loan default could also lead to the sale of collateral, which could include the ABS or other securities of the issuer, thereby affecting the market value of the ABS.

In view of the many potential conflicts of interest that may arise between participants and investors in an ABS (the examples set out in the preceding paragraphs above should by no means be regarded as comprehensive), and in view of the legislative history and the statutory use of the term “material conflict of interest,” we believe the rules issued by the Commission should focus on prohibiting the type of blatant conflict of interest described in the legislative history, while permitting other types of conflicts to exist subject to appropriate disclosure requirements. A rule which had the potential to include ordinary course activities of the type set out in the preceding paragraphs, or which was unclear in its application to such activities, would likely deter new ABS issuance.

Potential conflicts of the type described above that either exist, or are contemplated, at the time of an ABS transaction are customarily disclosed in the offering materials. Although the legislative history is clear that disclosure is not necessarily a cure for a conflict of interest arising out of profiting from a “designed to fail” transaction, we believe adequate disclosure should suffice to address these ordinary course conflicts.

2. The rules should clarify that the prohibition on material conflicts of interest does not extend to transactions unrelated to the relevant ABS transaction.

The language of Section 27B, referring to a “material conflict of interest with respect to any investor in a transaction arising out of such activity”, creates some ambiguity as to whether the phrase “arising out of such activity” is intended to identify the investor, or the context in which the potential conflict may arise. Underwriters, placement agents, initial purchasers and sponsors, or their affiliates, may have a variety of relationships with investors who purchase ABS from or through them. We believe the better reading of Section 27B is that the conflict of interest shall not arise in the context of the transaction with respect to which the investor acquired the ABS. This construction would help to assure the integrity of ABS offerings, while not imposing unreasonable restrictions on the overall relationships between the identified parties and sponsors, on the one hand, and ABS investors, on the other.

3. The rules should permit underwriters to sell unsold allotments.

Section 27B(c)(2) provides exceptions for purchases or sales of ABS pursuant to commitments to provide liquidity for the ABS or bona fide market-making in the ABS. Dispositions of unsold allotments by an underwriter or placement agent are similar to these customary activities, but are not explicitly addressed in the statutory wording. We believe the Commission should clarify in its rules that dispositions of unsold allotments are not transactions that would involve or result in a material conflict of interest with investors.

4. The rules should consider the effect of existing regulations and duties that may conflict with, or complicate compliance by, affiliates of sponsors

Section 27B applies to all affiliates of underwriters and placement agents, which could include banks, broker-dealers, asset managers and ERISA fiduciaries. Banks and their affiliates are already subject to statutory and regulatory provisions designed to prevent conflicts of interest and prevent the use of material nonpublic information, and these provisions may require the establishment of information walls between affiliated entities or between different departments of a bank. Additionally, entities which are fiduciaries are obligated to act for the benefit of their beneficiaries and must be permitted to sell securities and enforce loans based on the best interests of the beneficiaries. Underwriters and placement agents subject to Section 27B may have a large number of affiliates, which may result in significant administrative difficulties in applying the rule to all related entities. We ask the Commission to be mindful, when preparing its rules, of these existing obligations of transaction parties and their affiliates and of the compliance burdens which may result.

5. The rules should define “initial purchaser”.

Section 27B uses the term “initial purchaser,” which is not currently defined in the Securities Act of 1933. The term is often used in connection with Rule 144A transactions in which one or more broker-dealers buy the entire offering with the intention of reselling immediately to qualified institutional buyers under Rule 144A. Since the term “initial purchaser” could be confused with an initial investor in the ABS, we ask the Commission to clarify that the term “initial purchaser” as used in Section 27B refers to a broker-dealer functioning in a role equivalent to that of an underwriter or placement agent in a Rule 144A transaction.

6. The rules should define “sponsor”.

Section 27B also uses the term “sponsor”, which is not currently defined in the Securities Act of 1933. However, the term “sponsor” has been defined in Regulation AB, and the definition there is virtually identical to clause (B) of the definition of “securitizer” that is added to the Securities Exchange Act of 1934 by virtue of Section 941 of the Dodd-Frank Act. We recommend that the Commission utilize the definition of “sponsor” in Regulation AB for purposes of Section 27B.

Although beyond the scope of this letter, we note that many of the ordinary course activities described in this letter may also implicate the Volcker rule, especially for securitization transactions involving vehicles that rely on the exemptions from the Investment Company Act of 1940, as amended, provided by Section 3(c)(1) and Section 3(c)(7) thereof. Risk retention provisions for securitizations and implementation of the Volcker rule will also need to be coordinated. We appreciate that concurrent or staggered regulation across a broad range of areas is necessary to comply with Congressional mandates under the Dodd-Frank Act, but we ask that the Commission, to the extent possible, consider the overlapping nature and interplay of these different provisions in adopting rules under Section 621.

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Once again, the Committees appreciate the opportunity to submit these comments. Members of the Committees are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

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