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

Submitted via rule-comments@sec.gov

March 27th 2023

Dear Ms. Countryman,

AIMA/ACC Comments on SEC Proposed Rule 192 – Prohibition Against Conflicts of Interest in Certain Securitizations [File No. S7-01-23]

The Alternative Investment Management Association Limited ("AIMA")[1] and the Alternative Credit Council ("ACC")[2] appreciate the opportunity to comment on the Securities and Exchange Commission's (the "SEC") proposal entitled "Prohibition Against Conflicts of Interest in Certain Securitizations" (the "Proposal")[3] which introduces a new Rule 192 to implement Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

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[1] The Alternative Investment Management Association ("AIMA") is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] The Alternative Credit Council ("ACC") is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over $800 billion of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

[3] SEC, "Prohibition Against Conflicts of Interest in Certain Securitizations", SEC Rel. No. 33-11151 (Jan. 25, 2023) (the "Proposing Release").

While Rule 192's objective of tackling potential material conflicts of interest among securitization participants is commendable, we are concerned that the Proposal contains provisions that could harm the securitization markets and, as a consequence, undermine the credit markets that depend on securitization.

Securitization is a core feature of capital markets and it provides a mechanism by which loans originated by banks and finance companies are transferred to capital market investors. Securitization therefore allows investors to access asset classes such as real estate mortgages, auto loans and corporate loans (including those of SMEs) that would not be otherwise investible on an individual basis, providing much needed liquidity and investment. Additionally, securitization also frees up the balance sheets of banks, allowing them to originate new loans and continue providing finance to the real economy.

The importance of securitization to capital markets and the real economy cannot be understated, and we welcome the SEC's acknowledgement that "securitization markets are important for the U.S. economy and constitute a large fraction of the U.S. debt market."[4]

The content of proposed Rule 192 is much more prescriptive and detailed than its 2011 predecessor, Rule 127B, but there remain important points of ambiguity and concern, as well as points of conflict between what the rule is intended to achieve and its likely effects on the market.

The securitization markets have changed substantially since the publication of the Dodd-Frank Act. Changes to regulation and disclosure requirements introduced over the past decade already enhance investor protection and address many of the SEC's stated reasons for proposing Rule 192. In this regard, AIMA and the ACC welcome the SEC's acknowledgement that "[c]urrent market practices may be generally consistent with the re-proposed rule requirements as a result of market participants' current compliance with the existing rules and reputational incentives."[5] Consequently, we believe that the SEC should take into consideration current market practices and existing incentives and carefully redesign Rule 192 in a way that meets its objective while helping to protect the integrity of securitization markets, which crucially support and contribute to healthy credit markets.

We also acknowledge the SEC's statement that "despite the increased scrutiny at that time, we do not have data on the extent of securitization participants' participation in ABS transactions that are tainted by material conflicts of interest following the financial crisis of 2007-2009."[6] We believe that policymaking should be informed by an appropriate evidence base to inform need and proportionality in rulemaking. Absent such data it is unclear how the SEC has determined the need for Rule 192 to be proposed in the manner it has. Similarly, we believe that the SEC has not fully and rigorously

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4 *Id.* at 128.
5 *Id.* at 133.
6 *Id.*

considered the data on the costs that this approach would impose on market participants and, consequently, the economic impact that Rule 192 would have on the securitization markets.

The absence of data demonstrating market failures and the SEC's recognition that current market practices may address any potential concerns call into question the need and proportionality of the new requirements proposed within Rule 192. These requirements would likely only serve to impose unnecessary compliance costs and create disruption in the securitization market. We encourage the SEC to consider how its concerns may already be met by other means, take the time to develop an evidence base and redesign the proposed rule to achieve a framework that is more proportionate to any remaining risks.

We would also highlight that several provisions within the proposed rule are potentially unworkable as well as disproportionate to its objectives. If enforced, this rule would most likely disrupt credit markets and undermine the flow of financing to the real economy. Instead of this regulatory proposal, we believe that a targeted disclosure regime would provide the most proportionate approach to address potential conflicts of interest which may not already be addressed by existing disclosure requirements.

This approach would be more consistent with the approach of the Securities Act of 1933, which has traditionally favored disclosures over substantive regulation, as well as the approach employed for SEC-registered ABS offerings. We have provided more detailed comments in the annex to this letter but in summary, the provisions contained in Rule 192 raise questions surrounding the following key areas:

- **Scope and definitions of securitization participants:** We believe that the proposed definitions are too broad in scope and bring in a much broader range of participants and activities than is necessary. The broad scope of these definitions will act as a disincentive to participating in the market and undermine the effectiveness of the securitization market in supporting the allocation of capital to the real economy.

- **Scope of the exceptions**: We welcome the exceptions for bona fide market-making activities and risk-mitigating hedging, but believe that the lack of clarity and subjectivity regarding the scope of these exceptions undermines their workability. Uncertainty surrounding what constitutes compliance will increase costs and potentially reduce securitization activity. Furthermore, we believe that the conditions proposed by the SEC for including a much-needed conditional information barrier exception are not viable given other compliance requirements nor proportionate to the objectives of Rule 192.

- **Scope of the prohibition**: We believe that the SEC proposed prohibition does not have a clearly defined scope, particularly regarding the key terms that determine the application period of the prohibition. Additionally, the anti-circumvention provision is extremely broad in nature and lacks guidance to allow market participants to determine what economically equivalent transactions may be in scope. We believe that the inclusion of such a disproportionate catch-all provision

underscores the overarching lack of clarity regarding the problem that Rule 192 is trying to solve. Thus, we believe that this anti-circumvention provision should be eliminated.

- **Definitions of material conflicts of interest or conflicted transactions**: We believe that the definition of a short sale of a relevant ABS is potentially unworkable and does not take into account current market structures. Moreover, the way in which a conflicted transaction is described within Rule 192 is extremely broad. The absence of any guidance as to how this provision should be interpreted will create uncertainty and likely lead to an inconsistent application of the provision by market participants.

To ensure there is sufficient time for a reasonable consideration of how the proposed rule might affect the securitization market by both the industry and policymakers, we would ask the SEC to grant an extension to the comment period. We and other trade associations have previously highlighted[7] the need for the SEC to provide sufficient time for interested parties to exercise their rights to respond to the Proposal and to submit the public input that will be necessary for subsequent revisions. Therefore, we encourage the SEC to extend the comment period, as it would allow the SEC to receive more thoughtful and better developed responses, and would not entail a significant addition to the time that has passed since the U.S. Congress mandated the SEC to implement this prohibition.

We would be happy to elaborate further on any of the points raised in this letter or annex below. For further information please contact Nicholas Smith, Managing Director, Private Credit (nsmith@aima.org).

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs, AIMA
Global Head of the ACC

Cc: Securities and Exchange Commission
The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner

[7] https://www.sec.gov/comments/s7-01-22/s70122-20118198-271109.pdf.

The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Mr. Erik Gerding, Director of Division of Corporation Finance

Annex – AIMA and ACC comments on Proposed rule 192 – Prohibition Against Conflicts of Interest in Certain Securitizations

Scope and definitions of securitization participants

AIMA and the ACC welcome the SEC's acknowledgement that the functions performed by securitization participants "are essential to the design, creation, marketing, and/or sale of an ABS."[8] However, in establishing such a broad scope for what Rule 192 considers to be securitization participants, the SEC endangers their capacity to perform those functions that are essential for the ABS market. Below we highlight challenges with some of the key definitions proposed in Rule 192.

Proposed definition of sponsor

Rule 192 captures all parties that, whether by contractual right or otherwise, play a non-administrative role in directing or causing the direction of the ABS or the composition of the pool assets. This definition is broader than that used in the Dodd-Frank Act and in the original 2011 Rule 127B, and also diverges from traditional definitions of sponsor. We are concerned that this definition could apply to a much broader range of participants than is intended or proportionate for the purposes of Rule 192. For example, it could be deemed to include third-party servicers which may, as a result, then decide to stop entering into certain transactions.

The proposed definition of "securitization participant"

Under Rule 192 affiliates or subsidiaries, including investment advisers who are affiliates or subsidiaries of an ABS underwriter, placement agent, initial purchaser or sponsor would therefore also be considered "securitization participants." By using this definition, Rule 192 marks a significant departure from the Investment Advisers Act of 1940 ("Advisers Act") with respect to conflict of interest resolution for investment advisers, which generally focuses on appropriate disclosure to advisory clients and informed client consent as opposed to regulation. Indeed, proposed Rule 192 would mean that disclosure and consent are insufficient to address any potential conflicts between the investment adviser and an ABS investor. We believe that this departure from the Advisers Act is unnecessary, and that the SEC should not discard a disclosure and consent regime that has traditionally functioned well, and has also been preferred and encouraged by regulators in other contexts.

Foreign entities and subsidiaries

These fall under the scope of Rule 192, but it is unclear whether the SEC has such authority over foreign entities, apart from other legal and practical issues regarding supervision and enforcement. Proposed Rule 192 may therefore put U.S. firms at a competitive disadvantage to their international peers.

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[8] Proposing Release, *supra* note 3, at 19.

Small entities

Small entities are also covered by the prohibition, without granting a longer implementation period or any sort of accommodation to facilitate their compliance requirements. We believe that the additional costs that Rule 192 will impose are likely to limit the appetite of smaller firms to participate in securitizations and potentially limit investor choice.

Scope of the exceptions

Rule 192 includes affiliates and subsidiaries of underwriters, placement agents, initial purchasers or sponsor as securitization participants within the scope of the prohibition and makes no exceptions for affiliates or subsidiaries that are walled off by information barriers. Given the range of activities undertaken by our member firms we are unsure that Rule 192 would be workable in its current form unless some exemption is introduced to recognize the role of information barriers.

Large organizations will have a wide range of divisions that have no interaction with each other. Furthermore, there could be instances in which they may be legally prohibited from knowing about the actions that triggered the prohibition.

We therefore welcome the SEC's openness to considering a conditional information barrier exception and encourage the SEC to revise the proposed rule to include such exception.

Bona fide market-making activities

We welcome the proposed exemption for bona fide market-making activities and risk-mitigating hedging, however it is uncertain whether the scope of these exemptions is sufficiently clear so as to be relied upon. For example, the SEC emphasizes that in order to be permissible, the hedging activity must relate to "specific and identifiable" risks, not general risk or speculative activity, while demanding that securitization participants do not "overhedge".[9] It is unclear how such terms should be interpreted by the subjectivity that accompanies any assessment of risk and what may constitute a necessary degree of risk-mitigating hedging in any given circumstance.

In general, Rule 192 has more defined parameters than the 2011 original proposal and Rule 127B, but it still requires a substantial amount of facts and circumstances determinations by securitization participants. It is unclear how these determinations would be made across various industry participants in the market, which creates uncertainty regarding what constitutes compliance with Rule 192. Such uncertainty will increase costs that will ultimately be borne by end investors, and potentially reduce securitization activity.

[9] Proposing Release, *supra* note 3, at 88.

Scope of the prohibition

Rule 192 does not define what "agreement" or "substantial steps" are when determining the application period of the prohibition, which commences as soon as the securitization participant "has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an ABS."[10] Instead, the rule states that this is a "facts and circumstances" determination with no guidance on what factors any analysis should take into account. AIMA and the ACC believe that this lack of clarity and guidance in such definitions creates uncertainty in determining the scope of the rule's prohibition, which will most likely harm the functioning of securitization markets. Moreover, under the current proposal, the determination of a commencement point would be backward-looking and it would be difficult to determine while investment decisions are being made. Below we highlight further challenges regarding the scope of the rule's prohibition.

Synthetic and hybrid cash and synthetic ABS

These are included in the prohibition but are not defined in Proposed Rule 192 or elsewhere under applicable securities laws. Instead, the Proposing Release states that

> "synthetic transactions are generally effectuated through the use of derivatives such as a CDS or a total return swap or an ABS structure that replicates the terms of such a swap. We believe that our previous descriptions of synthetic securitizations are well understood by market participants and adequately address the key issues raised by commenters, and that market participants have been able to readily distinguish synthetic ABS from other types of transactions."[11]

AIMA and the ACC believe that this statement is too generic to be of use to firms seeking to comply with proposed Rule 192. We would ask that instead the SEC should further clarify what specific synthetic and hybrid cash and synthetic ABS it believes present potential risks to investors and should therefore be considered to be within scope. This will ensure that Rule 192 is targeted and proportionate to the risks identified while also providing market participants with greater clarity as they seek to comply with any new requirements.

Anti-circumvention

The anti-circumvention provision contained in Rule 192 seeks to capture transactions that fall outside the parameters of the definition of conflicted transaction but are "economically equivalent" to such transactions. To meet this catch-all aim, this provision does not clarify which transactions are considered to circumvent the prohibition and are therefore banned, which means that this anti-

[10] Proposed Rule 129(a)(1). .

[11] Proposing Release, *supra* note 3, at 14.

circumvention provision arguably changes the scope of Rule 192 from the more prescriptive and measurable terms set forth in the other provisions of the rule.

AIMA and the ACC believe that as proposed the anti-circumvention provision is not justified considering the already wide-ranging scope of the proposed prohibition and is not commensurate with the risks presented by the market. Furthermore, the current drafting of the provision lacks clarity and is not workable enough for market participants to be able to determine which transactions should be deemed to be economically equivalent activities. This places the burden on securitization participants to make potentially costly and time-consuming determinations about whether any and all transactions related to an ABS are "economically equivalent" to prohibited transactions without any clear guidance on how to do so. Therefore, considering the likely unjustified problems that this anti-circumvention provision will create for the industry, we believe that the SEC should eliminate the provision from the Proposal.

Definition of material conflicts of interest or conflicted transactions

Overall, we believe that these definitions confuse the scope of activities that are considered to create material conflicts of interest. Furthermore, Rule 192 is not concrete enough on whether activities involving single assets that are part of a pool can be considered conflicted transactions. We encourage the SEC to clarify that the prohibition would apply only to pools of assets. Below we highlight further challenges regarding the definition of material conflicts of interest.

Definition of a short sale of a relevant ABS

Rule 192 does not require a profit for a short sale transaction to be a conflicted transaction. Instead, "it is sufficient that the securitization participant sells the ABS short."[12] We believe that this definition is not workable within the current structures of the securitization market. Considering all short sale transactions to be potential conflicted transactions would have a disproportionate, significant and far-reaching impact on securitization markets, thus affecting the functioning of capital markets and ultimately the health of the real economy.

Investment decisions by reasonable investors

We believe that based on the definition stipulated in Rule 192, it is unclear how a securitization participant would be able to determine what a "reasonable investor" would consider to be material to an investment decision. We believe that, as highlighted above, a disclosure approach would be more effective at addressing these concerns at any point during the investment process. We also believe that this approach would have a less disruptive impact on securitization markets compared to the approach proposed in Rule 192.

[12] Proposing Release, *supra* note 3, at 64.