May 2, 2023

VIA ELECTRONIC SUBMISSION

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Prohibition Against Conflicts of Interest in Certain Securitizations (SEC Release No. 33-11151; File No. S7-01-23; RIN 3235-AL04)

Dear Ms. Countryman:

The LSTA[1] appreciates the opportunity to comment on the reproposed Rule 192, Prohibition Against Conflicts of Interest in Certain Securitizations (the "Proposed Rule"), issued under Section 27B of the Securities Act of 1933, as added by Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] As we noted in our previous comment letter dated March 27, 2023,[3] because of the short time frame offered by the Securities and Exchange Commission (the "Commission") to comment on the Proposed Rule, the LSTA intends to submit three separate comment letters; this is the second of those letters.[4]

I. Introduction

In our first letter we addressed the potentially vast negative implications of the application of the Proposed Rule to collateralized loan obligations ("CLOs") and the corporate loan markets that underlie them. In this letter, we focus on the securitization market more broadly. In this letter, we adopt, echo and support the findings and recommendations included in the comment letter dated March 27, 2023 submitted by the Securities Industry and Financial Markets Association ("SIFMA"), the Asset Management Group of SIFMA ("SIFMA AMG") and the Bank Policy Institute ("BPI"; SIFMA, SIFMA AMG and BPI being collectively referred to as the "Associations") (the "SIFMA Letter").[5]

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[1] The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trade of commercial loans. The 580+ members of the LSTA include commercial banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers, and other institutional lenders, as well as law firms, service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty. For more information, visit www.lsta.org.

[2] As published with commentary in the Federal Register, *Prohibitions against Conflicts of Interest in Certain Securitizations*, Release No. 33-11151, 88 Fed. Reg. 9678 (Feb. 14, 2023) ("Proposing Release").

[3] *See* Letter submitted to the Commission by LSTA, available at https://www.sec.gov/comments/s7-01-23/s70123-20161797-330673.pdf ("LSTA Letter 1").

[4] A final letter will focus on CLOs and corporate loans, explaining in detail the specific challenges the Proposed Rule poses for them and how some of the solutions proposed for securitizations generally might need to be refined to work for CLOs.

[5] *See* SIFMA Letter, available at https://www.sec.gov/comments/s7-01-23/s70123-20161806-330705.pdf.

366 Madison Avenue, 15th Fl., New York, NY 10017
Tel: 212-880-3000 Fax: 212-880-3040 www.lsta.org

As a starting point, we agree with the Associations' Executive Summary, including the proposition that the Proposed Rule is significantly flawed and should not be adopted, and that the Commission should propose a revised, more tailored rule under Section 27B.[6] The Proposed Rule is vague and overly broad, goes far beyond the mandate of Section 27B, and does not consider the vast changes that have taken place in the securitization market since the Dodd-Frank Act became law over 12 years ago. We also observe that the Commission ignores and fails to honor many of its own most basic, long-held interpretations and applications of fundamental securities law principles such as (1) the efficacy of disclosure and consent and information barriers and (2) the meaning of material conflict of interest. In the balance of this letter, we will address a number of the more critical issues raised by the Associations that would impact the securitization market generally and, in some cases, would be especially challenging for CLOs and the loan market.

II. *The Proposed Rule's Definition of "Securitization Participant" Should Be Narrowed and Clarified.*

The LSTA agrees with the views expressed by the Associations in Part V of the SIFMA Letter.[7] The Proposed Rule's extremely broad definition of "securitization participant" is particularly challenging for CLOs because many of the legal entities that participate in that market are affiliated with, or subsidiaries of, many other entities (including international affiliates and subsidiaries) that play no substantive role in (i) structuring, creating, marketing, or selling CLOs, (ii) structuring, creating, marketing, or selling the underlying leverage loans or high yield bond assets of a CLO or (iii) selecting (initially or during the reinvestment period for CLOs) the assets backing the asset-backed securities. In addition, they frequently have business units within them that are not involved with the CLO business. These "non-participating entities" are nevertheless caught up under the Proposed Rule. Moreover, when coupled with the Proposed Rule's puzzling prohibition of reliance on classic information barriers, the definition of "securitization participant" as applied to non-participating entities is unworkable. Similarly, investment advisers and their advisory clients should not be considered securitization participants simply due to an affiliation with an underwriter, placement agent, initial purchaser or sponsor.

We agree with the Associations that "a transaction entered into by a non-participating entity on its own, and without coordination with the underwriter, placement agent, initial purchaser or sponsor, does not give rise to a material conflict of interest with investors."[8] In the CLO market as in other securitization markets, these types of transactions do not implicate any securities law duties relating to the structuring, creation, marketing or selling of a CLO.

We strongly support the Associations' proposal that the Commission re-propose a rule under which information barriers are one of several methods that may be used to establish and demonstrate the separateness of non-participating entities and securitization participants. As the Associations note, the Commission has long recognized the efficacy and importance of information barriers to manage the potential misuse of material non-public information ("MNPI"), among the most significant of all securities law concerns.[9] Indeed, robust information barriers are ubiquitous in the loan and CLO markets and have proven to be effective in a market that routinely deals with confidential, private information, including, often, MNPI.[10] It is unclear why the Commission would take the position in the Proposed Rule that

[6] *See id.* at 3.
[7] *See id*. at 28-37.
[8] *See id*. at 28.
[9] *See id*. at 33.
[10] *See* "LSTA Statement of Principles for the Communication of Confidential Information by Loan Market Participants," available at https://www.lsta.org/content/lsta-confidentiality-principles-3/.

information barriers are insufficient to prevent conflicted transactions and why it would propose five unnecessary conditions for the use of information barriers. As the Associations further explain, requiring large institutions to establish custom-made information barriers for them to be recognized under the Proposed Rule would be "needlessly prescriptive and burdensome, and would compromise rather than facilitate compliance due to the confusion inherent in maintaining different sets of inconsistent, intersecting and conflicting information barriers."[11] Rather, any rule under Section 27B should create a set of standards to demonstrate and ensure that a securitization participant, on the one hand, and its related nonparticipating entities, on the other hand, "are in fact acting separately and that such securitization participant is not indirectly engaging in a prohibited transaction through, and in coordination with, a related non-participating entity."[12]

III. ***The Proposed Rule's Definition of "Conflicted Transaction" Should Be Narrowed and Clarified.***

The LSTA agrees with the Associations that (a) the Proposed Rule's definition of "conflict of interest" does not reflect the ordinary and natural meaning of that term; (b) the "catchall" provision of the definition of "conflicted transaction" is much too broad and does not describe transactions that create material conflicts of interest; (c) pre-securitization transactions should be expressly carved out of the definition of "conflicted transaction"; and (d) while a short sale of ABS by a securitization participant may create a conflict of interest between that securitization participant and investors, a short position in an index that references the ABS should be expressly carved out of the definition of "conflicted transaction."[13]

The definition of "conflicted transaction" in the Proposed Rule is unworkable, particularly as applied to CLOs, whose assets comprise loans that are traded and managed individually. The ordinary and natural meaning of "conflict of interest" is a conflict between one's duty and one's own self-interest. The Proposed Rule, however, employs the term "conflicted transactions" and ignores the statutory language of Section 27B, which directs the Commission to issue rules prohibiting "any transaction that would involve or result in any *material conflict of interest* with respect to any investor."[14] The term "conflicted transaction" is far broader and encompassing than "conflict of interest" and, consequently, the Proposed Rule captures transactions that do not conflict with the duties that securitization participants have under the securities laws.

Perhaps the most concerning part of the Proposed Rule, for all asset backed securities ("ABS") and especially for CLOs, is the "catchall" provision[15] of the definition of "conflicted transaction."[16] We agree with the Associations that the catchall provision is "vague and unworkable on its face."[17] We also agree

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[11] *See* SIFMA Letter at 35.

[12] *See id*.

[13] *See* Part VI of the SIFMA Letter, at 38-50. Similarly, we believe that a short sale of an index that includes assets that may be included in an ABS should likewise be expressly carved out of the definition of "conflicted transaction."

[14] 15 U.S.C. § 77z-2a(a).

[15] *See* clause (a)(3)(iii) of the Proposed Rule. Under the catchall, a conflicted transaction would include the following to the extent a reasonable investor would consider the transaction "important": "The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction through which the securitization participant would benefit from the actual, anticipated or potential: (A) Adverse performance of the asset pool supporting or referenced by the relevant asset-backed security; (B) Loss of principal, monetary default, or early amortization event on the relevant asset-backed security; or (C) Decline in the market value of the relevant asset-backed security."

[16] *See* Section III.A of LSTA Letter 1 for a brief listing of some of the legitimate loan market-related transactions that could be captured in the Proposed Rule because of the catchall clause. In our third letter, we intend to expand the list and explain in more detail the many types of legitimate and often unrelated loan market transactions that might get captured by the Proposed Rule because of the expansive catchall clause.

[17] *See* SIFMA Letter at 42.

that the catchall provision is entirely unnecessary since the first two prongs of the definition of "conflicted transaction" adequately capture actual and synthetic short sales of ABS.[18] If the Commission nevertheless decides to include a catchall provision in the final rule, we agree with the Associations that a more appropriate catchall would, among other things, "provide that such conflicted transactions must be the functional trading equivalent of a short sale, or synthetic short, of the relevant asset-backed security (essentially, a plan or scheme to evade the prohibitions covered by clauses (a)(3)(i) and (a)(3)(ii))" and "scope out taking a short position in a portion of the assets underlying or referencing an asset-backed security."[19] These two points are especially critical for CLOs given that the underlying assets in CLOs are loans that are routinely traded and managed individually and that, in the absence of such a clarification, countless legitimate, everyday transactions could be captured under the definition of "conflicted transaction."[20]

The Associations propose that pre-securitization transactions for all ABS should be expressly carved out.[21] The LSTA agrees and notes that the origination of a CLO entails many pre-securitization transactions while it is in the pipeline stage and as it "ramps up" its assets. These transactions include hedging, financing and trading.[22]

The LSTA also supports the Associations' position that a "short position in an index that references the ABS should be expressly carved out of the definition of 'conflicted transaction.'"[23] Our third letter will detail what form we believe this carveout should take for the CLO and corporate loan market.

IV. ***The Proposed Rule Should Permit Disclosure as a Means of Addressing Material Conflicts of Interest.***

The LSTA agrees with the Associations' position that under the securities laws, disclosure is the fundamental approach for addressing the risks faced by investors and that should be no different under the Proposed Rule.[24]

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[18] *See id*. at 43.

[19] *See id*.

[20] The LSTA also strongly supports the Associations' position that any catchall in a final rule should also:

- use a "materially adverse" standard (which is a prohibition standard) rather than a "reasonable investor" standard (which is a disclosure standard);
- clarify that transactions intrinsic to the creation of the asset-backed security are not "conflicted transactions"; and
- contain a knowledge qualifier that the securitization participant knows, or reasonably should have known, that it will achieve a net benefit contingent upon the adverse performance of the relevant asset-backed security. *See id.*

[21] *See* SIFMA Letter at 48-49. The Associations believe that the following transactions should be expressly carved out of the definition of "conflicted transaction":

- "*Pre-securitization hedging transactions.* Any interest rate hedge, credit hedge, index hedge, TBA market hedge or other hedge with respect to all or any portion of the pool of assets underlying an asset-backed security entered into prior to the related inclusion date for such assets and terminating with respect to the pool of assets or portion thereof on or prior to the related inclusion date for such assets;
- *Pre-securitization financing transactions.* Any financing (including warehouse financing, repo financing or other form of financing) of all or any portion of the pool of assets underlying the asset-backed security entered into prior to the related inclusion date for such assets and terminating with respect to the pool of assets or portion thereof on or prior to the related inclusion date for such assets;
- *Pre-securitization transfers.* Any purchase, sale, assignment, contribution or other transfer of all or any portion of the pool of assets underlying the asset-backed security prior to the related inclusion date for such assets; and
- *Other pre-securitization transactions.* Any other transaction relating to all or a portion of the pool of assets underlying the asset-backed security that concludes on or prior to the related inclusion date for such assets." *Id*. at 49.

[22] The LSTA will identify and describe these types of pipeline and ramp up transactions in detail in our third letter.

[23] *See* SIFMA Letter at 49.

[24] *See* Part VII of SIFMA Letter, at 51-54.

It is unclear why the Commission fails to provide for a disclosure alternative to a prohibition of material conflicts of interest in the Proposed Rule when the securities laws prescribe such an alternative in almost all other cases. As the Associations note, "our securities laws prescribe disclosure as the means of protecting investors against nearly every risk they face."[25] In the proposing release the Commission asked how a disclosure exception could be structured so that the resulting disclosure would not contain "vague boilerplate language." The LSTA agrees with the Associations' response[26] to that question: "[T]he Volcker Rule provides a suitable template to address that concern. Unlike the Proposed Rule, the Volcker Rule specifically contemplates disclosure as a means of addressing conflicts of interest:

> '(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity: (i) Timely and effective disclosure. (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and (B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest.'"[27]

The LSTA believes that any such disclosure can be with respect to a specific transaction or a class or type of transactions. If the disclosure is provided with respect to a class or type of transaction, disclosure should not be required with respect to specific transactions that fall within such class or type of transaction as long as the prior disclosure meets the standards set forth above.

As it does in almost every other context, we urge the SEC to recognize disclosure and consent as a viable alternative to the Proposed Rule. At a minimum, even if the Commission does not provide a general disclosure alternative, it should provide a disclosure alternative with respect to any catchall category of conflicted transactions.

V. ***The Definition of "Sponsor" Should Be Consistent With its Ordinary and Plain Meaning, and Not Include Investors, Credit Rating Agencies and Third-Party Service Providers.***

The LSTA agrees with the Associations that the definition of "sponsor" in the context of asset-backed securitization has an ordinary and natural meaning.[28] It is "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."[29] We agree also that clause (ii) of the definition[30] in the Proposed Rule extends far beyond its ordinary and natural meaning[31] and that it is so wide-ranging that it threatens to

[25] *See* SIFMA Letter at 51.
[26] *See id.* at 52.
[27] *See id.* (quoting 17 C.F.R. § 255.7(b)(2)(i) (2023)).
[28] *See* SIFMA Letter at 15.
[29] *Id.* (quoting Regulation AB and Regulation RR, respectively, at 17 C.F.R. § 229.1101(l) (2023) and 17 C.F.R. § 246.2 (2023)).
[30] Clause (ii) of the definition of "sponsor" in the Proposed Rule captures "Any person: (A) with a contractual right to direct or cause the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security; or (B) that directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security." Proposing Release, at 9727. Recognizing the broad sweep of the foregoing, paragraph (C) of clause (ii) provides that "Notwithstanding paragraphs (ii)(A) and (ii)(B) of this definition, a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security will not be a sponsor for purposes of this rule." *Id.*
[31] *See* SIFMA Letter at 15-18.

capture many entities that are not involved in the organization and initiation of an ABS—even, incredibly, investors.

At a minimum, credit rating agencies, investors in a long position in ABS, and third-party service providers, none of whom are involved in the organization or initiation of a securitization transaction, should be excluded from the definition of "sponsor." This issue is very important to the CLO market, where credit rating agencies and third-party service providers are not involved in the organization or initiation of CLOs, but play important roles in the credit assessment or ongoing administration of CLOs for the benefit of all transaction parties and market participants. As fee-based service providers, they have nothing to gain from a failed securitization transaction. While investors (which are always "long-only" investors) may specify preferences regarding the composition of the underlying assets or the structure, features and design of the CLO, the selection of assets is always the responsibility of the CLO's collateral manager. For the purposes of certainty and clarity, the SEC should expressly exclude these parties from the definition of "sponsor."

VI. ***The Beginning of the Compliance Period Should Be Clarified and More Closely Linked to the Date of the First Sale*.**

The LSTA agrees with the Associations that the compliance period for the Proposed Rule cannot begin with respect to an entity until it becomes an entity that is described in Section 27B—namely, an underwriter, placement agent, initial purchaser or sponsor.[32] In no event should the compliance period begin more than 30 days prior to the date of the first closing of the sale of the related asset-backed securities. Finally, the Proposed Rule's "substantial steps" standard is so vague that it fails to put market participants on notice that they are within the Proposed Rule's scope. In the CLO market, as in all other securitization markets, there is currently no ambiguity with respect to when an entity becomes an underwriter, placement agent, initial purchaser or sponsor. The Proposed Rule's vague "substantial steps" standard adds ambiguity and uncertainty where none currently exists. Even where it is clear when an entity becomes an underwriter, placement agent, initial purchaser or sponsor, the further removed a transaction is from the time the CLO exists, the more difficult it will be to assess whether it is a conflicted transaction. Thus, the compliance period should not begin more than 30 days prior to the date of the first closing of the sale of the ABS.[33]

VII. ***The Anti-Circumvention Provision Should Be Removed and Replaced with an Anti-Evasion Provision That Applies to the Exceptions and Safe Harbors*.**

The LSTA agrees with the Associations that the anti-circumvention provision should be removed and replaced with a more limited anti-evasion provision that applies only to the exceptions and safe harbors contained in the Proposed Rule.[34] The anti-circumvention provision goes above and beyond what is reasonable in this context and is not supported by the Proposed Rule's authorizing legislation, Section 621 of the Dodd-Frank Act. As the Associations point out, Section 621 differs significantly from Section 619 (the statutory authority for the Volcker Rule), in that Section 619 includes an anti-evasion provision in the section itself, whereas Section 621 does not.[35] Yet, the Proposed Rule contains an anti-circumvention provision that is much broader than the anti-evasion provision found in the Volcker Rule. Moreover, unlike the Volcker Rule, the Proposed Rule's formulation does not contemplate any basic due process limitations.[36] The final rule should not contain an anti-evasion or anti-circumvention provision that applies

[32] *See* Part III of the SIFMA Letter, at 22-24.
[33] *See id*. at 24.
[34] *See* Part IX of the SIFMA Letter, at 57-60.
[35] *See id.* at 58.
[36] *See id.* (contrasting the Volcker Rule's due process protections with the absence of any in the Proposed Rule).

to the entire rule. Instead, the provision should specify that an exception or safe harbor to the Proposed Rule is not available with respect to any transaction or series of transactions that, although in technical compliance with that exception or safe harbor, is part of a plan or scheme to evade the general prohibition contained in the rule. The anti-circumvention provision found in the Proposed Rule has the potential to be both overinclusive and vague, not only by operation of its own overly broad terms, but particularly in conjunction with the overly broad language in the general prohibition itself and its application to all affiliates and subsidiaries of any securitization participant. The Associations noted that the "fundamental problem is that no market participant can determine with requisite certainty which transactions the Proposed Rule would prohibit."[37]

As we discussed in our previous letter,[38] the challenges presented by the breadth and vagueness of the term "conflicted transaction" are even more acute in the CLO and loan markets given the nature of the underlying loan assets, and so it follows that the broad and vague application of the anti-circumvention provision would be more problematic as well.

VIII. ***The Exceptions to the Prohibition Should Be Modified and Expanded***.

The LSTA agrees with the Associations that (a) the risk mitigating hedging activities and bona fide market making activities exceptions should be clarified and simplified; (b) the risk mitigating hedging activities exception should include permitted risk transfer transactions; and (c) the risk mitigating hedging activities exception should include interest rate, currency and other non-credit related trading and hedging activities. (We take no position on the other aspects of the Associations views in Part X of the SIFMA Letter since they are not germane to the CLO market).[39] The LSTA specifically supports the proposed rule-text amendments contained in Part X of the SIFMA letter relating to risk mitigating hedges and bona fide market making activities.[40]

IX. ***The Final Rule Should Include a Compliance Date that Includes a Transition Period.***

The LSTA agrees with the Associations' position that a rule as complex as the Proposed Rule requires a significant transition period before becoming effective.[41] Specifically, the LSTA agrees that market participants will need adequate time to understand its terms and design and implement policies and procedures to comply with it and, therefore, that any final rule should provide that the prohibition therein applies only to those transactions engaged in by a securitization participant, and asset-backed securities for which the date of the first closing of the sale thereof occur, on or after a date that is at least twelve months following the date that the final rule is published in the Federal Register.[42]

X. ***The Commission's Economic Analysis Is Incomplete and Insufficient.***

As we explained in our previous letter, the LSTA believes that the costs of the Proposed Rule as applied to CLOs would outweigh any perceived benefits.[43] The LSTA also agrees with the Associations that the Commission's general economic analysis is incomplete and inadequate.[44] Specifically, the quantified data

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[37] *Id.* at 60.
[38] *See* LSTA Letter 1 at 2.
[39] *See* Part X of the SIFMA Letter, at 61-66.
[40] *Id.* at 62, 64-65.
[41] *See* Part XII of the SIFMA Letter, at 68.
[42] *See id.*
[43] *See* LSTA Letter 1 at 8.
[44] *See* Part XIV of the SIFMA Letter, at 70-73.

points provided by the Commission are incomplete and insufficient, the Commission does not present empirical data to support the Proposed Rule, and the Commission's analysis of the effects of the Proposed Rule on efficiency, competition, and capital formation is inadequate.[45]

XI. ***Conclusion.***

The LSTA appreciates this opportunity to comment and stands ready to assist the Commission in its rulemaking. To that end, we will be submitting a final letter that will focus on CLOs and corporate loans, explaining in detail the specific challenges the Proposed Rule poses for them and how some of the solutions proposed for securitizations generally might need to be refined to work for CLOs.

Sincerely,

Elliot Ganz, Head of Advocacy, Co-head of Public Policy

Meredith Coffey, Executive Vice President – Research, Co-head of Public Policy

[45] *See id.*