March 27, 2023

Via Email to: rule-comments@sec.gov

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

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

Dear Ms. Countryman,

The Housing Policy Council[1] ("HPC") submits this letter in response to the Securities and Exchange Commission (the "Commission") proposed Rule 192 (the "Re-Proposed Rule")[2] issued pursuant to Section 621 of the Dodd-Frank Act.[3] The Re-Proposed Rule addresses asset-based security ("ABS") transactions that would involve or result in any material conflict of interest with respect to investors. More specifically, the Re-Proposed Rule prohibits securitization participants from engaging in transactions that could motivate a participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors. For example, it would prohibit ABS transactions in which one or more participants structure the transaction or select the underlying assets with the intent or expectation that the ABS securities will default, decline in value, or fail. The Re-Proposed Rule also includes certain exceptions for risk-mitigating hedging activities, bona fide market-making activities, and liquidity commitments.

HPC's members have a direct interest in the Re-Proposed Rule as it relates to mortgage-backed securities ("MBS") for the Private Label Securities ("PLS") market, the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac" and, together with Fannie Mae, the "Enterprises") and the Government National Mortgage Association ("Ginnie Mae").

HPC's members recognize that the Commission has modified its initial 2011 proposal to clarify the scope of prohibited and permitted conduct. However, to preserve legitimate transactions entered in good faith in the secondary market for residential mortgages, we recommend that the Re-Proposed Rule be narrowed to address only those securitization transactions structured with an intent to deceive investors. Moreover, narrowing the Re-Proposed Rule would eliminate the need to exempt the

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org.
[2] 88 Fed. Reg. 9678 (February 14, 2023). The Commission initially published the Re-Proposed Rule for public comment in 2011 as Rule 127B.
[3] Section 621 of the Dodd-Frank Act added a new Section 27B to the Securities Act of 1933.

Enterprises from the definition of sponsor, as well as other legitimate transactions entered in good faith in the secondary market for residential mortgages. The application of this rule and SEC regulatory treatment of the Enterprises should be consistent with that applied to other market participants.

The Rule Should be Focused on Intentional Conflicts not Bona Fide Portfolio Hedging or Asset-Liability Transactions

We recommend that the Re-Proposed Rule be revised to address only those securitization transactions that are structured with an intent to deceive investors. Narrowing the scope of the Re-Proposed Rule to an intentionally designed-to-fail standard would eliminate the need for specialized exemptions to permit legitimate transactions.

We recognize that in issuing the Re-Proposed Rule, the Commission considered, but rejected, the inclusion of an intentionally designed-to-fail standard. We believe, however, that such a standard is consistent with the statutory and regulatory intent. Both the preamble to the Re-Proposed Rule and the text of the rule indicate that the purpose of the Re-Proposed Rule is to capture transactions that constitute a "bet" against the relevant ABS or its underlying pool of assets. The preamble to the Re-Proposed Rule cites Senator Carl Levin's statement during the Congressional consideration of Section 27B that the "conflict of interest prohibition . . . is intended to prevent firms that assemble, underwrite, place or sponsor these instruments from *making proprietary bets against* those same instruments."[4] The preamble also states that the Re-Proposed Rule targets transactions that effectively represent *a bet against a securitization* and focuses on the types of transactions that were the subject of regulatory and Congressional investigations and were among the most widely cited examples of ABS-related misconduct during the lead up to the financial crisis of 2007-2009.[5]

A "bet" inherently includes an element of intent, to achieve a certain outcome. As such, intent is a necessary element in determining the existence of a material conflict of interest. As seen through its legislative history, Section 621 was aimed at eliminating "designed-to-fail" transactions and ending conflicts of interest arising when financial institutions create a security, sell it to investors and bet on its failure. Yet, instead of limiting prohibited conflicts to those related to "designed-to-fail" transactions, the Re-Proposed Rule would capture a broad range of risk-mitigating or common operational transactions where a securitization participant's redistribution of risk could be perceived to be a conflict with an investor but, in fact, the transaction mitigates risk and the securitization participant has not intentionally or deceptively designed a transaction to fail. We believe that a securitization participant should only fall within the scope of the rule if such participant intended to profit from the securitization transaction to the detriment of investors. If the "material conflict of interest" test is not narrowed to target only "designed-to-fail" transactions, legitimate securitization activity will be prohibited.

Furthermore, the inclusion of an intentionally designed-to-fail standard should not lead to attempts to evade the rule or make enforcement of the rule more difficult. The Commission has a long and successful history of enforcing rules that require a showing of intent.

[4] 88 Fed. Reg. 9679 (February 14, 2023), emphasis added.

[5] Id., emphasis added.

Explicit Exemptions or Clarifications

If the Commission decides not to narrow the application of the rule by including an intentionally designed-to-fail standard, HPC recommends that the rule should clarify that several common practices that are routinely used in the mortgage market are not within the scope of and therefore not subject to the rule OR that the Commission explicitly exempt these practices, including the following transactions and market participants:

Interest Rate Risk Mitigation - Investors do have interest rate risk with MBS investments. The MBS can fluctuate in value due to changes in prevailing interest rates. Owners of Enterprise as well as PLS MBS do not enter into "short" transactions whereby they seek to gain from reductions in value of their mortgage securities occasioned by increases in interest rates. They do, however, enter into debt and derivatives transactions to protect the value of their portfolios from interest rate fluctuations. These transactions are targeted to the outstanding portfolio and consequently the Commission should clarify, or expressly state, that they fit within the exception for hedging activities set forth in the Proposed Rule.

Credit Risk Transfers – As proposed, the Enterprise exclusion from the definition of sponsor would not extend to Credit Risk Transfer ("CRT") securities issued by the Enterprises.[1] The Enterprises should be covered by the rule, with clarification or explicit exemption for CRT transactions regardless of sponsor. Enterprise CRT has accomplished several important public policy objectives that are relevant for the MBS market as a whole. CRT attracted a broad set of investors to analyze and price the mortgage credit risk held by the Enterprises and that assume some of that risk using their own capital. In so doing, CRT has helped to promote more effective deployment of capital and reduce the concentration of mortgage credit risk on the Enterprises' balance sheets. Private mortgage insurers began using the same financial technology to reinsure mortgage insurance policies using mortgage insurance linked notes ("MILNs"). We believe the final rule should clarify that CRTs and MILNS, regardless of sponsor, are not considered conflicted transactions or that they fit within the exception for hedging activities set forth in the Re-Proposed Rule.

Mortgage Insurance Linked Notes Are Not Synthetic Asset-Backed Securities - We are also concerned about the potential impact that the Re-Proposed Rule could have on Mortgage Insurance-Linked Note ("MILN") transactions that have been utilized by the mortgage insurance industry since 2015 to procure reinsurance through the capital markets. The Re-Proposed Rule does not define the term "synthetic asset-backed securities" and does not provide specific guidance regarding whether any particular products are synthetic ABS. Rather, the Commission states its belief that its previous descriptions of the term are well understood by market participants and adequately address key issues raised by commenters on the prior version of the Re-Proposed Rule, and that market participants have been able to readily distinguish synthetic ABS from other types of transactions.[2] In the preamble, the Commission does seek comment on whether the rule should define the term and asks whether there are "particular products (1) where additional clarity is necessary as to whether such products are 'synthetic ABS' or (2) that the rule should expressly state are not 'synthetic ABS'."[3] MILNs are not synthetic ABS, as we understand the term, as they are not designed to create exposure to mortgage loans for securitization, but rather provide reinsurance on insurance policies written in the ordinary

[1] 88 Fed. Reg. 9688 (February 14, 2023).
[2] 88 Fed. Reg. 9680 (February 14, 2023).
[3] 88 Fed. Reg. 9682 (February 14, 2023), Request for Comment 4.

course of a U.S. regulated insurance business. However, the Commission should clarify, or expressly state, that MILNs are not synthetic ABS. For further context on MILNs, HPC directs the Commission to the comments provided separately by the U.S. private mortgage insurance industry.

Conclusion

In conclusion, HPC supports the Commission's goal to strike an appropriate balance between prohibiting the specific type of conduct at which Section 621 is aimed without restricting other securitization activities. In view of this stated purpose, we respectfully submit that "intent" be a necessary element of the definition of material conflict of interest and that securitizations that are not deliberately designed-to-fail should be permitted. Short of that narrow construction – the rule should specifically clarify that the types of transactions that shift risk transparently and with full disclosure across the parties, (as happens in Enterprise and private mortgage markets), as well as the standard actions taken by lenders and servicers in the course of their duties, are not subject to the rule. This would allow the rule to apply to all participants in the ABS markets, including the Enterprises, but in a such a manner that it would not curtail legitimate risk mitigating activities.

Should you have any immediate questions regarding these comments, please do not hesitate to contact us.

Yours truly,

Edward J. DeMarco
President
Housing Policy Council