March 27, 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) (January 25, 2023)

Dear Ms. Countryman:

The American Investment Council (the "AIC") appreciates the opportunity to comment on the recent proposal[1] (the "Proposal") of the U.S. Securities and Exchange Commission (the "Commission") to adopt regulations regarding conflicts of interest in asset-backed securities ("ABS") transactions.

We submit this letter on behalf of our members, which are the world's leading private equity and private credit firms, united by their commitment to growing and strengthening the businesses in which they invest.[2] Our member organizations, together with the funds and portfolio companies they manage, participate in the ABS markets both as investors and as sponsors, and as such, we have a vested interest in ensuring the continuing health of the ABS markets.

The Commission indicates in the Proposal that it does not intend to "unnecessarily hinder . . . routine securitization activities that do not give rise to the risks that Section 27B was

[1] See *Prohibition Against Conflicts of Interest in Certain Securitizations*, 88 Fed. Reg. 9678 (Feb. 14, 2023).

[2] The American Investment Council, based in Washington, D.C., is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about private equity and private credit industries and their contributions to the US and global economy. Established in 2007 and formerly known as the Private Equity Growth Capital Council, the AIC's members include the world's leading private equity and private credit firms which have experience with the investment needs of insurance companies. As such, our members are committed to growing and strengthening the companies in which, or on whose behalf, they invest, to helping secure the retirement of millions of pension holders and to helping ensure the protection of insurance policyholders by investing insurance company general accounts in appropriate, risk-adjusted investment strategies. For further information about the AIC and its members, please visit our website at http://www.investmentcouncil.org.

intended to address."[3] The proposed Rule 192 (the "Proposed Rule") will do just that. If the Proposed Rule is adopted as proposed, it would sweep far more broadly than necessary or appropriate, and would do so at the expense of legitimate and important market activities that do not present the same concerns that Section 27B was designed to mitigate.

We identify our most pressing concerns below.

I. The comment period for the Proposal is insufficient and does not provide a meaningful opportunity for public input.

As an initial matter, we strongly support the comments separately submitted to the Commission by other associations urging the Commission to provide more time to comment on the Proposal.[4] The AIC's members have not been afforded the time that they need in order to fully gauge the impact of the Proposed Rule, and the AIC has not had the time that it needs in order to fully discuss the impact of the Proposed Rule with its membership. A two-month comment period is simply insufficient in light of the breadth of the Proposed Rule and the sheer number of questions posed by the Proposal. Moreover, the comment period for the Proposal overlaps with comment periods for other similarly sweeping regulatory proposals that are also expected to have a significant impact on the AIC and its members[5] and is the latest in a rapid series of Commission rulemakings with wide-ranging economic effects on our members.[6]

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[3] Proposal at 9679. Section 27B of the Securities Act was added by Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (July 21, 2010) (the "Dodd-Frank Act"), and was codified at 15 U.S.C. § 77z-2a.

[4] *See* Letter from American Property Casualty Insurance Association, Association for Financial Markets in Europe, Bank Policy Institute ("BPI"), CRE Finance Council, Housing Policy Council, International Association of Credit Portfolio Managers, Loan Syndications and Trading Association ("LSTA"), Mortgage Bankers Association, Reinsurance Association of America, Securities Industry and Financial Markets Association ("SIFMA"), Structured Finance Association and U.S. Mortgage Insurers to Vanessa A. Countryman, Secretary, SEC (Feb. 16, 2023), https://www.sec.gov/comments/s7-01-23/s70123-20157901-326057.pdf (the "Joint Extension Request"); *see also* Letter from LSTA to Vanessa A. Countryman, Secretary, SEC (Mar. 1, 2023), https://www.sec.gov/comments/s7-01-23/s70123-20158317-326370.pdf.

[5] For example, the comment period for the Proposal overlaps with the comment period for the Commission's proposal in *Safeguarding Advisory Client Assets*, 88 Fed. Reg. 9678 (Feb. 14, 2023); the proposal of the Federal Trade Commission in *Non-Compete Clause Rule*, 88 Fed. Reg. 3582 (Jan. 19, 2023); and the proposal of the Department of Health and Human Services, Centers for Medicare & Medicaid Services in Medicare and Medicaid Programs; *Disclosures of Ownership and Additional Disclosable Parties Information for Skilled Nursing Facilities and Nursing Facilities*, 88 Fed. Reg. 9820 (Feb. 15, 2023).

[6] For example, in 2022 alone, the AIC and its members submitted comments in six significant and expansive Commission rulemakings. The AIC submitted comments to the Commission's proposal in *Amendments to Form PF To Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, 87 Fed. Reg. 9106 (Feb. 17, 2022); *Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, 87 Fed. Reg. 13524 (Mar. 9, 2022); *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*, 87 Fed. Reg. 16590 (Mar. 23, 2022); *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 87 Fed. Reg. 16886 (Mar. 24, 2022); *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21334 (Apr. 11, 2022); and *Enhanced Disclosures by Certain Investment Advisers and Investment*

In 2022, we joined 24 other organizations to submit a letter to Chair Gensler expressing our concern over recent Commission comment period trends.[7] The joint 2022 letter made the point that notice-and-comment rulemaking must afford interested persons a *meaningful* opportunity to comment. Unfortunately, the current deadline does not afford one.

We will not repeat at length the various concerns that were raised in the joint 2022 letter, nor the various concerns raised by legislators, press, and even Commissioners about the Commission's rulemaking practices. However, we reiterate to the Commission that, in stacking overlapping comment periods with short deadlines one on top of another, without due regard for other current regulatory burdens of market participants, the Commission does a disservice to market participants, including investors, who are not afforded the time that is necessary to give those proposals due consideration. The Commission also does a disservice to itself: short comment periods limit both the quality and the quantity of comments received, and erode public trust in the integrity of the agency's decision-making process.

These detrimental effects are particularly consequential here, where the Commission has acknowledged both that the effects of the Proposed Rule could be significant and that it lacks data critical for an informed rulemaking.[8] The Proposal seeks comment in several places on the economic effects of the Proposed Rule, and in particular highlights the importance of supporting data.[9] But it takes a significant amount of time to gather the kind of data sought by the

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Companies About Environmental, Social, and Governance Investment Practices, 87 Fed. Reg. 36654 (June 17, 2022).

[7] *See* Letter from Alternative Credit Council, Alternative Investment Management Association, American Bankers Association, American Council of Life Insurers, AIC, BPI, Bond Dealers of America, FIA Principal Traders Group, Financial Services Forum, Institute of International Bankers, Institute for Portfolio Alternatives, Investment Adviser Association, Investment Company Institute, LSTA, The Managed Funds Association, National Association of Corporate Treasurers, National Association of Investment Companies, National Venture Capital Association, The Real Estate Roundtable, Risk Management Association, SIFMA, SIFMA Asset Management Group, Security Traders Association, Small Business Investor Alliance and U.S. Chamber of Commerce Center for Capital Markets Competitiveness to Gary Gensler, Chair, SEC (Apr. 5, 2022), *Importance of Appropriate Length of Comment Periods*, https://www.sifma.org/wp-content/uploads/2022/02/SEC_Joint-Trades_Comment-Period-Letter_4-5-2022.pdf.

[8] *See infra*, Parts II and V.

[9] *See, e.g.*, Proposal at 9679 ("we do not have data on the extent of such conduct following the financial crisis of 2007-2009"); *id.* at 9710 (noting that comments are "of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments"); *id.* at 9711 ("we are unable to reliably quantify many of the economic effects due to limitations on available data . . . We further note that even in cases where we have some data regarding certain economic effects, the quantification of these effects is particularly challenging due to the number of assumptions that we need to make to forecast how the ABS issuance practice would change in response to the re-proposed rule, and how those responses would, in turn, affect the broader ABS market . . . We are soliciting comment and requesting data to assist it with assessing and quantifying economic effects of the re-proposed rule."); *id.* at 9712 ("we lack data related to the number of [contractual rights sponsors and directing sponsors], as the proposed definition expands the concept to certain securitization participants that currently are not counted as sponsors in any existing database to the best of our knowledge. . . . we do not have data to quantitatively determine the number of such sponsors."); *id.* at 9713 ("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 . . . we do not have data on the actual incidence of conflicted

Commission from various participants and stakeholders, to verify that data, and to present it in a useful manner. By providing such a brief comment period, the Commission undermines the quality of its own economic analysis, and prevents the public from meaningfully engaging with the Commission regarding the economic impacts of the Proposed Rule.

During the 2011 rulemaking, the Commission allowed industry participants approximately five months to comment.[10] Given that over twelve years have passed since the Commission was directed to issue rules implementing Section 27B, a more reasonable comment period would do no harm. We ask the Commission to extend the comment period for the Proposal, and more broadly, we once again ask the Commission to reconsider its current practices regarding notice-and-comment periods for proposed rulemakings.

II. The Commission incorrectly assumes that the ABS markets of today are the same ABS markets of 2007.

The Proposal purports to implement the Commission's statutory mandate to adopt regulations implementing Section 27B of the Securities Act of 1933, as amended (the "Securities Act"). Section 27B represents a legislative judgment that ABS transactions that are designed to fail at the expense of investors have no place in a fair and well-functioning marketplace.[11] The AIC appreciates the Commission's efforts to implement this statutory mandate, but the Proposed Rule does not appropriately take into account the various developments since the financial crisis that have improved the functionality of ABS markets and helped safeguard the rights and interests of investors. Indeed, the Commission acknowledges that it does not have data on the extent of potentially conflicted transactions following the financial crisis of 2007-2009.[12]

Today's ABS markets have been shaped in no small part by other provisions of the Dodd-Frank Act that have already been implemented. For example, the promulgation of Regulation RR[13] in 2014 required sponsors of securitization transactions to "eat their own cooking" by retaining some of the credit risk in the ABS. A sponsor's retained credit risk is

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transactions"); *id.* at 9721 ("Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on costs and benefits estimates.").

[10] As noted in the Joint Extension Request, the proposing release for Rule 127B was published in the Federal Register on September 28, 2011, and specified a three-month comment deadline of December 19, 2011. *See* 76 Fed. Reg. 60320 (Sept. 28, 2011). The Commission then extended the comment deadline to January 13, 2012. *See* 76 Fed. Reg. 78181 (Dec. 16, 2011). The Commission again extended the comment deadline to February 13, 2012. *See* 77 Fed. Reg. 24 (Jan. 3, 2012).

[11] 156 CONG. REC. S5899 (daily ed. July 15, 2010) (statement of Sen. Levin) ("The intent of [Section 621] is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures.").

[12] Proposal at 9679; *see also id.* at 9713 ("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").

[13] 17 C.F.R. § 246. Regulation RR was promulgated under, *inter alia*, section 15G of the Securities Exchange Act of 1934, as amended (the "Exchange Act") (15 U.S.C. § 78o–11).

subject to prohibitions on hedging, transfers and financing,[14] which is designed to ensure that the sponsor remains appropriately exposed to the credit risk of the securitization.[15] In addition, the promulgation of the Volcker Rule[16] in 2015 restricted banks from engaging in proprietary trading. Both of these regulatory developments, together with other developments in the ABS markets, have materially aligned the incentives of investors and securitization participants, and have increased the transparency of transaction structures.

ABS plays a central role in the United States capital markets. As a source of financing, ABS is a critical tool for providing liquidity for originators, and its benefits are shared by investors, issuers, originators and borrowers alike.[17] We understand that the Commission has a statutory mandate to issue regulations implementing Section 27B. But Congress did not mandate that the Commission promulgate a regulation as expansive as the Proposed Rule, and in fact, Senator Levin expressly indicated that the expectation was that the Commission would implement Section 27B in a way that "protect[s] . . . the healthy functioning of our capital markets."[18] The Commission has the authority—indeed, the obligation[19]—to appropriately tailor the Proposed Rule to the realities of the ABS market as it exists today: a market shaped by a decade of new rules that have superseded the conditions in which Section 27B was promulgated. We therefore respectfully request that the Commission take the time to appropriately consider the significant evolution of the ABS markets since the financial crisis, and the importance of ABS to the health of the wider capital markets, and to revise the Proposed Rule accordingly.

[14] 12 C.F.R. § 244.12.

[15] *Credit Risk Retention*, 76 Fed. Reg. 24090 (Apr. 29, 2011) (initial proposal).

[16] 12 C.F.R. § 248. The Volcker Rule was promulgated, *inter alia*, under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. § 1851).

[17] CLOs alone "provide a trillion dollars of capital for US companies, represent 67% of the market for broadly syndicated institutional loans and a significant portion of the rowing market for private, direct credit loans." Letter from LSTA to Vanessa A. Countryman, Secretary, SEC (Mar. 1, 2023), https://www.sec.gov/comments/s7-01-23/s70123-20158317-326370.pdf.

[18] 156 CONG. REC. S5899 (daily ed. July 15, 2010) (statement of Sen. Levin) ("We believe that the Securities and Exchange Commission has sufficient authority to define the contours of the rule in such a way as to remove the vast majority of conflicts of interest from these transactions, while also protecting the healthy functioning of our capital markets.").

[19] "Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 77b(b).

III. The Proposed Rule's definition of "sponsor" is inappropriately broad, and its application to affiliates and subsidiaries of "securitization participants" will have unintended consequences.

A. The definition of "sponsor" is overly broad and exceeds the Commission's authority.

The definition of "sponsor" in the Proposed Rule incorporates the definition of "sponsor" that largely tracks the parallel definition in Regulation AB[20]—a person that "organizes and initiates an [ABS] transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the entity that issues the [ABS]."[21] However, the Proposed Rule goes far beyond the common understanding of that term by adding two new sets of parties—persons with a "contractual right to direct or cause the direction of the structure, design, or assembly of an [ABS] or the composition of the pool of assets underlying the [ABS]" ("contractual rights sponsors"), and persons that "direct or cause . . . the direction of the structure, design, or assembly of an [ABS] or the composition of the pool of assets underlying the [ABS]" ("directing sponsors").[22] The Commission explains that the definition was intended to encompass, among other parties, "a portfolio selection agent for a CDO transaction, a collateral manager for a CLO transaction with the contractual right to direct asset purchases or sales on behalf of the CLO, or a hedge fund manager or other private fund manager who directs the structure of the ABS or the composition of the pool of assets underlying the ABS . . . ."[23]

This is not the first time that the Commission has sought to expand the term "sponsor" beyond its intended meaning. In *The Loan Syndications and Trading Association v. Securities and Exchange Commission et al.*, 882 F.3d 220 (D.C. Cir. 2018) (the "LSTA Decision"), the U.S. Court of Appeals for the District of Columbia Circuit held that the Commission's application of the term "sponsor" to CLO collateral managers[24] unreasonably overstepped its authority, and called the Commission's attempt to do so "an astonishing stretch of language."[25] The Commission's proposed definition of "sponsor" in the Proposed Rule appears to be in no small part an attempt to sidestep the logic of the LSTA Decision.

Section 27B does not define "sponsor," but the Commission does not begin with a blank slate. The Regulation AB definition of "sponsor" had broad currency in the ABS markets well before the enactment of the Dodd-Frank Act, a fact of which Congress was aware when it

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[20] *See* 17 C.F.R. § 229.1101(l).

[21] *See* Proposed Rule 192(c).

[22] *See id.* The terms "contractual rights sponsor" and "directing sponsor" are taken from the Proposal's discussion of the definition of "sponsor" at Proposal at 9685-87.

[23] Proposal at 9684.

[24] *See* 12 C.F.R. § 244.9.

[25] LSTA Decision at 225. Technically, the statutory term at issue in the LSTA Decision was the term "securitizer" as defined in 15 U.S.C. §78o-11(a)(3), which incorporates the traditional definition of "sponsor" in addition to the issuer of an ABS.

enacted Section 27B, and Congress did not find it necessary to displace that understanding with a statutory definition. As a term of art, the term "sponsor" as used in Section 27B is presumed to have its technical meaning,[26] and its technical meaning was elucidated in the LSTA Decision.[27] The Commission takes the position that the traditional definition is inappropriate because it would not capture the full universe of persons that are in "a unique position to structure the ABS and/or construct the underlying asset pool or reference pool in a way that would position the person to benefit from the actual, anticipated, or potential adverse performance of the relevant ABS or its underlying asset pool if such person were to enter into a conflicted transaction."[28] The LSTA Decision rejected similar arguments.[29] In the words of the D.C. Circuit, "the agencies' policy concerns cannot compel us to redraft the statutory boundaries set by Congress."[30]

By defining "sponsor" to mean something more than "the person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity,"[31] the Commission fails to heed the D.C. Circuit's guidance and exceeds the scope of its authority. We therefore request that the definition of "sponsor" in the Proposed Rule be limited to the definition used in Regulation AB.[32]

However, if the Commission remains reticent to hew to the commonly understood Regulation AB definition, there are a number of other alternatives available to the Commission. For example, as currently drafted, the Proposed Rule provides that a person that is *either* a directing sponsor *or* a contractual rights sponsor is a "sponsor" for purposes of the Proposed

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[26] *See, e.g.*, *Morissette v. United States*, 342 U.S. 246, 253 (1952); *see also United States v. Castleman*, 572 U.S. 157, 162-65 (2014); *Sekhar v. United States*, 570 U.S. 729, 732-33 (2013).

[27] LSTA Decision at 227.

[28] Proposal at 9685.

[29] *See* LSTA Decision at 226 ("[T]he agencies make a special argument that requires a somewhat detailed response. If CLO managers are not covered by § 941, they contend, our interpretation 'would do violence to the statutory scheme' and 'create a loophole that would allow securitizers of other types of transactions to structure around their risk retention obligation.' Policy concerns cannot, to be sure, turn a textually unreasonable interpretation into a reasonable one. . . . [I]f that is a 'loophole,' it is one that the statute itself creates, and not one that the agencies may close with an unreasonable distortion of the text's ordinary meaning.") (internal citations omitted).

[30] *Id.* at 229.

[31] 17 C.F.R. § 229.1101(l).

[32] In the Proposal, the Commission expresses a concern that the Regulation AB definition of "sponsor" would be inappropriate because, in the context of Regulation AB, "the definition of 'sponsor' was adopted for the limited purpose and scope applicable only to those ABS eligible for registration under Regulation AB, and would not be appropriate to cover the full range of ABS that would be covered by the re-proposed rule, including those that are unregistered." Proposal at 9685. We agree that it would be appropriate for the Proposed Rule to govern unregistered issuances in addition to registered issuances. However, the Commission's concern could be addressed simply by adopting the definition of "sponsor" set forth in Regulation AB and expressly applying it to all "asset-backed securities" within the meaning of the Proposed Rule.

Rule.[33] We respectfully request that the Commission consider narrowing the universe of additional "sponsors" to encompass only those persons who are *both* contractual rights sponsors and directing sponsors with respect to an ABS. A person who is in fact involved in the structuring of an ABS or in the composition of an underlying asset pool, but has no contractual right to direct a Regulation AB sponsor in the structuring of an ABS or the composition of the asset pool, would have no practical ability to structure the ABS to fail; a true Regulation AB "sponsor" with exposure to the credit risk of an ABS by operation of the risk retention rules would have no reason to take such a direction from a person with no legal authority to direct it to do anything. Conversely, a person who has a contractual right to direct the structuring of an ABS or the composition of an asset pool, but is not in fact involved in such matters, had no opportunity to structure the ABS to fail; a person in such a position has no real culpability, and should not be seen as having a conflict of interest with respect to investors in that ABS. As such, only a person who is *both* a contractual rights sponsor and a directing sponsor would have both the incentive and the practical ability to design an ABS to fail.

Additionally, as discussed in further detail in Part IV.B below, the "ministerial exception" in the definition of "sponsor" does not protect service providers that perform servicing, trust administration or other ministerial duties in the operation or management of the ABS or the underlying assets. We therefore respectfully request that the Commission clarify in the definition of "sponsor" that such service providers do not fall under the definition thereof, notwithstanding that those service providers may perform such ministerial acts with respect to the securitization vehicle after the issuance of the ABS.[34]

B. The Proposed Rule's application to affiliates and subsidiaries of securitization participants makes the Proposed Rule unworkable as written.

Section 27B applies by its terms to "any affiliate or subsidiary" of "[a]n underwriter, placement agent, initial purchaser, or sponsor."[35] The inclusion of affiliates and subsidiaries makes some sense in light of Section 27B's purpose to prohibit a securitization participant from reaping a reward from the failure of an ABS that it designed to fail. Indeed, we agree that a securitization participant should not be permitted to design an ABS transaction to fail simply by directing an affiliate or subsidiary to do its bidding. However, because the Proposed Rule sweeps so much more broadly than Section 27B, the inclusion of affiliates and subsidiaries creates complications and significant unintended consequences.

As discussed in Part IV below, the definition of "conflicted transaction" does not require the securitization participant to intend to bet against the ABS transaction, or even to know about the ABS transaction at all. In the Proposal, the Commission makes clear that the Proposed Rule is intended to address the *incentive* a securitization participant may have to structure a deal to

[33] Proposed Rule 192(c).

[34] In order to fully address this problem, the Commission would also need to revise or clarify the definition of "conflicted transaction." *See infra*, Part IV.B.

[35] 15 U.S.C. § 77z-2a(a).

fail.[36] But no such incentive could be imputed to an affiliate or subsidiary of a securitization participant that has no awareness of the existence of the ABS transaction in question, whether due to the existence of a firewall, or due to its fundamental independence as a separate operating company.

In the private fund context, a manager will often serve as a general partner of various funds with distinct investment strategies.[37] Some private funds sponsor ABS, some private funds invest in ABS, and some do both. In addition, many private funds own portfolio companies, and those portfolio companies may also sponsor and/or invest in ABS themselves. In many cases, the funds themselves generally have no relationship with one another, and the portfolio companies have no relationship with one another, aside from the fact that they happen to share the same manager.[38]

Nonetheless, under the Proposed Rule, these private funds and portfolio companies would be required to monitor the securitization activities of one another merely by virtue of their indirect common control by the same manager, and each of those funds and portfolio companies would unwittingly become a "securitization participant" due to the unrelated securitization activities of the others.[39] There are numerous consequences that follow from that designation, but a significant one is that it materially limits the ability of related companies to manage their own credit risk. Many companies use index-based hedges such as CMBX to mitigate their

[36] *See, e.g.*, Proposal at 9680 ("We believe that the re-proposed rule would help to prevent the abusive conduct that Section 27B is designed to prevent by reducing the incentive for a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors."); *see also id.* at 9682 ("The re-proposed rule focuses on transactions that could give such persons the incentive to market or structure ABS and/or construct underlying asset pools in a way that would position them to benefit from the actual, anticipated, or potential adverse performance of the relevant ABS or its underlying asset pool."); *id.* at 9685 (a "contractual rights sponsor" that "enters into a conflicted transaction would have the incentive and ability to engage in the conduct that is prohibited by Section 27B"); *id.* at 9686 (noting that the Commission seeks to "avoid having the scope of the proposed definition of 'sponsor' extend beyond those persons with the incentive and ability to engage in the conduct that is prohibited by Section 27B"); and *id.* at 9692 (arguing that the "substantial steps" trigger is appropriate because it "is the point at which a person may be incentivized and/or can act on an incentive to engage in the misconduct that Section 27B is designed to prevent.").

[37] For purposes of this letter, we generally use the term "private fund" to encompass private equity funds, private credit funds, and other private investment vehicles.

[38] To the extent that the funds do in fact have relationships with one another, managers generally already have policies and procedures in place to manage any conflicts of interest that may arise from those relationships.

[39] A "securitization participant" is "[a]n underwriter, placement agent, initial purchaser, or sponsor of an [ABS]," and "[a]ny affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405)" thereof. Proposed Rule 192(d). Rule 405 provides that "[a]n *affiliate* of, or person *affiliated* with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified." 17 C.F.R. § 230.405 (emphasis in original). Rule 405 also provides that "[t]he term *control* (including the terms *controlling*, *controlled by* and *under common control with*) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *Id.* (emphasis in original).

exposure to certain credit risks.[40] What happens if, unbeknownst to that company, another related fund or portfolio company happens to be a securitization participant with respect to a commercial mortgage-backed securities ("CMBS") transaction referenced by CMBX?[41] In this scenario, it is possible that the company could be forced to abandon its hedging strategy, and thereby its ability to manage credit risk, for fear of unintentionally violating the Proposed Rule.

Moreover, the manager itself is placed in an impossible position. Managers owe a fiduciary duty to act in their funds' best interests, without regard to the activities of other funds. If it is in one fund's best interest to enter into a transaction that could be construed as a "conflicted transaction" with another unrelated fund, the manager must choose between faithfully executing its fiduciary duties and complying with the Proposed Rule. In the context of private funds and portfolio companies with unrelated and independent businesses, the Proposed Rule operates to the detriment of all parties involved.

This is simply not faithful to Section 27B, a statute designed to target transactions *designed to fail*.

This convoluted result could be avoided simply by giving due consideration to the facts and circumstances of securitization participants' relationships with their affiliates and subsidiaries. The Commission could do so in a number of ways. In addition to revising the definition of "sponsor," our preferred solution, as discussed below in Part IV, would be to align the Proposed Rule with the intent of Section 27B by providing that a transaction is only a "conflicted transaction" insofar as the securitization participant has actual knowledge of the ABS at issue, and structures the transaction to fail. It is plain that a party with no knowledge of an ABS transaction, or learns about the ABS transaction only after it has been structured and closed, has no incentive or opportunity to design it to fail.

Alternatively, if the Commission remains opposed to incorporating an "intent" standard in the Proposed Rule,[42] the Commission could remove affiliates and subsidiaries from the definition of "securitization participant" and revise the anti-evasion clause to provide that a securitization participant may not circumvent the prohibition of the Proposed Rule by utilizing an affiliate or a subsidiary to implement the scheme, and that the securitization participant's direction to do so is a necessary element of the prohibited conduct.[43]

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[40] "CMBX" refers to a series of indices referencing selections of CMBS securities, with respect to which investors have the option to take either long or short positions. Adam Hayes, *CMBX Indexes* (Jan. 1, 2022), https://www.investopedia.com/terms/c/cmbx_indexes.asp.

[41] The company would be unable to rely on the risk-mitigating hedging exception in Proposed Rule 192(b)(1). The company has no long exposure to the securitization with respect to which it is a "securitization participant" and therefore would be net short.

[42] *See* Proposal at 9697 ("We are not proposing an intentionally designed-to-fail test to determine what constitutes a material conflict of interest because we believe that such a test could lead to attempts to evade the rule.").

[43] As discussed in Part IV.D, *infra*, we believe that the anti-evasion clause should be removed entirely. However, this revision would help to mitigate our concerns regarding its vagueness.

One potential solution considered by the Proposal,[44] but not incorporated in the Proposed Rule, is an "informational barriers" exception. An "informational barrier" exception generally provides that, so long as a securitization participant does not share information regarding the ABS at issue with its affiliates and subsidiaries, those affiliates and subsidiaries may execute transactions without regard to the restrictions of the Proposed Rule. Information barriers are recognized as critical compliance tools in many regulatory contexts, including the federal securities laws.[45] But in many cases, *de facto* information barriers already exist between private funds and their portfolio companies simply by virtue of the fact they are independent businesses that operate as such, notwithstanding their common control by a shared manager, and may have no relationship or communication with one another in the first place. In those situations, knowledge of the ABS transaction at issue should not be imputed to one private fund or portfolio company for the sole reason that the management of another related fund or portfolio company was involved in its structuring.

In addition, as discussed below in Part V, most of our members are not banks or broker-dealers and are not subject to the Volcker Rule, which served as the template for the hedging and market-making exceptions in the Proposed Rule.[46] For organizations not already subject to the Volcker Rule, compliance will be a more burdensome and costly affair. We understand the potential utility of an "informational barriers" exception, but a one-size-fits-all "informational barriers" exception could be unduly burdensome for parties like funds and portfolio companies with a common manager that operate independently of each other and may not communicate with one another in the first place.[47] We therefore respectfully request that, to the extent that the Commission adopts an "informational barriers" exception, the Commission take into consideration the wide spectrum of regulated parties that would be required to institute them by acknowledging that *de facto* firewalls may already exist for companies engaged in unrelated businesses that already do not communicate with one another, and by ensuring that the knowledge of individuals structuring an ABS is not imputed to private funds engaging in unrelated businesses.

Lastly, the Proposal lacks any meaningful discussion on whether the Proposed Rule has any extraterritorial application.[48] Many financial institutions count among their affiliates various

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[44] Proposal at 9690-91; *see also id.* at 9720.

[45] The Commission itself recognizes as much in the Proposal. *See id.* at 9690 ("Information barriers, in the form of written, reasonably designed policies and procedures, have been recognized in others [sic] areas of the Federal securities laws and the rules thereunder. For example, brokers and dealers have used information barriers to manage the potential misuse of material non-public information to adhere to Section 15(g) of the Exchange Act. Also, Regulation M contains an exception for affiliated purchasers if, among other requirements, the affiliate maintains and enforces written policies and procedures reasonably designed to prevent the flow of information to or from the affiliate that might result in a violation of Regulation M.").

[46] *See* Proposal at 9703, 9705.

[47] *See infra*, Part V.

[48] The economic analysis of the Proposed Rule mentions that "domestic and foreign affiliates and subsidiaries" of "entities that provide services in the securitization process" will be affected by the Proposed Rule, but the Proposal does not discuss or analyze the inclusion of foreign entities. Proposal at 9712.

foreign entities that engage in business unrelated to their United States securitization activities, which may have only attenuated relationships with the United States capital markets, and which are subject to their own set of regulatory requirements.[49] In the Regulation RR rulemaking, the Commission and the other adopting agencies recognized as much by proposing, and ultimately adopting, a "safe harbor" provision for securitization transactions with respect to which "the effects on U.S. interests are sufficiently remote so as not to significantly impact underwriting standards and risk management practices in the United States or the interests of U.S. investors."[50] The same considerations counsel in favor of a similar safe harbor in the Proposed Rule. We respectfully request that the Commission adopt a similar safe harbor for foreign entities and transactions. The Commission could do so by exempting foreign entities from the definition of "securitization participant" and by excluding securities issued pursuant to Regulation S from the definition of "asset-backed security."

IV. The ambiguities in the Proposed Rule, and in particular the definition of "conflicted transaction," will result in significant uncertainty for market participants and will chill legitimate market activity.

The Proposal explains that the intent of the Proposed Rule is to target only those transactions that "effectively represent a bet against a securitization"[51] and to leave untouched "transactions that are wholly independent of, and not in connection to, the relevant securitization."[52] However, the layers of ambiguity in the Proposed Rule, and in particular, in the definition of "conflicted transaction," belie that intent. As a result, it is unclear precisely where the rule begins and where it ends.

A. The materiality standard is a disclosure-based standard and is fundamentally inappropriate for a prohibitive rule.

Under the Proposed Rule, a transaction is a "conflicted transaction" only to the extent that "there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the

[49] We do not believe that the Commission should apply the Proposed Rule extraterritorially. However, to the extent that the Commission intended that the Proposed Rule have extraterritorial application, the Proposed Rule does not make that clear, and any potential extraterritorial application of the Proposed Rule was not meaningfully analyzed in the Proposal's cost-benefit analysis. The Proposal expressly states that, to the extent that data from Green Street databases was considered, only "deals sold in the U.S." were included in its analysis. Proposal at 9712 n.203. To the extent that the Commission intends for the Proposed Rule to have an extraterritorial application, the Commission should issue a second notice of proposed rulemaking with details regarding the Proposed Rule's extraterritorial application, and should analyze the impact of that application in a subsequent cost-benefit analysis. *See infra*, Part V.

[50] *Credit Risk Retention*, 79 Fed. Reg. 77602 (Dec. 24, 2014), at 77735 (adopting release). The foreign transaction safe harbor for Regulation RR is codified at 12 C.F.R. § 244.20.

[51] Proposal at 9679.

[52] *Id.* at 9696.

[ABS]."[53] As the Commission notes, this standard is borrowed from *Basic v. Levinson*, 485 U.S. 224 (1988), a leading Supreme Court case on the application of Rule 10b-5.[54]

The use of a disclosure standard in a prohibitive provision is unusual and its application will prove to be fundamentally confusing. For example, a sponsor-affiliated portfolio company considering whether a proposed transaction would constitute a "conflicted transaction" with another portfolio company would need to apply the *Basic* standard to determine whether the conflict is sufficiently material to rise to the level of a "conflicted transaction." Even assuming that this portfolio company was somehow aware of its attenuated affiliation with the other portfolio company, in order to perform a *Basic* analysis, it would need to know details about the ABS transaction that it would have no reason to know. Ultimately, the portfolio company could only guess what a reasonable investor in an unrelated ABS would think.

This issue could be solved simply by focusing the definition of "conflicted transaction" where it belongs—transactions that entitle the securitization participant to profit from an intentional bet against the ABS or the underlying pool of assets.

B. Prong (iii) of the definition of "conflicted transaction" is inappropriately broad.

Subject to the materiality condition discussed above in Part IV.A, the definition of "conflicted transaction" includes "[a] short sale of the relevant [ABS]" and "[t]he purchase of a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant [ABS]."[55] On their face, prongs (i) and (ii) of the definition seem sufficiently clear, and provided that the Proposed Rule is otherwise appropriately narrowed as described elsewhere in this letter, these types of transactions seem responsive to the concerns of Section 27B.

However, we are concerned about the scope of prong (iii) of the definition of "conflicted transaction," which, subject to the materiality condition discussed above, includes "[t]he purchase or sale of any financial instrument (other than the relevant [ABS]) 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 [ABS];
(B) Loss of principal, monetary default, or early amortization event on the relevant [ABS]; or
(C) Decline in the market value of the relevant [ABS]."[56]

[53] Proposed Rule 192(a)(3).

[54] Proposal at 9696.

[55] Proposed Rule 192(a)(3)(i)-(ii).

[56] Proposed Rule 192(a)(3)(iii).

Prong (iii) is intentionally broad; as the Commission notes, its goal is to "alleviate the risk of any attempted evasion of the rule that is premised on the form of the transaction rather than its substance."[57] We are sensitive to that concern and agree that it would be appropriate for the final rule to include some kind of category that encompasses transactions that substantially replicate the economic effects of a short sale of, or credit default swap on, the relevant ABS. But prong (iii) goes too far in several respects. As Senator Levin explained on the Senate floor, Section 27B was intended to prohibit "underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures. This practice has been likened to selling someone a car with no brakes and then taking out a life insurance policy on the purchaser. . . . [Sponsors and underwriters], like the mechanic servicing a car, would know if the vehicle has been designed to fail."[58] Prong (iii) pushes the scope of the Proposed Rule well beyond transactions like those contemplated by Congress when Section 27B was enacted.

First, prong (iii) applies to "financial instrument[s]" and "transaction[s]." The text of the Proposed Rule clarifies that "financial instrument[s]" do not include the ABS at issue, but no similar parenthetical qualifies the term "transaction." As a result, it is unclear whether a securitization participant's exercise of its rights and obligations under the ABS transaction documents itself represents a "conflicted transaction." Even more broadly, "transaction" could even be read to encompass requests for consents and waivers under the underlying loan documents. The Proposal notes that "entering into an agreement to serve as a securitization participant with respect to an ABS would not itself be a 'conflicted transaction,'" but says nothing about the exercise of a securitization participant's rights after the issuance of the ABS.[59] We therefore request that the Commission clarify that the exercise of a securitization participant's rights under the ABS transaction documents does not constitute a "conflicted transaction" with respect to that ABS.

Second, and relatedly, clause (iii)(A) prohibits securitization participants from benefiting from the "[a]dverse performance of the asset pool supporting or referenced by the relevant [ABS]."[60] Sometimes, managers, funds and portfolio companies serve as servicers of ABS transactions that they sponsor, or serve in certain other administrative capacities, and in those capacities, they must deal with assets that become distressed. These servicers earn fees as compensation for their services, which are typically paid by the ABS issuer. Typically, whether or not the service provider is an affiliate of the sponsor, its fees are paid at a higher priority than distributions to investors, meaning that, in the event that poor pool performance results in a cash shortfall, service providers get paid even if investors realize losses on their investments. Indeed, in CMBS transactions, parties such as special servicers are engaged for the sole purpose of working out or liquidating distressed assets, and therefore earn the vast majority of their fees

[57] Proposal at 9695.

[58] 156 CONG. REC. S5899 (daily ed. July 15, 2010) (statement of Sen. Levin).

[59] Proposal at 9695.

[60] Proposed Rule 192(a)(3)(iii)(A).

from recoveries on distressed assets. By doing so, it could be argued that service providers dealing with distressed assets technically "benefit from the actual, anticipated or potential . . . [a]dverse performance of the asset pool . . . . "[61] However, as discussed below, this would be an inappropriate outcome.

Service providers affiliated with the sponsor would be "securitization participants" by virtue of that affiliation. However, even unaffiliated service providers risk inadvertently becoming "securitization participants." The Proposed Rule includes a "ministerial" exception from the definition of "sponsor" which provides that "a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of an [ABS] or the composition of the pool of assets underlying the [ABS] will not be a sponsor for purposes of this rule."[62] Servicers are not included in that list. The Proposal suggests that servicers may or not be "sponsors" depending on the "facts and circumstances," but does not offer any guidance on where and how to draw the line.[63] Additionally, the ministerial exception protects those performing ministerial acts in connection with the "structure, design, or assembly" of the ABS or the "composition of the pool of assets."[64] But servicers are only nominally involved in the structuring of the ABS or the composition of the pool; like any other party, they negotiate the terms of the ABS transaction documents for their own benefit, but they perform their duties after the closing of the ABS in the course of their operation and management of the pool of assets. As a result, both affiliated and unaffiliated service providers are exposed to the risk that they might inadvertently enter into a "conflicted transaction" simply by getting paid for doing their job.

It would be inappropriate to consider a service provider's provision of services to an ABS transaction to be, or to give rise to, a "conflicted transaction," whether or not the service provider is an affiliate of the sponsor. The identities of these service providers are disclosed in offering materials, as are the material terms of their engagement. Investors invest in the ABS with the knowledge that service providers are engaged to perform services necessary to keep the ABS vehicle functioning, and in some cases, even voice a preference for affiliated service providers. These service providers, whether affiliated or unaffiliated with the sponsor, are governed by strict standards of conduct that require them to act in the best interests of investors and to maximize recoveries on the underlying assets, without regard to conflicts of interest to which they may be subject. If the Commission takes such an overly broad view, then service providers could decline to accept new assignments for ABS-related services, resign from existing mandates, materially increase their fees, or shut down their ABS lines of business altogether, which in each case would result in unnecessary disruption to the ABS markets. In each case, it would be investors that pay the price.

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[61] Proposed Rule 192(a)(3)(iii)(A).

[62] Proposed Rule 192(c).

[63] Proposal at 9684-85.

[64] Proposed Rule 192(c).

There is no reason that a service provider should be considered to be engaging in a "conflicted transaction" simply by receiving fees for the services it was hired to perform, even if those fees arise from dealing with distressed assets. We therefore respectfully request that the Commission clarify that the collection of fees for servicing or administering the ABS or the underlying collateral does not constitute a "conflicted transaction," regardless of whether or not the service provider is an affiliate of the sponsor.[65]

Third, clause (iii)(A) could arguably be broadly read to restrict a securitization participant from entering into a transaction in respect of a single asset, or even a single obligor, in a pool of assets. This outcome would be problematic in that, as discussed in Part III.B above, it would unduly restrict the ability of sponsor-affiliates to manage their own credit risk. Our interpretation of the current language of the Proposed Rule is that, to rise to the level of a "conflicted transaction" under clause (iii)(A), the securitization participant must have a short position with respect to a material concentration of the assets underlying an ABS. The use of the term "asset pool" in clause (iii)(A) implies that a "conflicted transaction" must represent an actual, anticipated or potential benefit from the adverse performance of the pool of collateral when considered in its entirety. Additionally, as discussed in Part IV.A above, the definition of "conflicted transaction" is subject to an overarching materiality standard, and we believe that, generally, a reasonable investor would likely not consider a sponsor-affiliate's short position with respect to a single asset in a pool to be important to its investment decision. But that interpretation is uncertain given the broad and vague language in clause (iii)(A), and we therefore respectfully request that the Commission confirm our understanding of the language in clause (iii)(A) of the Proposed Rule.

Fourth, prong (iii)(B) prohibits securitization participants from benefiting from an "early amortization event on the relevant [ABS]."[66] But ABS routinely amortize prior to maturity due to early prepayments on the underlying assets. When an obligor under a securitized loan prepays its loan before its maturity date, the outstanding principal balance of the ABS is similarly reduced, thereby decreasing the amount of interest that ABS investors will be entitled to receive on future payment dates. If an obligor of a loan held by an ABS is also a securitization participant with respect to the ABS, would the obligor be prohibited from refinancing its loan into one with more favorable terms, on the grounds that doing so would reduce interest payments ultimately received by investors in the ABS? Relatedly, would the sponsor be prohibited from providing that refinancing to the obligor?

Our interpretation of the Proposed Rule, as drafted, is that the obligor would not be prohibited from refinancing its loan, and that the sponsor would not be prohibited from providing the financing necessary to do so. We believe that "early amortization event" in clause (iii)(B) means an event akin to what would occur in the event of a monetary default or a loss of principal

[65] As discussed in Part III.A, *supra*, the Commission could also address this issue, insofar as it concerns unaffiliated service providers, by expanding the ministerial exception to the definition of "sponsor." However, as discussed above, that revision does not address the issue for affiliated service providers that would otherwise be captured in the definition of "securitization participant."

[66] Proposed Rule 192(a)(3)(iii)(B).

due to realized losses—such as the failure to satisfy certain required performance triggers—and does not mean amortization caused by events like early prepayments on the collateral that are customary for the underlying assets and therefore inherent in the structure of ABS. But here, too, that interpretation is not obvious. For that reason, we ask the Commission to clarify that the term "early amortization event" does not include amortization due to events that are inherent to ABS transactions, such as prepayments on the underlying assets. Alternatively, the Commission could remove the phrase "early amortization event," as clause (iii)(B) already includes events such as "[l]oss of principal" and "monetary default."[67]

Again, the various ambiguities created by the definition of "conflicted transaction" would be easily resolved by narrowing the scope of the definition to the types of transactions that were the focus of Section 27B—those in which a securitization participant makes a deliberate bet against an ABS that it structured. However, if the Commission does not ultimately adopt such a standard, we believe that these revisions would go a long way toward minimizing the Proposed Rule's unintended consequences while remaining faithful to the intent of Section 27B.

C. Disclosure is a valuable tool and should be used where possible to mitigate the materiality of the conflict.

The Commission is clear that it considers disclosure an inappropriate curative tool.[68] We do not agree. The value of disclosure is a cornerstone of the federal securities laws, and the use of disclosure as a mitigant should not be so quickly dismissed. As noted by American Securitization Forum ("ASF") in the 2011 rulemaking, the legislative record demonstrates that one of the authors of Section 27B considered disclosure insufficient to cure the conflict in situations where "disclosures cannot be made to the appropriate party or because the disclosure is not sufficiently meaningful."[69]

We believe that an "all-or-nothing" approach is unnecessary. The Commission has the flexibility under Section 27B to make use of disclosure in lieu of a prohibition to mitigate the materiality of certain conflicts that do not implicate the central concerns of Section 27B, provided that any such disclosure is made to the appropriate party, is sufficiently meaningful and takes into consideration the sophistication of the parties involved. We therefore respectfully request that the Commission reconsider the use of disclosure as a curative tool, instead of imposing a universal prohibition on even the most trivial "conflicted transactions."

D. The anti-evasion clause renders the boundaries of the Proposed Rule indiscernible.

The Proposed Rule provides that "[i]f a securitization participant engages in a transaction that circumvents the prohibition in paragraph (a)(1) . . . the transaction will be deemed to violate

[67] Proposed Rule 192(a)(3)(iii)(B).

[68] Proposal at 9696-97.

[69] *See* Letter of ASF (Feb. 13, 2012), at 12 (citing 156 CONG. REC. S5899 and S5901 (daily ed. July 15, 2010)), https://www.sec.gov/comments/s7-38-11/s73811-40.pdf.

paragraph (a)(1) . . . ."[70] In her statement regarding the Proposal, Commissioner Peirce expressed concern that this provision could "unnecessarily cloud the rule's perimeters" and may not even be "necessary given the breadth of the prohibition."[71] We share the Commissioner's concern.

As noted above, the Proposed Rule features one ambiguity after another, and the Commission repeatedly takes the position in the Proposal that these ambiguities are necessary in order to prevent market participants from evading the substantive prohibition of the Proposed Rule.[72] The anti-evasion clause is a redundant addition to the already over-expansive provisions

[70] Proposed Rule 192(d).

[71] Commissioner Hester M. Peirce, *Statement on Proposed Rule: "Prohibition Against Conflicts of Interest in Certain Securitizations"* (Jan. 25, 2023), https://www.sec.gov/news/statement/peirce-statement-prohibition-against-conflicts-interest-012523.

[72] *See, e.g.*, Proposal at 9681 ("We are concerned that any particular definition of 'synthetic ABS' would be susceptible to potential overinclusiveness or underinclusiveness. Because of the inherent complexity of the transactions involved in a synthetic ABS, we are also concerned that a securitization participant might attempt to evade the re-proposed rule's prohibition by structuring such transactions around any particular definition of 'synthetic ABS' while nonetheless creating a product that would be a synthetic ABS within the commonly-understood meaning of the term"); *id.* at 9684 ("We believe that function-based definitions [of 'underwriter,' 'placement agent' and 'initial purchaser'] would encompass those persons who have a key role in the creation or sale of an ABS transaction, which would help prevent evasion by persons seeking to avoid the re-proposed rule's prohibitions by using a different title to refer to themselves, even though they perform the function described in the definition. These function-based definitions should address evasion concerns raised by certain commenters."); *id.* at 9685 ("Consistent with our concerns about the potential underinclusiveness of the Regulation AB definition of 'sponsor' for purposes of the re-proposed rule, paragraph (ii) of the proposed definition of 'sponsor' in proposed Rule 192(c) would apply more broadly to also cover, subject to certain exceptions, [contractual rights sponsors and directing sponsors]"); *id.* at 9690 ("Including affiliates and subsidiaries in the re-proposed rule would help to prevent affiliates and subsidiaries from being used to evade the rule's prohibitions . . . The re-proposed rule does not include the use of information barriers as an exception for affiliates and subsidiaries because we are concerned about the potential to use an affiliate or subsidiary to evade the re-proposed rule's prohibition."); *id.* at 9693 ("We believe that a commencement point that begins on the date of the first marketing or offering materials for the ABS, the pricing date for the ABS, or the point in time when an issuer engages those involved in structuring and marketing the ABS could be underinclusive because a securitization participant could engage in the misconduct that Section 27B is designed to prevent just prior to such commencement points and the rule would, as a result, not cover misconduct prior to those dates."); *id.* at 9695 ("given the potential ability of market participants to craft novel financial structures that can replicate the economic mechanisms of the types of transactions described in proposed Rule 192(a)(3)(i) and (ii) without triggering those prongs, proposed Rule 192(a)(3)(iii) should help alleviate the risk of any attempted evasion of the rule that is premised on the form of the transaction rather than its substance."); *id.* at 9695 (noting that the phrase "entry into a transaction" "should similarly help alleviate the risk of any attempted evasion of the rule that is premised on the form of the transaction rather than its substance."); *id.* at 9697 ("We are not proposing an intentionally designed-to-fail test to determine what constitutes a material conflict of interest because we believe that such a test could lead to attempts to evade the rule."); *id.* at 9699 (discussion of anti-evasion provision generally); *id.* at 9701 ("in order to prevent evasion, the requirements of [Rule 192(b)(1)(ii)(B)] would apply not only at the inception of the hedging activity but also whenever such hedging activity is subsequently adjusted"); *id.* at 9708 (noting that Proposed Rule 192(b)(3)(ii)(B) was included to respond to concerns that "requiring activity to be client-driven can help avoid a securitization participant providing a cover for activity that is not client-driven but is rather a bet against an ABS"); *id.* at 9715 ("the proposed definition [of 'sponsor'] would reduce rule evasion executed through non-contractual control over the composition of the asset pool for ABS"); *id.* at 9715 (noting that the "substantial steps" trigger "would help prevent evasive conduct that might happen before closing of a securitization . . . covering affiliates or subsidiaries of securitization participants under the proposed

of the Proposed Rule, and makes it unnecessarily difficult for market participants to actually comply with it or even understand it. As the Commission speculates, the cumulative effect of these ambiguities is that the Proposed Rule will chill even legitimate market conduct.[73]

We therefore respectfully request that the Commission remove the anti-evasion provision altogether. Alternatively, as discussed in Part III.B above, the Commission could more narrowly tailor the provision to, for example, apply only to the securitization participant's intentional use of an affiliate or subsidiary to accomplish an otherwise prohibited result. In either case, market participants need to be able to clearly distinguish between the types of conduct that are prohibited by the Proposed Rule, and the types of conduct that are not.

E. The Proposed Rule does not permit securitization participants to seek exemptive relief for ambiguous circumstances.

Lastly, we note that the Proposed Rule does not permit a securitization participant to seek exemptive relief from the Commission. The Commission has broad statutory authority to provide exemptive relief in certain circumstances to market participants.[74]

In the absence of exemptive relief, a securitization participant could submit a request that the staff of the Commission issue a no-action letter with respect to a particular set of circumstances. However, as the Commission has repeatedly cautioned, no-action letters are not considered to be statements of the Commission and have no legal force or effect.[75] Given the

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definition of 'securitization participant' would help ensure that the benefits of the re-proposed rule are not nullified through evasive conduct executed via such affiliates or subsidiaries"); *id.* at 9716 ("Defining the scope of these exceptions may also ease compliance with the rule, although benefits from specificity could be dampened by the proposed anti-circumvention provision which states that a transaction circumventing the proposed prohibition will be deemed a conflicted transaction. To the extent the proposed anti-circumvention provision prevents misuse of the exceptions, however, that provision would strengthen investor protections."); *id.* at 9719-20 (rejecting narrower definitions of "underwriter," "placement agent" and "initial purchaser" because "this could increase the circumstances in which a person attempts to evade the rule by engaging in prohibited conduct prior to when the person signed an agreement to be a securitization participant"); and *id.* at 9720 (rejecting a narrow definition of "securitization participant" because "this could also create opportunities to evade the intended prohibition of Section 27B and the re-proposed rule.").

[73] *Id.* at 9721.

[74] *See, e.g.*, 15 U.S.C. § 77z-3 ("The Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation issued under this subchapter, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.").

[75] *See, e.g.*, Letter from Josephine Tao, Assistant Director, Office of Trading Practices, Division of Trading and Markets to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA, Amended Rule 15c2-11 in Relation to Fixed Income Securities (Nov. 30, 2022), https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-113022.pdf, at 2 n.4 ("This letter represents the views of the staff of the Division. It is not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved its content. This letter, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person."); *cf. Gryl ex rel. Shire Pharms. Group Plc v. Shire Pharms. Group Plc*, 298 F.3d 136, 145 (2d Cir. 2002) ("SEC no-action letters

myriad ambiguities in the Proposed Rule, and the deliberate breadth of its scope, the Commission should provide for a process by which a securitization participant can obtain exemptive relief from the Commission upon which it may rely.

V. The Commission's cost-benefit analysis significantly understates anticipated costs and discounts significant concerns about the impact the Proposed Rule could have on capital formation.

The economic analysis undertaken by the Commission in the Proposal identifies some alarming risks. The Commission acknowledges that:

- The economic effects of the Proposed Rule could ripple through broader credit markets separate from the ABS markets.[76]
- The Proposed Rule may lead to potentially significant compliance costs.[77]
- The Proposed Rule may result in increased fees and costs, which would likely be passed on to investors.[78]
- The Proposed Rule would likely cause the curtailment or complete cessation of some activities or lines of business, even in "legitimate circumstances."[79]
- The Proposed Rule could cause a disruption in market relationships, including a loss of clientele.[80]
- The Proposed Rule could lead to adverse effects on market liquidity and investor choice.[81]
- The Proposed Rule could reduce information efficiency in ABS prices.[82]
- The Proposed Rule could ultimately have a negative impact on consumers whose loans back ABS products.[83]

We share all of these concerns, but the Commission dismisses them without due consideration.

We are particularly concerned about the compliance costs that the Proposed Rule will impose on our members. Unlike banks or broker-dealers, many of our members are not subject to the Volcker Rule. Regardless of whether the final rule is enacted with an information barriers

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constitute neither agency rule-making nor adjudication and thus are entitled to no deference beyond whatever persuasive value they might have . . . .").

[76] Proposal at 9714.

[77] *Id.* at 9716-19, 9725.

[78] *Id.* at 9717.

[79] *Id.* at 9717-19, 9721.

[80] *Id.* at 9717, 9719-20.

[81] *Id.* at 9717.

[82] *Id.* at 9719.

[83] *Id.* at 9719.

exception, our members will be required to incur significant additional compliance costs, which we expect to be materially higher than those of banks and broker-dealers that already have roughly similar compliance frameworks in place, without any real benefit. The Commission acknowledges this concern, and even acknowledges that this disparity could result in a competitive disadvantage for securitization participants not subject to the Volcker Rule,[84] only to dismiss it without a compelling reason to do so.

We understand the potential utility that compliance programs will provide toward achieving the goals of Section 27B. However, in its economic analysis, the Commission should balance the expected value of novel and complex compliance programs against the actual risk that the regulated party would engage in the type of conduct prohibited by Section 27B in the first place. That risk is not the same for each person that is currently captured in the definition of "securitization participant," and is especially remote for those persons that would be considered "securitization participants" merely because they have a remote and attenuated technical affiliation with a "sponsor." As a result, mandating cost-intensive compliance programs for parties such as managers and their portfolio companies yields very little regulatory benefit.

The Commission could mitigate these concerns for certain parties, such as managers, in a number of ways. One possible avenue could be revising the Proposed Rule to require that managers advise the funds and portfolio companies that they manage about the applicability of the Proposed Rule, and relieve the manager of the logistically fraught task of policing the actions of each and every portfolio company with which it has a relationship. An even simpler alternative would be to revise the definition of "sponsor" and "conflicted transaction" as described in Parts III.A and IV.B above. But in either event, the Commission's economic analysis should take into account the distance between the significant compliance costs for managers and portfolio companies, and the nominal benefits they would bring about, and the Commission should pause to consider whether a "one-size-fits-all" approach is necessary for all institutions.

We are also particularly concerned about the impact that the Proposed Rule will have on our members' business relationships. As the Commission notes, firm-investor relationships are both "costly to develop" and "valuable to maintain";[85] however, as the Commission also acknowledges, even legitimate market activity could be chilled as a result of the Proposed Rule, resulting in loss of clientele and disruption of relationships.[86] The Commission also acknowledges that this will have a disproportionate impact on firms like our members, many of

[84] *Id.* at 9718 ("The re-proposed rule could create competitive benefits for less diversified firms and firms that already have in place policies and procedures similar to the ones required by the re-proposed rule."); *see also id.* (noting that the similarity between the Proposed Rule's exceptions and the provisions of the Volcker Rule "would be more beneficial to securitization participants that are already familiar with the Volcker Rule compliance issues and already have relevant programs in place, because these securitization participants would incur lower initial costs of initial compliance. . . . Accordingly, those that are not subject to the requirements of the Volcker Rule could incur larger initial compliance costs.").

[85] *Id.* at 9719.

[86] *See, e.g.*, *id.* at 9717-18, 9721.

which are "diversified firms that service different risk-mitigation and investment needs of clients, customers, or counterparties."[87] The Commission all too casually ignores the real impact the Proposed Rule will have on those vital relationships.

The Commission suggests in the Proposal that the Proposed Rule could actually have a *positive* impact on capital formation.[88] For the reasons discussed in this letter, we think that outcome is highly unlikely. As currently drafted, the Proposed Rule could have a significant chilling effect by causing investors, sponsors, initial purchasers, underwriters and placement agents to exit the ABS markets, and by causing their affiliates and subsidiaries to abandon strategies that may be economically prudent for fear of inadvertently violating the Proposed Rule. And as noted above in Part IV.B, increased regulatory risk for service providers could have significant consequences for the operation of ABS transactions. The Proposed Rule, as proposed, would impact capital formation in only a negative way, and given the tremendous importance of securitization to the broader capital markets, those negative impacts would likely ripple well beyond the ABS markets.

Additionally, we are not confident in many of the Commission's factual assumptions. For example, the Commission assumes that the annual hourly burden for each securitization participant relying on an exception will be only 33 hours,[89] that the total annual direct compliance cost for the Proposed Rule for the entire market will be a mere $27,324,000,[90] and that there is no significant credit risk transfer activity outside of the credit risk transfer transactions sponsored by government-sponsored enterprises,[91] each of which seems implausible on its face. Additionally, the Commission's estimates regarding annual issuance of private-label ABS transactions and the total number of securitization participants relies on data presented in databases maintained by Green Street.[92] But the Green Street databases exclude wide swaths of the private-label market. The Commission acknowledges that these databases exclude unrated transactions,[93] but does not attempt to quantify the volume of unrated ABS transactions to which the Proposed Rule would apply. In addition, the Green Street databases also exclude tax-exempt issues, issues that are fully retained by an affiliate of the sponsor, issues that are sold to a commercial paper conduit operated by an affiliate of the sponsor and commercial paper and other

[87] *Id.* at 9717; *see also id.* ("Restricting the ability of securitization participants to maintain relationships that service multiple objectives could ultimately negatively affect both financial firms and their clients', customers', or counterparties' ability to conduct economically efficient activities.").

[88] *See, e.g.*, *id.* at 9717 ("Enhanced investor protection and more stable ABS markets could result in greater investor participation, resulting in higher capital formation. To the extent that the re-proposed rule reduces the adverse selection costs and improves pricing efficiency that follow from the asymmetric information problem discussed . . . above, it would result in more efficient allocation of capital and thereby enhance capital formation.").

[89] *Id.* at 9722.

[90] *Id.* at 9717.

[91] *Id.* at 9718.

[92] *Id.* at 9712, 23.

[93] *Id.* at 9712 n.203.

continuously offered securities such as medium-term notes,[94] each of which would also be subject to the Proposed Rule.[95]

Lastly, the economic analysis in the Proposed Rule gives no consideration to the time and money spent by regulated parties in considering and responding to the Proposal itself. When considered together with the time and money spent by those regulated entities in considering and responding to other Commission proposals, and other proposals by various other regulators, the cost becomes even more significant. We therefore request that the Commission conduct a second and more thorough economic analysis than the one in the Proposal, giving due consideration to the significant economic effects the Proposed Rule will have on our membership.

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In the interest of time, this letter presents the most pressing concerns of the AIC and its members. Discussions remain ongoing among the AIC, its members, and other market participants impacted by the Proposed Rule. Because of the ambiguous contours of the Proposed Rule, and the brevity of the comment period, it is almost certain that the AIC and its members will identify additional concerns after the comment period has ended. Unfortunately, at that point, neither the AIC nor its members will have any opportunity to present those concerns for the Commission's consideration.

The Commission has shown that it appreciates the central role that the ABS markets have in our financial system, and has recognized the possibility that the Proposed Rule will have significant and detrimental impacts on the ABS markets and on broader credit markets. We agree with that assessment. The Proposed Rule could be narrowly tailored to target problems at the heart of Section 27B, give due consideration to the various developments in the ABS markets since the financial crisis, and make room for legitimate market activities conducted without malicious intent. The AIC would likely support such a rule. Instead, the Proposed Rule targets invented problems and creates real ones, and for that reason, the AIC cannot support the Proposal. We respectfully encourage the Commission to proceed judiciously in light of the Proposed Rule's potential to disrupt a critical segment of the United States capital markets for a marginal benefit.

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[94] Green Street, *ABS Database Methodology*, https://my.greenstreet.com/pdf/debt-databases/Debt%20Database_ABS%20Database%20Methodology.pdf (last visited Mar. 20, 2023); Green Street, *CMBS Database Methodology* https://my.greenstreet.com/pdf/debt-databases/Debt%20Database_CRE%20CLO%20Database%20Methodology.pdf (last visited Mar. 20, 2023) Green Street, *CRE CLO Database Methodology*, https://my.greenstreet.com/pdf/debt-databases/Debt%20Database_CMBS%20Database%20Methodology.pdf (last visited Mar. 20, 2023).

[95] Relatedly, it is unclear whether the Green Street data considered by the Commission included commercial real estate collateralized loan obligation ("CRE CLO") transactions. CRE CLO transactions are reported in Commercial Mortgage Alert, but information about CRE CLO transactions is maintained by Green Street in a separate database. Green Street, *CRE CLO Database Methodology*, https://my.greenstreet.com/pdf/debt-databases/Debt%20Database_CRE%20CLO%20Database%20Methodology.pdf (last visited Mar. 20, 2023).

We appreciate your consideration and would be pleased to answer any questions you might have concerning our comments.

Respectfully submitted,

/s/ Rebekah Goshorn Jurata

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