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Via Electronic Submission

April 5, 2023

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

Re: Prohibition Against Conflicts of Interests in Certain Securitizations (Rel. No. 33-11151, File No. S7-01-23)

Dear Ms. Countryman:

This letter is submitted on behalf of the Securitization and Structured Finance Committee and Federal Regulation of Securities Committee (collectively, the "Committee") of the Business Law Section of the American Bar Association (the "ABA") in response to Proposed Rule 192 (the "Proposed Rule") under the Securities Act of 1933, as amended (the "1933 Act"), relating to the Prohibition against Conflicts of Interest in Certain Securitizations referenced above (the "Proposal") released by the U.S. Securities and Exchange Commission (the "Commission" or the "SEC"). The views expressed in this letter have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore should not be construed as representing the policy of the ABA.

As you know, the Proposal re-proposes a rule that the Commission initially proposed in September 2011. The Proposed Rule would implement Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") prohibiting an underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security ("ABS") (including a synthetic asset-backed security), or any affiliate or subsidiary of such an entity, from engaging in certain transactions that would involve or result in certain material conflicts of interest. We are pleased to offer our thoughts on the Proposal and thank the Commission for this opportunity.

I. Executive summary.

We appreciate the efforts of the Commission to propose a rule on conflicts of interest that is intended to restrict only transactions that represent a "bet" against the ABS by securitization participants. As we discuss throughout this letter, we are concerned that the Proposed Rule goes much further and would have a chilling effect on financial institutions' and other market participants' access to capital and ability to manage risks, with significant negative effects on financial stability, consumers' ability to borrow and the economy as a whole.

The following is a brief summary of the points that we make in more detail throughout the letter:

A. Mitigation of conflicts of interest.

Consistent with the approach taken by the Commission and other regulators in the regulations adopted under the Volcker Rule, the Commission should acknowledge that information barriers and disclosure can effectively mitigate conflicts of interest so that they would not be material.

B. The agreements that are essential to the structuring and issuance of the ABS should not be treated as "conflicted transactions".

The Commission has tried to distinguish between the issuance of ABS (permitted) and the agreements, such as those that create exposure to the reference pool for synthetics, that are essential to the structure of the ABS (potentially prohibited). These are not distinguishable, and, so long as there is full and fair disclosure, securitization participants should be permitted to enter into them with the issuing entity of the ABS.

C. Scope of Proposed Rule should be consistent with the Risk Retention Rules.

The conflict of interest rules should use a definition of ABS consistent with that used in the Risk Retention Rules, except for the mandated inclusion of synthetic ABS, and should have the same foreign safe harbor for transactions with limited US nexus.

D. The Commission should define "synthetic asset-backed security."

To ensure that the scope of the Proposed Rule is clear, the Commission should define "synthetic asset-backed security" as "a

security issued by a special purpose entity for which the timing and amount of payments to investors are determined based on the performance of a reference self-liquidating financial asset or a reference pool of self-liquidating financial assets, in each case as allocated through a hypothetical priority of payments."

E. Risk transfer or risk management by a securitization participant that has long exposure to the pool assets or the ABS should not be a conflicted transaction.

So long as appropriate disclosure is provided, transactions that transfer or mitigate the risk of long positions held by the securitization participant should not be prohibited.

F. Investors, warehouse lenders and others that reject pool assets based on underwriting criteria should not be treated as sponsors.

The Commission should recognize that entities that prevent low-quality assets from entering the asset pool are not selecting assets in a way that makes them a sponsor but are managing their own risk because those entities will have long exposure to such assets.

G. Affiliates and subsidiaries of securitization participants should only be subject to the Proposed Rule if they know about the ABS transaction.

In our view, it is important that securitization participants not share information about pending ABS transactions with affiliates that are not actively engaged in structuring or servicing the ABS. The Commission should support information barriers and should only apply the Proposed Rule to affiliates and subsidiaries of securitization participants that have an active role, are acting at the direction of a securitization participant, or are otherwise acting in concert with a securitization participant.

H. The commencement of the compliance period should be based on (i) a written engagement letter and (ii) commencement of marketing or pricing of the ABS. A "substantial steps" approach is too vague to be workable.

I. The definition of "conflicted transactions" should be significantly narrowed and should be based on the receipt of, or effort to obtain, speculative profit, rather than "benefits" that may include risk mitigation.

The Proposed Rule should only constrain transactions that are bets against the ABS and thus should not define "conflicted transactions" to include the benefits, including risk mitigation and access to capital, that are the fully-disclosed reason for the securitization.

J. The definition of "risk mitigating hedging" should consider only whether the securitization participant is reducing exposure to a long position that the participant holds, and should not have the significant compliance and recalibration burdens that apply to entities subject to the Volcker Rule.

The Commission should acknowledge that many securitization participants are less well-equipped than large financial institutions to establish the sort of structure that was mandated in the Volcker Rule (and that those entities that are subject to the Volcker Rule continue to be bound by its strictures in the context of an ABS transaction).

We discuss each of these points in detail below.

II. Introduction

The Dodd-Frank Act was adopted almost 13 years ago, in the immediate aftermath of the 2007-09 financial crisis, and initiated a fundamental transformation of the regulatory landscape for the financial industry. The Commission has adopted, including as a participant in the multi-agency adoption of, a great number of new rules in those 13 years. Risk retention regulations now require securitization sponsors to retain the credit risk of securitized assets to align the interests of such sponsors with the interests of investors.[1] Section 619 of the Dodd-Frank Act (the "Volcker Rule") prohibits banking entities from engaging in proprietary trading and making investments in private funds, subject to certain exceptions.[2] Swaps and security-based swaps have moved from the unregulated world of shadow banking to a robust oversight regime, under which they are subject to clearing and reporting requirements, and the Commission and the Commodity Futures Trading Commission (the "CFTC") have oversight of

[1] *See* 17 C.F.R. § 246.
[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 1851 (2010).

key market participants in swaps and security-based swaps, which are subject to regulatory capital requirements and margining standards. The Commission has made significant changes in the regulation of nationally recognized statistical rating organizations to enhance transparency and eliminate conflicts of interest in connection with the issuance of ABS. These are merely the most prominent of the recently adopted regulations affecting ABS markets.

A. Information barriers and disclosure should be permitted to mitigate conflicts of interest so that they are not "material," consistent with the stance the Commission has already adopted in the Volcker Rule regulations.

The Commission seeks to introduce the Proposed Rule into a very different regulatory landscape than the one that existed when Congress adopted Section 621. That does not, of course, mean that there is no need for a conflicts-of-interest rule for securitizations, but it does mean that the overlay of the Proposed Rule onto the now-existing regulatory framework should be approached with care. For instance, information barriers established by banking entities, as part of their Volcker Rule compliance programs, play an important role in mitigating conflicts of interest with their clients, customers, and counterparties but would prevent those banking entities from sharing information with affiliates about pending transactions, and interfere with the ability of those affiliates to comply with certain aspects of the Proposed Rule.

Indeed, the adoption of these information barriers, and the regulatory approval of such information barriers in the adopting release implementing the Volcker Rule, is particularly significant. The same language that is at the heart of Section 621 of the Dodd-Frank Act—the prohibition on certain transactions that involve "material conflicts of interest"—has already been interpreted by the Commission and the Office of the Comptroller of the Currency, Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Department of Housing and Urban Development in the adoption of regulations under Section 619. Specifically, the preamble to the adopting release states:

> The final rule recognizes that a banking entity may address or substantially mitigate a potential conflict of interest by making adequate disclosures or creating and enforcing informational barriers. Some commenters argued that the legislative history of the Dodd-Frank Act suggests that disclosure or informational barriers are not adequate to address a material conflict of interest. However, section 13 of the BHC Act directs the Agencies to define "material conflict of interest" and gives the Agencies

> discretion to determine how to define this term for purposes of the rule. Under the final rule, a material conflict of interest exists when the banking entity engages in transactions or activities that cause its interests to be materially adverse to the interests of its client, customer, or counterparty. At the same time, the final rule provides banking entities the opportunity to take certain actions to address the conflict, such that the conflict does not have a materially adverse effect on that client, customer, or counterparty. Under the final rule, a banking entity may address a conflict by establishing, maintaining, and enforcing information barriers reasonably designed to avoid a conflict's materially adverse effect, or by disclosing the conflict in a manner that allows the client, customer, or counterparty to substantially mitigate or negate any materially adverse effect created by the conflict of interest. *The Agencies believe that, to the extent the materially adverse effect of a conflict has been substantially mitigated, negated, or avoided, it is appropriate to allow the transaction, class of transaction, or activity under the final rule. Continuing to view the conflict as a material conflict of interest under these circumstances would not appear to benefit the banking entity's client, customer, or counterparty.* The disclosure standard under the final rule requires clear and meaningful information be provided to the client, customer, or counterparty in a manner that provides such party the opportunity to negate or substantially mitigate, any materially adverse effects on such party created by the conflict.[3]

In our view, the final rules adopted by the Commission under Section 621 of the Dodd-Frank Act (Section 27B of the 1933 Act) should take an approach to material conflicts of interest which is consistent with the approach that the Commission took in interpreting the identical phrase in the final rules adopted by the Commission under Section 619 of the Dodd-Frank Act. To do otherwise would risk upending the now-established policies and procedures that have been implemented by banking entities as part of their Volcker Rule compliance systems. What that would mean, as a practical matter, is that both information barriers and a disclosure standard that requires "clear and meaningful information" to be provided to investors would mitigate certain conflicts so that they are no longer a "material conflict of interest" for purposes of Section 621.

[3] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5,662. (Jan. 31, 2014) (footnotes omitted, emphasis added).

The reach of Section 621 is greater than the reach of Section 619, in that Section 621 applies to many entities that are outside the scope of the Volcker Rule. Although in many cases, "[a]n underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity of an asset-backed security" may be a banking entity, and thus has already been effectively prohibited from engaging in transactions involving material conflicts of interests of the type intended to be prohibited under Section 621, many remain outside the purview of the Volcker Rule. We therefore see one of the key aspects of the Commission's rulemaking to be to extend existing prohibitions (and existing mitigations) to a broad range of participants in ABS.

The Commission's purpose under the securities laws is two-fold: it exists both to protect investors and to support the formation of capital. We believe that both purposes are essential, and we recognize that striking the appropriate balance between them is an ongoing challenge. One of the Commission's guiding principles throughout its existence has been that full and fair disclosure allows that balance to be struck in the right place in most circumstances; the final regulations under Section 619 embrace that principle. Accordingly, although Section 621 requires the Commission to prohibit transactions that represent a material conflict of interest, in our view a definition of "material conflict of interest" which reflects the mitigating effects of disclosure is appropriate, is consistent with the Commission's history and other regulatory actions (including under the Dodd-Frank Act), and will best maintain the right balance.

B. The language of Section 621 does not by its terms prohibit transactions that are a core part of the issuance of the applicable ABS.

The key prohibition of Section 621 of the Dodd-Frank Act is set forth in what is now clause (a) of Section 27B of the 1933 Act:

> An underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity of an asset-backed security (as such term is defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c), which for purposes of this section shall include a synthetic asset-backed security, shall not, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security, engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity.

This language, unfortunately, is not drafted with precision. For example, there is no antecedent for "such activity" at the end of this provision, inasmuch as the word "activity" does not previously appear. As a result, it is likewise unclear what a "transaction arising out of such activity"—the phrase at the heart of the prohibition—means.

This is not merely semantics. Because the Commission is required to *prohibit* the transactions described in this language, understanding what transactions, and what conflicts, are specifically forbidden is essential. Although Section 27B lacks precision in certain respects, its key operative terms ("material conflict of interest," "sponsor," "underwriter," "placement agent" and "initial purchaser") have ordinary and well-understood meanings that should guide the Commission's rulemaking. In particular:

- The ordinary meaning of "conflict of interest" is a conflict between a legal duty and a personal interest. Thus, in defining "conflicted transactions" and determining the extent to which the rule should apply to transactions engaged in by affiliates and subsidiaries, we think it is useful to consider whether and to what extent the personal interest that a sponsor, underwriter, placement agent or initial purchaser has with respect to a transaction may lead that entity to disregard its duties under the securities laws.

- The ordinary meaning of "sponsor" in the context of securitization is the meaning codified in Regulation AB – "the person who organizes and initiates an asset-backed securities transaction by selling or transferred assets, either directly or indirectly, including through an affiliate, to the issuing entity."

In our view, the text of Section 27B allows the Commission to draft a final rule that is consistent with Congressional intent and recognizes the complexities involved in balancing the prohibition of the statute with the important roles that securitization transactions play across the financial sector. In particular, we believe that the Commission has significant leeway to conclude that transactions that are a fundamental part of the structure of the ABS—and fully disclosed—are outside the prohibition. As we discuss below, this is of particular importance in connection with synthetic ABS, because the Proposed Rule suggests that the swap or other contract that operates to create the synthetic security may create a conflict with investors which must be prohibited under the Proposed Rule. We do not believe that this is a required, or appropriate, interpretation of the statutory language.

III. Scope of Proposed Rule: transactions covered, participants, and time frame.

A. The scope of transactions covered by the Proposed Rule should be consistent with the scope of transactions covered by the Risk Retention Rules, except for the statutorily mandated inclusion of synthetic ABS.

Section 941 of the Dodd-Frank Act requires that securitization sponsors retain five percent of the credit risk of their securitized assets, to better align the interests of the sponsors of securitization transactions with those of the investors in such transactions. The expectation was that such alignment would cause sponsors to originate and securitize higher quality assets if they were required to retain a portion of the credit risk of those assets, rather than transferring all of the risk to investors through an "originate to distribute" model. The Commission, together with five other federal agencies, adopted the risk retention rules to implement Section 941 (the "Risk Retention Rules").[4]

Although the Risk Retention Rules work to align the interests of securitization participants with those of investors by requiring the securitization sponsor (or its majority-owned affiliate) to invest alongside third-party investors, the Proposed Rule seeks to achieve a similar objective by expressly prohibiting transactions that represent a material conflict of interest with the securitization's investors. The objectives of the Risk Retention Rules are thus similar to the objectives of the Proposed Rule, both sets of rules were mandated by the same statute, and we see no reason that the scope of the Proposed Rule should be different than that of the Risk Retention Rules beyond the inclusion of synthetic ABS.

1. The definition of "asset-backed security" for purposes of the Proposed Rule should be no different than the existing definition of "asset-backed security" in Section 3(a)(79) of the Exchange Act, except for the inclusion of synthetic ABS.

The Commission has proposed to base its definition of "asset-backed security" on the existing definition of "asset-backed security" in Section 3(a)(79) of the Securities and Exchange Act of 1934, as amended ("Exchange Act"),[5] and has requested comment on this proposal. We believe that this is a reasonable approach, in that market participants have now had significant experience in distinguishing ABS from other securities under that definition in connection with the implementation of the Risk Retention Rule. We do note that from time to

[4] *See* 17 C.F.R. § 246.

[5] "Asset-backed security has the same meaning as in Section 3(a)(79) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(79)), and also includes synthetic asset-backed securities and hybrid cash and synthetic asset-backed securities.

time the Commission has published guidance regarding whether an instrument is an "asset-backed security". For example, in one telephone interpretation, the Commission clarified that "the definition of 'asset-backed security' under Section 3(a)(79) of the Exchange Act requires, in relevant part, that a security meeting that definition be collateralized by a self-liquidating financial asset.[6] As such, a funding agreement entered into by an insurance company with a special purpose vehicle, where the insurance company is directly liable for the funding agreement that backs the notes, is not an "asset-backed security".[7] In cases where the Commission has already considered an interpretive question regarding Section 3(a)(79) and has provided formal or informal guidance, as with funding agreement backed notes, we believe formalizing that guidance by clarifying it in the adopting release would be helpful to market participants.

2. The Proposal should include a foreign safe harbor comparable to the foreign safe harbor included in the Commission's Risk Retention Rules.

The Risk Retention Rules include a foreign safe harbor which provides that, if a securitization transaction satisfies certain criteria that relate to the transaction's connections (or absence thereof) to the United States, then the transaction is exempt from the Risk Retention Rule.[8] We note that a transaction

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[6] *See* Regulation AB and Related Rules, U.S. Securities and Exchange Commission (Sep. 6, 2016), https://www.sec.gov/corpfin/divisionscorpfinguidanceregulation-ab-interpshtm

[7] *See* Id.

[8] The criteria are:

(1) The securitization transaction is not required to be and is not registered under the [1933 Act];

(2) No more than 10 percent of the dollar value (or equivalent amount in the currency in which the ABS interests are issued, as applicable) of all classes of ABS interests in the securitization transaction are sold or transferred to U.S. persons (as defined in the Risk Retention Rules) or for the account or benefit of U.S. persons;

(3) Neither the sponsor of the securitization transaction nor the issuing entity is:

(i) Chartered, incorporated, or organized under the laws of the United States or any State;

(ii) An unincorporated branch or office (wherever located) of an entity chartered, incorporated, or organized under the laws of the United States or any State; or

(iii) An unincorporated branch or office located in the United States or any State of an entity that is chartered, incorporated, or organized under the laws of a jurisdiction other than the United States or any State; and

(4) If the sponsor or issuing entity is chartered, incorporated, or organized under the laws of a jurisdiction other than the United States or any State, no more than 25 percent (as determined based on unpaid principal balance) of the assets that collateralize the ABS interests sold in the securitization transaction were acquired by the sponsor or issuing entity, directly or indirectly, from:

(i) A majority-owned affiliate of the sponsor or issuing entity that is chartered, incorporated, or organized under the laws of the United States or any State; or

that qualifies for the safe harbor may have some connection to the United States. Up to 10% of the dollar (or the applicable currency) value of the ABS interests may be transferred to U.S. persons (as defined in the Risk Retention Rules), and up to 25% of the assets that collateralize the ABS interests may be acquired from entities that are chartered, incorporated, or organized under the laws of the United States or any state, or located in the United States or any state, without disqualifying the related securitization transaction from the safe harbor. In the preamble to the adopting release for the final Risk Retention Rules, the adopting agencies stated: "The safe harbor was intended to exclude from the risk retention requirements *transactions in 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"*[9].

In our view, in light of the similar objectives of the Proposed Rule on conflicts of interest, and the Risk Retention Rules, we see no reason that a comparable foreign safe harbor should not be available under the Proposed Rules. Nor do we see a reason that the geographic scope of the Proposed Rule should be more expansive or the need for investor protection more acute in the case of the Proposed Rule than in the case of the Risk Retention Rules. Accordingly, we believe that the Proposed Rule should be modified to include a safe harbor that is substantially the same as the safe harbor included in the Risk Retention Rules.

3. The Commission should define "synthetic asset-backed security" to provide clarity to securitization participants about the scope of the Proposed Rule.

We recognize that the Commission has received conflicting comments in the past with respect to defining "synthetic securitization" or "synthetic asset-backed securities." In our view, a definition is necessary. As the Proposal notes, the Commission has previously described synthetic securitizations, in general, "as securitizations that are designed to create exposure to an asset that is not transferred to or otherwise part of the asset pool".[10] However, given that the core concept of a securitization is the issuance of an ABS, and the definition of ABS looks to whether the payment of the securities depends primarily on the cash flows from self-liquidating financial assets, it is unclear how a "securitization" could exist in the absence of such cash flows. One construct that would be consistent with transactions commonly thought of as synthetic securitizations

(ii) An unincorporated branch or office of the sponsor or issuing entity that is located in the United States or any State.

[9] Credit Risk Retention, 79 Fed. Reg. 77668 (Dec. 24, 2014).

[10] For a general discussion of synthetic securitizations, see Section III.A.2. of 2004 Regulation AB Adopting Release.

would be to tie the transaction to a hypothetical structure. For instance, the Commission might define a synthetic ABS as follows:

> A "synthetic asset backed security" is a security issued by a special purpose entity[11] for which the timing and amount of payments to investors are determined based on the performance of a reference self-liquidating financial asset or a reference pool of self-liquidating financial assets, in each case as allocated through a hypothetical priority of payments.

We recognize that the Commission may be concerned about defining the term too narrowly; however, the Proposal currently allows for too much ambiguity in describing synthetic transactions and thus may call into question the permissibility of a wide range of securities and transactions that either were not intended by Congress to be impermissible or that do not raise the sort of material conflicts of interest that Congress sought to regulate, thus impairing the ability of market participants to use such transactions as a necessary means to allocate various kinds of risk in their portfolios.

a. Treatment of credit risk transfer transactions (agency and non-agency) and credit-linked notes.

Although credit risk transfer ("CRT") transactions are not specifically prohibited by the Proposed Rule itself, the discussion in the Proposal regarding such transactions indicates that the Commission believes that the Proposed Rule would *per se* prohibit at least a portion of them. With respect to security-based CRT transactions issued by the Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac" and together with Fannie Mae, the "Enterprises"), the Commission suggests that such CRT transactions could be a "conflicted transaction" under the Proposed Rule with respect to an Enterprise's guaranteed ABS but for the Proposed Rule's conditional exemption of the Enterprises from the definition of sponsors.[12] It is unclear how the Commission views CRTs that are not security-based.

With respect to private CRT transactions, the Commission's discussion in the "Exception for Risk-Mitigating Hedging Activities" section specifically states that

[11] We suggest specifying that a synthetic asset-backed security is one issued by a special purpose entity to distinguish these securities from securities issued off a corporate balance sheet, such as certain structured notes, that may have payments correlated to various indices, commodities or assets but that are corporate debt obligations of an operating company.

[12] *See* Prohibition Against Conflicts of Interest in Certain Securitizations, 88 Fed. Reg. 9678. (Feb. 14, 2023) (to be codified at 17 C.F.R. 230).

> the initial issuance of an ABS, such as a synthetic ABS, would not be risk-mitigating hedging activity…the re-proposed rule prohibits a securitization participant from creating and/or selling a new synthetic ABS to hedge a position or holding. In these synthetic ABS transactions, a securitization participant is typically a party to a CDS contract with the issuing entity of the ABS. We are concerned that such activity would weaken the conflicts of interest protection of the re-proposed rule by allowing a securitization participant to engage in a transaction (the CDS contract(s) with the issuer) where cash paid by ABS investors to acquire the newly created synthetic ABS would fund the relevant CDS contract(s) and be available to make a payment to the securitization participant upon the occurrence of an adverse event. This type of transaction was the focus of Congressional scrutiny in connection with the financial crisis of 2007–2009. Moreover, the securitization participant would perform a central role in creating, structuring, and/or marketing the relevant synthetic ABS that is being issued and, in connection with such role, would likely obtain additional benefits such as arranger or manager compensation. These factors would go beyond engaging in risk-mitigating hedging activity that is designed to reduce specific risks to the securitization participant in connection with positions or holdings arising out of its securitization activities and could raise conflicts of interest with investors in the new synthetic ABS that we believe Section 27B is intended to prohibit."[13]

This language is unclear. It appears to state that synthetic ABS transactions are prohibited. It also appears to state that the proposed definition of the term "conflicted transaction" does not prohibit the issuance of synthetic ABS but does prohibit the entry into the contract that creates exposure to the reference assets by a securitization participant, which is effectively the same thing.[14] It is also unclear what issuance the Commission believes created the ABS, which must exist for there to be a conflicted transaction. At the beginning of this statement, the Proposal implies that the relevant ABS is something the securitization participant currently holds ("…creating and/or selling a new synthetic ABS to hedge a position or holding"). However, at the end of the statement, the conflict of interest is between the securitization participant and the holders of the new synthetic ABS. Indeed, the Commission states that "the re-proposed rule ***prohibits*** a securitization participant from creating and/or selling a new synthetic ABS to hedge a position or holding" (emphasis added). Although the Commission has built a "reasonable investor" test into the Proposed Rule, here the Commission disregards that test and replaces it with the Commission's own determination that such a transaction is prohibited. To illustrate that this is indeed the intended result, the Commission again, in request for comment 57, states that

[13] *See* Id. at 9700.
[14] *See* Id. fn. 133.

"[u]nder the re-proposed rule, the issuance of a synthetic ABS where a securitization participant enters into the short side of the transaction with the issuing entity of the synthetic ABS would be a "conflicted transaction" because the securitization participant would be entitled to payment if the referenced assets, and thus the ABS, perform poorly."[15] Perhaps the Commission is trying to say that certain types of synthetic ABS are *per se* prohibited (such as those that are speculative in nature) but others are not (such as those where the securitization participant is long the underlying asset).

One possible way to read these comments together in a way that does not indicate that all synthetic ABS is prohibited is to go back to the Commission's discussion of Enterprise CRT transactions. There are ***two*** asset-backed securities that are related to the Enterprise CRTs, which we will refer to as the MBS (the mortgage-backed securities that are established and guaranteed by the Enterprises) and the CRTs, which hedge the credit risk of the underlying assets (but generally reflect a broad swath of mortgages and not only those that relate to a specific MBS). The Commission appears to be saying that, as long as the MBS are backed by the full faith and credit of the US federal government, the Enterprises are not securitization participants with respect to the MBS and the issuance of the CRTs are not conflicted transactions with respect to the MBS. However, the Enterprises are sponsors, and thus securitization participants, with respect to the CRTs, and so short selling the CRTs would be prohibited. When the Enterprises emerge from conservatorship, they will become sponsors of the MBS. Does the Commission intend to say that the Enterprises, by entering into the derivative contract that establishes the CRT, would be engaged in a conflicted transaction at that point with respect to ***the investors in the MBS*** or with respect to ***the investors in the CRT***, or ***both***? If the conflicted transaction is with the investors in the CRT, then whether the Enterprise is in conservatorship should not be relevant, and the CRTs—and by extension, all synthetic ABS that involves a derivative-like contract between the sponsor and the issuing entity, which means effectively all or nearly all synthetic ABS—would be prohibited. If the conflicted transaction is ***only*** with the investors in the MBS, that is still an issue and the definition of risk-mitigating hedging is not providing the protection that it should—but it is not an issue of the same magnitude as the apparent prohibition of all synthetic ABS.

Although there is nothing in either the text of Section 27B or its legislative history that suggests that Congress intended that the Commission ban classes or

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[15] *See* Id. at 9698. This is contradicted by the economic analysis section of the Proposal, which notes that "current market practices may be generally consistent with the re-proposed rule requirements as a result of compliance with … existing rules." *See* Proposal at 9712. Clearly CRTs are current market practices. This inconsistency makes it even more imperative that the Commission clarify this position.

categories of securitization transactions, that is one reading of the Proposal that the drafting committee for this letter has struggled to understand. We urge the Commission to make clear in any final rule that CRTs, synthetic ABS, mortgage-insurance linked notes and similar credit risk mitigation transactions are not per se "conflicted transactions" under the Proposed Rule and, in fact, are generally permissible unless they evidence an intentional bet against a ***separate*** ABS by an entity that is a securitization participant ***for that separate ABS*** and that is not engaged in risk mitigation hedging of long exposure that it holds with respect to the separate ABS or the assets underlying that separate ABS. Banks use CRTs, synthetic ABS, mortgage insurance-linked notes ("MILN"s) and other credit risk mitigation transactions to manage their credit risks. If the final rule prevents financial institutions from managing their credit risks effectively with securitization transactions, we are concerned that the potential consequences may extend beyond any one financial institution, as recent events have demonstrated. Impediments to the bank risk management activities of financial institutions pose a threat to the financial stability of the United States because the failure of a single financial institution can have cascading effects and an outsized impact on the US financial system.

4. To the extent a security-based swap or similar agreement or instrument is embedded in a synthetic securitization, this arrangement should be viewed not as a conflicted transaction but as a core element of the structure.

Synthetic ABS transactions often use derivatives such as credit default swaps, total return swaps or similar contractual frameworks mirroring the features of a swap.[16] A total return swap is a contract between two parties, in which one party makes fixed payments while the other party makes payments based on the total return of an underlying asset. Many of these fall within the defined term "security-based swap" and thus are within the Commission's jurisdiction.

The Commission appears to assert that the use of total return swaps and other security-based swaps present securitization participants with an opportunity to benefit from such adverse performance of the relevant ABS or the underlying collateral.[17] Because the swaps present an opportunity to benefit from the adverse performance, the Commission states that the transaction would fall within the scope of the Proposed Rule.[18] In fact, the Commission goes on further to say that synthetic ABS transactions that are structured similar to swaps, but not otherwise documented as swaps, would still fall within the scope of the Proposed

[16] Id. at 9681.
[17] Id. at 9695.
[18] Id.

Rule since the transaction would still present an opportunity to benefit from the adverse performance of the assets.[19]

Much like CRT transactions, the use of swaps is integral to the synthetic ABS market and constitutes a standard form of risk mitigation that should be excluded from the scope of the Proposed Rule. The use of swaps is normally negotiated at the outset of structuring a transaction, allowing for the parties to take on both the type and amount of risk associated with a certain pool of collateral which best serves the respective transaction participant. Stated more simply, the Proposal characterizes an agreed-upon and fully-disclosed risk and profit allocation in many transactions as a potentially nefarious gamble rather than the economic "meeting of the minds" that it is.

5. The Commission should not consider the security-based swap, total return swap or similar agreement or instrument embedded in a synthetic ABS or other type of security as a material conflict of interest so long as the terms of the swap are fully and fairly disclosed to investors.

The Proposed Rule should clarify that the embedded swap or other contract used to create synthetic exposure to an asset pool as part of the issuance of synthetic ABS is an integral component of the issuance of the synthetic ABS and not a separate, conflicted transaction. These synthetic ABS are issued in transactions for which the express, explicit, fully disclosed purpose of the transaction is to transfer risk from a transaction participant to capital markets participants who expressly choose to take on such risk. The agreements between a sponsor or other securitization participant and the issuer of the synthetic ABS in these types of transactions, which include MILN transactions, issuances of funding agreement-backed notes, credit-linked notes, CRT securities, synthetic balance sheet CLOs and similar transactions used by banks, insurance companies and other financial market participants to manage risk and regulatory capital, should be excluded from the definition of conflicted transaction, inasmuch as the parties to the transaction explicitly understand the risk that is being transferred, and that the transfer of such risk is the economic rationale underpinning the transaction. As was the case with our earlier discussion of the ways in which disclosure has been understood to mitigate conflicts of interest such that they are not "material conflicts of interest," this is an area in which we believe that market practice has aligned with the Commission's long-standing emphasis on clear and complete disclosure as the primary way of enabling investors to evaluate and mitigate the risk. The Commission states that investor consent should not constitute an exception to the Proposed Rule, positing that such consent would cause securitization participants to pressure investors and undermine the

[19] Id.

effectiveness of the Proposed Rule.[20] These transactions, however, do not entail a risk that is ancillary to the transaction. Instead, these transactions are negotiated with the understanding that the risk is the essential element of the transaction, an element that could benefit all parties involved. The sophisticated market participants to which these synthetic ABS are sold should be permitted to make their own evaluation of the risks and conflicts in these transactions.

a. Many regulated financial institutions depend on synthetic ABS for risk mitigating hedging and other aspects of financial management and would lose a critical risk management tool if these agreements were prohibited.

Credit portfolio management ("CPM") transactions, which are often structured as synthetic ABS, are an important tool for banks in prudently managing their risks. If CPM transactions are successful in transferring risks associated with banks' lending books to a wider market, banks will be safer from a risk management perspective and will be better positioned to lend to the real economy. The ability and willingness of banks to increase lending depends on their ability to mitigate risk on their exposure through a variety of instruments, including by means of executing risk transfer transactions efficiently. Prudential supervisors and policy makers scrutinize such transaction entered into with regulated financial institutions to ensure that there is an effective transfer of risk.

In Europe and the UK, a mature market has developed for synthetic securitizations that are used as risk management tools. Banking institutions in those geographies frequently enter into synthetic securitizations in respect of books of loans on their balance sheet, in order to manage exposure limits in respect of assets that remain on the consolidated balance sheet of the originator's group. Prudential regulators (at the EU or national level) review applications relating to significant risk transfer transactions and may either approve them or raise an objection. Any extra-territorial application of the Proposed Rule which may in its proposed form be interpreted as prohibiting such transactions even outside the United States would have a significant adverse effect on the ability of EU and UK financial institutions to continue to use this essential risk management tool, with negative implications across the global economy.

Similar concerns exist with respect to US banks, which as noted earlier are already subject to the Volcker Rule prohibition on transactions involving material conflicts of interest—and nonetheless currently have the ability to use these types of transactions for risk management purposes. At a time when banks are under significant financial strain, depriving them of their ability to use

[20] Id. at 9697.

synthetic asset-backed securities as part of their prudential risk management tools would have materially adverse implications far beyond the securitization markets.

6. The Commission should not consider MILNs to be synthetic asset-backed securities or the reinsurance agreements embedded in MILNs to be conflicted transactions prohibited by the Proposed Rule.

It appears that the Proposed Rule could view MILNs as synthetic securitizations and the reinsurance agreements used in MILNs as prohibited conflicted transactions. Because a MILN is not collateralized by a self-liquidating financial asset, a MILN does not satisfy the definition of an asset-backed security under Section 3(a)(79) of the Exchange Act. However, although the market does not consider a MILN to be a synthetic securitization, the Proposal includes language that suggests that the SEC may view a MILN as a synthetic securitization.[21] If a MILN were within the scope of the Proposed Rule, it is not clear whether Section 192(a)(3)(iii)(A) would prohibit, as a conflicted transaction, the reinsurance agreement used in that MILN as "a transaction through which the securitization participant [(i.e., the mortgage insurer)] would benefit from the actual, anticipated or potential adverse performance of the asset pool … referenced by the relevant asset-backed security." We suggest that the Commission clarify that MILNs are transactions exempt from the Proposed Rule and that the reinsurance agreements embedded in MILNs are not conflicted transactions prohibited by the Proposed Rule.

MILNs provide mortgage insurers with reinsurance on specified pools of mortgage insurance policies, a structure which state insurance regulators and both Enterprises have historically approved and encouraged. In a MILN structure, a mortgage insurer enters into a reinsurance agreement with a special purpose insurance company. The special purpose insurance company issues securities to investors, places the proceeds of those securities in a reinsurance trust and uses the funds in the reinsurance trust to make any payments that the company is required to make to the mortgage insurer under the reinsurance agreement. The reinsurance agreement requires the special purpose insurer to make payments based on certain losses incurred on a specified pool of mortgage insurance policies that are obligations of the mortgage insurer. In consideration for the reinsurance coverage provided to the mortgage insurer under the reinsurance agreement, the insurer pays premiums to the special purpose insurance company,

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[21] See, text at footnote 38, stating that a synthetic securitization is a transaction "designed to create exposure to an asset that is not transferred to or otherwise part of the asset pool," text at footnote 40 and the following statement from page 9695 of the Proposal "the relevant agreement that the securitization participant enters into with the special purpose entity that issues the synthetic ABS may in some circumstances not be documented in the form of a swap."

which premiums the special purpose insurance company uses to pay its operating expenses, including interest on any bonds it has issued.

The mortgage insurer engaging in a MILN transaction does not transfer the pool of mortgage insurance policies to the special purpose insurer. The mortgage insurer remains directly responsible to the insured under the related policies for its policy obligations regardless of whether it receives any payment under the reinsurance agreement.

The mortgage insurer also retains risk on the mortgage insurance policies that is not reinsured by the reinsurance agreement. The reinsurance agreement in a MILN identifies levels or layers of risk on the underlying policies. Above a certain level or layer, the mortgage insurer retains the risk on the policies. The mortgage insurer also retains the risk on the policies for all losses below a specified level or layer.

The mortgage insurer is only entitled to recover its actual loss (i.e., it can only recover under the reinsurance agreement if it has made a payment on one of the mortgage insurance policies in the identified pool). In order to obtain a payment under the reinsurance agreement, the mortgage insurer must always retain an insurable interest in the mortgage insurance policies.

Because the relevant mortgage insurer (i) remains responsible for payment on the mortgage insurance policies in the pool, (ii) retains risk on the mortgage insurance policies and (iii) is only entitled to recover its actual losses incurred under the mortgage insurance policies, it appears that, even if the Commission viewed MILNs as synthetic securitizations, MILNs are not the type of speculative transactions that the Commission intends to be included as conflicted transactions prohibited by the Proposed Rule. Therefore, we suggest that the Proposed Rule include clarifications that MILNs are transactions exempt from the Proposed Rule and that the reinsurance agreements embedded in MILNs are not conflicted transactions prohibited by the Proposed Rule.

B. The "securitization participant" definition should exclude entities with a long exposure to the assets and the power to direct the exclusion of assets from the collateral pool based on underwriting criteria or risk appetite.

1. Contractual rights sponsors and directing sponsor.

We think that expanding the definition of securitization participant to encompass both "contractual rights sponsors" and "directing sponsors", as proposed, makes the Proposed Rule overly broad. We recognize that, in

proposing this expanded scope, the Commission is seeking to capture a transaction party that has played a significant role in structuring the collateral or the reference portfolio. However, the Proposed Rule's definition of "sponsor" goes beyond its well-understood and ordinary meaning in the context of securitization, as that meaning was codified in Regulation AB and again in the Risk Retention Rules. Although the approach proposed by the Commission may succeed in capturing an investor that actively determined the composition of the asset pool, it is difficult to reconcile that result with the language of Section 27B itself, which refers to sponsors, underwriters, placement agents and initial purchasers, not investors. In any event, the Proposed Rule's definition of sponsor will implicate numerous other entities that perform roles related to or that facilitate an ABS transaction, even if such entities are not sponsors, underwriters, placement agents or initial purchasers (within the ordinary meaning of those terms).

One category of transaction parties that may be captured by the new terminology is warehouse lenders. Warehouse lenders provide capital to sponsors to acquire and aggregate assets for securitization according to strict underwriting standards designed around the lenders' risk tolerance. As it is the warehouse lenders that bear the risk with respect to any assets that cannot be securitized, their underwriting standards inevitably influence the type of collateral acquired by the sponsor. However, such influence may be described as determining the types of assets that should be excluded from the collateral, as opposed to actively selecting or directing the section of assets, which serves as a constraint on portfolio risk for the warehouse lenders. We therefore think that there is a meaningful distinction between such entities and an investor that actively collaborates with the sponsor on the composition of the collateral pool. In addition, warehouse lenders take a long position with respect to the assets proposed to be securitized and, consequently, their interests are broadly aligned with the interests of ABS investors in any take-out securitization. Warehouse lenders typically need to hedge their exposure to the asset pool during the warehouse phase of any ABS deal in order to comply with safety and soundness concerns and regulatory requirements. To that end, we think that the "securitization participant" definition should exclude any entities that have a long exposure to the assets and, in connection with such exposure, have at any time had the power to direct the exclusion of assets from the collateral pool based on documented underwriting criteria or risk appetite.

Similarly, so-called "B-piece" buyers could inadvertently be brought into the scope of the Proposed Rule through the "contractual rights sponsors" and "directing sponsors" terms. "B-piece" bonds are a common feature in Commercial Mortgage Backed Securities ("CMBS") transactions and offer higher yields to investors seeking higher returns compared to more-highly-rated

CMBS. B-piece bondholders must wait until all A-class bondholders are fully paid before the former receive any payments from the CMBS. Typically, if there is a servicer termination event in the CMBS transaction, a "B-piece" buyer can in certain circumstances step in as a replacement servicer. Therefore, because of their subordinated position in the CMBS waterfall and the fact that such investors may be required to manage the collateral in a default scenario, the risk appetite of "B-piece" buyers can often influence the composition of the collateral. "B-piece" buyers typically provide feedback on the proposed collateral composition and assets to be excluded from it and, although neither the sponsor nor the arranger of the transaction is obligated to implement such feedback, in practice they may do so in order for the transaction to succeed. As with warehouse lenders, however, the influence of "B-piece" buyers is limited to influencing the exclusion of assets against which such investors do not have risk appetite, as opposed to affirmatively collaborating on the composition of the collateral in order to design a transaction to fail.

In addition, incorporating the "contractual rights sponsors" and "directing sponsors" terms into the Proposed Rule means that open-market CLO collateral managers would be covered by the Proposed Rule. Managers of open-market CLOs are typically registered investment advisers that are already subject to a robust fiduciary obligation with respect to their clients, including the CLO issuing entity. However, such managers also typically advise other clients that may have conflicting interests, and we are concerned that the inclusion of such managers may impact their ability to manage other asset pools. We believe that a registered investment adviser, because of its fiduciary duty, would not have a "material conflict of interest" with the investors in its managed CLOs and that the Commission already has robust enforcement tools at its disposal to wield against an investment adviser that breaches its fiduciary duty.

We think that the definition of "sponsor" for purposes of the Proposed Rule should be refined to correspond with the ordinary meaning of that term in the context of a securitization, particularly the "organizing" and "initiating" function that any entity must have in order to be considered a sponsor of a securitization transaction. To the extent that the Commission retains the concept of a directing sponsor or contractual rights sponsor the definition should have an express carve-out in clause (ii)(C) of the definition of "sponsor" for any entity (i) that would otherwise be a directing sponsor or contractual sponsor and that has acquired, or is acquiring, a material long position in an ABS or the underlying collateral pool or (ii) that for purposes of the exercise of such entity's contractual rights, has a fiduciary obligation to the issuing entity and/or the ABS investors.

C. The Commission should take a narrow approach with respect to the inclusion of subsidiaries and affiliates in the Proposed Rule, including permitting the use of information barriers and excluding funds managed by the same investment adviser.

We recognize that Section 621 of the Dodd-Frank Act specifically includes affiliates and subsidiaries of transaction participants under the conflict of interest restrictions, and we agree that, in circumstances in which entities are directly involved in the structuring or asset selection for an asset-backed security on behalf of an affiliate that is itself a securitization participant, or are entering into a conflicted transaction at the behest of, or with information obtained from, an affiliated securitization participant, those entities should be subject to the Proposed Rule to the same extent as their securitization participant affiliates. However, we think that the universe of affiliates and subsidiaries that would have a meaningful engagement with the securitization and thus are appropriately the subjects of the Proposed Rule is far narrower than the Commission has recognized in the Proposed Rule. Moreover, for some—especially those that sit behind information barriers that have already been established as part of Volcker Rule compliance, or for purposes of compliance with other federal securities laws, as the Commission has noted, such as those established to prevent the mis-use of material non-public information or to comply with Regulation M—compliance with the Proposed Rule will be impossible; this is because such parties may find themselves engaging in conflicted transactions with respect to securitizations of which they have no knowledge through random bad luck. Indeed, the level of dissemination of information about pending securities transactions that would be necessary to allow the global affiliates and subsidiaries of securitization participants to ensure that they would not enter into conflicted transactions, in addition to being extraordinarily burdensome for all involved, would be harmful to the securitization markets, create broad opportunities for abuse, likely violate confidentiality provisions in agreements such as engagement letters, and create the opportunity for trading based on material nonpublic information. In our view, subsidiaries and affiliates should be subject to the Proposed Rule only to the extent that they are acting in concert with their affiliated securitization participant by (i) directly engaging in the structuring of or asset selection for the securitization, (ii) directly engaging in other activities in support of the issuance and distribution of the asset-backed security, or (iii) otherwise acting in concert with their affiliated securitization participant (through sharing of information or coordinating of trading activities, for example). In our view, there must be some element of coordination between a securitization participant and its affiliates or subsidiaries in order for the actions of such affiliates or subsidiaries to induce or, otherwise cause the securitization participant to breach a securities law duty pertaining to the securitization transaction. Furthermore, we believe that funds advised by the same asset

manager should not be considered affiliates to the extent that the manager is bound by fiduciary duties to the issuing entity for the securitization and/or its investors.

Currently, the Proposed Rule does not include exceptions allowing a securitization participant to use information barriers as a means of establishing the separateness of transactions conducted by its affiliates and subsidiaries from the securitization-related activities of such securitization participant.[22] As we have noted, we believe that affiliates and subsidiaries should be covered only in the limited circumstances in which they have a role, or are acting in concert with a securitization participant. At a bare minimum, we think it is essential that the Proposed Rule acknowledges the critical role that information barriers play in mitigating conflicts of interest. The Commission expressed concern that securitization participants would use an affiliate or subsidiary to evade the Proposed Rule.[23] We think the anti-evasion standard discussed later in this letter is sufficient to address such concerns.

The Commission has suggested a number of conditions that might be involved in the establishment of information barriers in relation to the Proposed Rule.[24] In particular, the Commission has suggested that, in order to rely on information barriers, a party to the securitization should (1) establish written policies and procedures to prevent the flow of information that would result in a violation of the Proposed Rule; (2) form internal groups within the party that would enforce and maintain the information barriers; (3) obtain independent assessments on an annual basis that would review the policies, procedures, implementation and maintenance of the information barriers; (4) prohibit any officer (or persons in similar roles) or non-clerical employees of such party from being an officer or non-clerical employee of the other parties; and/or (5) have no reason to know that, notwithstanding the prior conditions, the transaction would involve a material conflict of interest. We support the use of written policies and procedures and the protection of the barrier falling away if it has been effectively breached. We are concerned that the other proposed conditions may be too burdensome or expensive relative to the limited protection they would add. We also note that information barriers may be one of many compliance tools that a securitization participant can use to ensure that it is not acting in concert with an affiliate or subsidiary to conduct an otherwise prohibited transaction.

In its Proposal, the Commission noted that information barriers are used often in other areas of Federal securities laws in addition to the examples provided by the Commission relating to Section 15(g) of the Exchange Act and Regulation

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[22] *See* Prohibition Against Conflicts of Interest in Certain Securitizations at 9690.
[23] Id.
[24] Id. at 9690-9691.

M. [25] We believe that information barriers can be effective; for example, attorneys and law firms regularly establish and maintain information barriers to manage client conflicts of interest. Any effort to include affiliates and subsidiaries in the prohibition while not allowing an exception for information barriers would undermine other existing regulatory frameworks and financial industry participant compliance systems.

In addition, the concern that an affiliate or subsidiary would engage in, and gain from participating in, a conflicted transaction arises only to the extent that the affiliate or subsidiary has knowledge of such conflict. If an information barrier has been established and the affiliate or subsidiary has been restricted from gaining information about the conflicted transaction, the risks noted by the Commission, including relating to adverse selection,[26] would be mitigated, inasmuch as the affiliate or subsidiary would not have known about the transaction in the first place. The affiliate or subsidiary should only fall within the scope of the Proposed Rule if the affiliate or subsidiary has knowledge of such transaction. Moreover, any use of such entities by an actual transaction participant to circumvent the Proposed Rule can be adequately addressed through anti-evasion provisions.

Although we recognize the concern expressed by the Commission that affiliates and subsidiaries might violate the Proposed Rule notwithstanding the use of information barriers, the Proposed Rule would be able to address that risk through its anti-evasion provisions. Failing to include an exception for information barriers would not align with existing regimes and financial compliance programs. We believe, however, that narrowing the scope of affiliates and subsidiaries subject to the Proposed Rule would be the most effective approach.

D. The Proposed Rule should not apply until (i) an agreement is reached to become a securitization participant by both parties and (ii) marketing or pricing of the ABS has commenced.

Section 27B of the 1933 Act requires that the prohibition on engaging in a transaction that would involve "a material conflict of interest" apply "at any time for a period ending on the date that is one year after the day of the first closing of the sale of the ABS." This statutory period does not refer to a specific commencement date upon which an underwriter, placement agent, initial purchaser or sponsor assumes such role; instead, the period relies on the closing date of the relevant transaction. Under the Proposed Rule, the prohibition would begin on the date on which a person has reached, or taken "substantial steps" to

[25] Id. at 9690.
[26] *See* Id. at 9720.

reach, an agreement to become a securitization participant. By setting a point in time that is inherently subjective, the Commission creates a substantial risk of uncertainty for market participants. We recommend that the Commission apply the statutory requirement and determine as of the closing date of the transaction the parties that are subject to the prohibition.

1. The concept of "substantial steps" to reach an agreement is too vague and will not provide clarity to securitization market participants.

The Commission has proposed that the prohibition on conflicts would apply to a securitization participant beginning on the date on which a person has reached, or taken "substantial steps" to reach, an agreement to become a securitization participant. Such a standard is challenging for potential securitization participants to comply with because it presumes that there is a clear time at which a participant would know that it is taking substantial steps. In many cases, before the execution of a written agreement or engagement letter, a prospective securitization participant, particularly an underwriter, initial purchaser or placement agent, does not know that it will, in fact, be engaged. Under the Commission's standard, merely presenting a proposal to be a securitization participant to an issuer may cause such prospective participant to become subject to the prohibition in the Proposed Rule. Until the successful issuance and sale of the ABS, no transaction yet exists for there to be a material conflict of interest.

By applying the Proposed Rule to securitization participants before a transaction is closed and an ABS is issued, the Commission creates significant uncertainty for ordinary course transactions that are not within the scope of Section 27B. For example, a prospective issuer commonly enters into a warehouse facility with a financial institution that commonly becomes a party to a securitization transaction once sufficient assets are originated and financed in such warehouse facility. The availability of such warehouse facility and the commitment a financial institution makes to assist a prospective issuer in completing a securitization transaction could constitute taking "substantial steps" to reach an agreement to be a securitization participant. In addition, such warehouse lender will be involved in selecting assets that are eligible for such warehouse facility substantially before any ABS is issued. The uncertainty such a framework would create for financial institutions and securitization participants will make compliance with the Proposed Rule challenging and may limit the ability of warehouse lenders to provide assistance to issuers in structuring and executing ordinary course transactions. It is also unclear how this standard would apply to master trust structures, under which a pool of assets is assembled in a trust months or even years before any one particular ABS offering is contemplated.

We acknowledge that certain conflicted transactions could arise at the point at which the pool assets have been identified and it is relatively likely that an ABS will be issued. For that reason, we suggest that the Commission look both to the presence of an executed engagement letter and the commencement of marketing of the ABS. Without any standard that can be objectively determined by a securitization participant prior to becoming a securitization participant, the Commission introduces significant uncertainty into the market.

IV. The definition of "conflicted transaction" is too broad and should only prohibit transactions involving speculative short positions.

A. The proposed definition would prohibit a broad range of risk and balance sheet management transactions that are not "bets against" an ABS or its assets and therefore has a broader reach than the Commission seems to have intended.

The definition of transactions involving material conflicts of interests, or "conflicted transactions," as the Commission has proposed to define them, is at the heart of the Proposal and critical to the impact of the Proposed Rule. As discussed in the introduction and elsewhere in this letter, we believe that an approach consistent with that adopted by the Commission and the other applicable agencies in the Volcker Rule—in which both disclosure and information barriers can mitigate conflicts of interest such that they are not material—should be an important component of the final rule. In addition, we suggest that the Commission take a principles-based approach. Specifically, we believe that transactions involving "material conflicts of interest" of a type that cannot be mitigated through disclosure should be those in which the securitization participant creates a speculative short position for itself in either the assets underlying the securitization or in the ABS. We believe that this would capture Congressional intent, in that it would prohibit transactions in which the securitization participant is "betting against" either the assets or the ABS, and would do so without requiring that the Commission determine the intent of the parties.

We have included in this section of our comment letter a revised draft of the "conflicted transactions" definition, which is intended to include only those transactions in which a securitization participation would have a speculative short position. With such an approach, clause (i) of the definition of "conflicted transaction," prohibiting a short sale of the relevant ABS, would remain in the Proposed Rule as drafted, as would clause (ii) to the extent the securitization participant did not hold a long position in the ABS to which the credit default swap or other credit derivative related. This approach would nonetheless permit securitization transactions, including synthetic securitizations and CRT securities, that are designed to protect the sponsor against credit losses on long

positions that it holds. Clause (iii) of the definition would be narrowed so that transactions would be prohibited when the "benefit" would be in the form of a speculative profit, rather than the offsetting of a loss the securitization participant would otherwise incur. Our revised approach would also include a robust disclosure requirement with respect to transactions that involve conflicts of interest that do not rise to the level of "conflicted transactions" such that they are prohibited under the Proposed Rule, but that nonetheless would be material to an investor's investment decision.

In the proposing release, the Commission states that "the proposed definition of 'conflicted transaction' is limited in scope to transactions that are effectively a bet against the relevant ABS or its underlying pool of assets."[27] Similarly, in the introduction to the Proposed Rule, the Commission states that "[t]he 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."[28] We appreciate and support the effort to limit the prohibition in the Proposed Rule to those transactions that are effectively a bet against the ABS or the asset pool; however, we do not believe the Proposed Rule as drafted would be limited as stated and instead would have a profound adverse effect and expansive reach, prohibiting transactions that are essential to the necessary risk and balance sheet management of many securitization participants.

B. ABS play an essential role in the financial system and should not be unnecessarily curtailed.

ABS, whether cash ABS or synthetic ABS, play important roles in the financial sector, providing critical capital, balance sheet management and risk reduction to a variety of financial and non-financial entities. In the 2007-09 financial crisis, when residential mortgage-backed securities ("RMBS") began to default because of issues with the underlying mortgage loans, investors withdrew from the RMBS market. For banks and other mortgage lenders that relied on securitizations to finance their mortgage loan portfolios, including those that had maintained robust underwriting standards in the lead-up to the crisis, this pullback was devastating—without the liquidity provided by the ability to sell mortgage loans into the capital markets and thus obtain funds to make new mortgage loans, these lenders faced a significant contraction of their ability to lend. The availability of mortgage loans decreased dramatically. Buyers could no longer obtain mortgage loans and thus were shut out of the housing market. Home owners could neither sell their homes nor borrow against their homeowners'

[27] Id. at 9696.
[28] Id. at 9679 (footnote omitted).

equity. Housing prices fell, which increased the strain on the outstanding RMBS. Accordingly, although the origination of low quality mortgage loans, supported by the ready availability of securitization as a financing source, was one of the factors that contributed to the 2007-09 crisis, the loss of access to the capital that securitization had provided arguably played a larger role in pushing the impacts of the crisis down to ordinary Americans.

As noted earlier, the Volcker Rule has been addressing conflicts of interest for banking entities effectively for the past 10 years. It is important that the Section 621 conflict of interest rules recognize the work that the Volcker Rule is already doing. It is also important that the Section 621 rules not have so broad a reach that they impair access to capital, block key opportunities to manage balance sheets and monetize assets, and impair risk management functions, especially at a time when the national economy is already under significant stress.

C. The complete set of transactions that effectuate the structuring and issuance of ABS should be considered as a single transaction

One of the key challenges under the Proposal arises from the Commission's rejection of the request to consider the suite of agreements under which a securitization is issued as a whole:

> Under the re-proposed rule, entering into an agreement to serve as a securitization participant with respect to an ABS would not itself be a "conflicted transaction." However, any transaction that the securitization participant enters into with respect to the creation or sale of such ABS (e.g., a transaction whereby a securitization participant takes the short position in connection with the creation of a synthetic ABS) would need to be analyzed to determine if it would be a "conflicted transaction" under the re-proposed rule.[29]

Securitizations generally do not involve only the issuance of a security. They may include transfer agreements that move the assets from the sponsor or depositor into the issuing entity; credit enhancement agreements; collateral account control agreements; servicing agreements; asset management agreements; trust agreements; indentures; loan agreements; derivatives; reinsurance agreements; loss sharing agreements; and other agreements that are an essential part of the securitization structure and that also create potential conflicts. It is not clear to us how the Commission would distinguish "an agreement to serve as a securitization participant" from "any transaction that the

[29] Id. at 9695.

securitization participant enters into with the respect to the creation or sale of such ABS."

The tension, and challenge, in the Commission's approach is most apparent in relation to the CRT securities sponsored by Freddie Mac and Fannie Mae. These transactions were mandated by the Enterprises' regulator, the Federal Housing Finance Authority, which states:

> "The credit risk transfer (CRT) programs at Fannie Mae and Freddie Mac (the Enterprises) were established to reduce taxpayer exposure to risks arising from credit guarantees extended by the Enterprises through their normal courses of business. The Federal Housing Finance Agency (FHFA) initiated development of a CRT program in 2012 to reduce risk at the Enterprises during their conservatorships, and Fannie Mae and Freddie Mac began implementing their CRT programs in 2013. Under FHFA's oversight through guidelines, instructions, strategic plans, and Scorecard objectives, the programs have since become a core part of the Enterprises' single-family guarantee businesses, similar to how risk sharing with the private sector is an integral part of the Enterprises' multifamily businesses. Using a range of different transaction structures, the Enterprises have transferred to private investors a substantial amount of credit risk assumed through the acquisition of single-family loans in targeted loan categories. The programs include or have included CRTs via capital markets issuances (both corporate debt and bankruptcy remote trust structures), insurance/reinsurance transactions, senior/subordinate transactions, and a variety of lender collateralized recourse transactions. The Enterprises continue to evaluate the scope of their CRT programs and innovate within the CRT market by employing different structures as part of their efforts to further reduce risk, all while using transactions that are economically sensible."[30]

In the Proposal, the Commission goes to some length to clarify that, so long as the Enterprises are in conservatorship and their guarantee of their mortgage-backed securities is supported by the full faith and credit of the United States government, they are not a "sponsor" of the MBS and thus the entry into the CRT transactions is not a conflicted transaction with respect to the MBS. However, the Commission notes that the Enterprises *are* a sponsor of the CRTs, and thus "would be prohibited from engaging in conflicted transactions with

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[30] Credit Risk Transfer, Federal Housing Finance Agency (May 2, 2022), https://www fhfa.gov/PolicyProgramsResearch/Policy/Pages/Credit-Risk-Transfer.aspx

respect to investors in CRT securities (e.g., a short sale of the relevant CRT security)."[31]

We agree that a short sale of the CRT security would be prohibited under the Proposed Rule; however, as discussed earlier, it also appears that the CRT security itself may be prohibited under prong (iii) of the proposed definition of conflicted transaction. The Commission states:

> The financial instruments captured under Proposed Rule 192(a)(3)(iii) would, for example, include entering into the short-side of a derivative (with the special purpose entity issuer of a synthetic CDO or otherwise) that references the performance of the pool of assets underlying the ABS with respect to which the person is a securitization participant under the re-proposed rule and pursuant to which the securitization participant would benefit if the referenced asset pool performs adversely.[32]

In the Enterprise CRT transactions, the applicable Enterprise enters into an agreement with the special purpose entity issuer that references the performance of the pool of assets, pursuant to which the Enterprise receives payment from the SPE issuer in connection with default of reference assets. The SPE issuer's obligation to repay investors declines by a similar amount. Although this could be viewed as "entering into the short-side of a derivative," the Enterprises have long exposure to the assets in the reference pool and are expressly entering into these transactions to reduce the Enterprises' risk. The proposed exception for risk-mitigating hedging (which we discuss in more detail below), however, may be too narrow to allow this transaction. In particular, that definition states that "the initial distribution of an ABS is not risk-mitigating hedging activity for purposes of paragraph (b)(1) of this section." Although the Commission appears to be trying to distinguish the issuance or initial distribution of an ABS from the components of the agreements under which it is established, it is not clear to us that these are severable.

The CRT transactions thus can serve, in some ways, as a case study. The Commission does not seem to be intending to preclude them, but we, as lawyers, would find it difficult to conclude under the Proposal that they were permitted. In addition, the Proposal does not provide assurance that securitization participants other than the sponsor with respect to the guaranteed ABS would not be prohibited from taking part in Enterprise CRT. An approach that looks to define "conflicted transaction" based on whether it creates a speculative short position for the securitization participant would be clearer and more effective. In addition, we do answer in the affirmative to the Commission's request for

[31] Prohibition Against Conflicts of Interest in Certain Securitizations at 9715.
[32] Id. at 9695.

comment as to whether the definition of asset-backed security should include an exception to "for an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the Enterprises while operating under the conservatorship or receivership of FHFA with capital support from the United States"[33] so that it is clear that any securitization participant with respect to that excepted securities would be able to participate in a subsequent Enterprise CRT that relates to the same excepted securities.

D. Clause (iii) of the proposed definition of "conflicted transaction" would prohibit an unnecessarily broad range of transactions.

In our view, clause (iii)—which prohibits transactions in which a securitization participant would "benefit" from certain "actual, anticipated or potential" adverse outcomes with respect to the ABS or its underlying assets is staggering in its breadth. Committee members have expressed concerns that, for example, clause (A) would prohibit buying credit protection based on a broad index if the assets underlying an ABS are included in the index; clause (B) would prohibit purchasing an insurance product that would insure the holder from risks such as property or casualty losses as a result of a natural disaster; and clause (C), which could include transactions to mitigate against a "potential decline" in the market value of the ABS, would prohibit a broad range of actions to protect against market downturns in general. We view the inclusion of the terms "anticipated or potential" to be particularly problematic, as well as unnecessary given the broad anti-evasion provisions that appear elsewhere in the Proposed Rule.

We note, as well, that there is a fundamental difference between an early amortization event and an event of default or loss of principal in securitizations. Early amortization events are, in essence, early warning indicators, which are designed to trigger early repayment of investors to avoid investor losses. Early amortization events typically cut off reinvestment in new assets, or leakage of cash flow to equity investors, if performance metrics start to falter. Those metrics can decline for a variety of reasons unrelated to the quality of the assets or the actions of market participants; a notable instance occurred in the run-up to the effectiveness of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, during which record numbers of people rushed to file for bankruptcy ahead of the effective date of the law. That rush dramatically, though briefly, increased charge-offs of credit card receivables, causing a decline in excess spread in credit card securitizations, and in some cases triggered early

[33] Id. at 9690.

amortization of affected deals.[34] Securitization sponsors may plan for these events by obtaining backup liquidity facilities, unfunded warehouse lines that may be drawn down if new investments in assets are curtailed, or other contingency plans that reflect prudent risk management and should not be "conflicted transactions" even if a securitization party would benefit—e.g., from the perspective of being able to continue operating their lending business—from such transactions.

E. The "reasonable investor" standard of materiality should be replaced with the same "materially adverse" standard as is used in the Volcker Rule's conflict of interest provision.

In defining a "material conflict of interest," the Proposed Rule identifies three categories of conflicted transactions and deems them to be material if "a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the asset-backed security." We note that whether a reasonable investor would consider a *transaction* important to its investment decision does not necessarily mean that a reasonable investor would consider any *conflict of interest* associated with that transaction to be important. In addition, we view the "reasonable investor" standard as purely a disclosure standard[35] and not a standard that is appropriate for use in sorting transactions into permissible and impermissible categories. In the context of a conflict of interest, we view the "materially adverse" standard as more appropriate and we note that the "materially adverse" standard is used in the Volcker Rule's conflict of interest provision.

F. We propose a "conflicted transaction" definition that strikes a better balance.

In the years since the passage of the Dodd-Frank Act and the adoption of the Volcker Rule, even in the absence of the regulations called for by Section 621, we have not seen the sort of transactions that inspired Section 621.[36] The

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[34] *See* The Bankruptcy Abuse Prevention and Consumer Protection Act: Means-Testing or Mean Spirited, Ashcraft, Adam; Dick, Astrid; Morgan, Donald, (2007) https://www newyorkfed.org/medialibrary/media/research/staff_reports/sr279.html

[35] We note that the "reasonable investor" standard is a limiting principle, rather than a prescriptive one. Under Rule 405, the term "material" "limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."

[36] The Proposed Rule confirms the Commission has not seen them either: "*[W]hile we do not have data on the extent of such conduct following the financial crisis of 2007-2009*, we believe that securitization transactions continue to present securitization participants with the opportunity to engage in the conduct that is prohibited by Section 27B." Emphasis added. Prohibition Against Conflicts of Interest in Certain Securitizations at 9679.

Volcker Rule, by prohibiting proprietary trading and certain material conflicts of interest, and the Commission's own enforcement actions[37], have likely both had a positive impact in this regard. We consider this significant as we look at the Commission's proposed approach now to implementing Section 621, because we believe that the risk of evasion of Section 621 is relatively low, especially given its explicit anti-evasion provisions, while the risk to the functioning of the securitization and credit markets, credit availability, risk and balance sheet management and the financial sector as a whole from an overly broad proscription is relatively high. We have tried to strike a better balance in our proposed revision to Proposed Rule 192(a)(3) set forth below:

> Conflicted transaction. For purposes of this section, a conflicted transaction means any of the following transactions to the extent any such transaction is materially adverse to the interests of investors:
>
> (i) A short sale of the relevant asset-backed security;
>
> (ii) The 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 asset-backed security**, other than payments that would offset a loss with respect to the securitization participant's long position in such asset-backed security**; or
>
> (iii) The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction **(other than the transactions comprising the securitization)** through which the securitization participant would ~~benefit~~**profit** from~~ the actual, anticipated or potential~~:
>
> (A) ~~Adverse~~**The adverse** performance of the asset pool supporting or referenced by the relevant asset-backed security;
>
> (B) ~~Loss~~**The loss** of principal~~,~~ **or** monetary default~~, or early amortization event~~ on the relevant asset-backed security; or
>
> (C) Decline in the market value of the relevant asset-backed security.

[37] *See*, e.g. at 9713 fn 216.

As used in this clause (iii), “profit” means the receipt of income or gain as a result of (i) the settlement of a speculative short position in the asset-backed security or the asset pool, or (ii) receipt of payment under (or resulting from the disposition of) any contract, swap or derivative that provides loss protection with respect to such asset-backed security or such asset pool to the extent the securitization participant does not hold a long position in such asset-backed security or such asset pool.

G. Disclosure should be considered to mitigate conflicts of interest that do not involve a “conflicted transaction” and thus are not “material conflicts of interest”.

As noted earlier, the Volcker Rule allows banking entities to mitigate the effects of conflicts of interest and thus to exclude them from the definition of “material conflicts of interest.” Under the Volcker Rule, interests of a banking entity which are materially adverse to the entity’s customers, clients or counterparties would be prohibited as material conflicts of interest unless “[p]rior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity . . . (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and (B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest.” We believe that, except with respect to the narrow set of conflicted transactions described above (e.g., short sales of the ABS), which would be prohibited, such disclosure would be appropriate to protect investors where there are inherent conflicts of interest between their interests and those of the securitization participants. We believe that such conflicts, in deals that include a prospectus or an offering memorandum, are already generally disclosed.

V. The proposed risk-mitigation provisions significantly limit the availability of exceptions and thereby unduly restrict the risk management tool provided by securitizations.

The Commission’s proposed exception for risk-mitigating hedging activities appears to have been drawn from the comparable Volcker Rule exception. However, the context for the Volcker Rule—the prohibition of proprietary trading, including by creating mismatches between a risk and the

hedging transaction to mitigate that risk—was rather different, and the regulatory and compliance framework under which banking entities operate is generally more robust than that of many securitization participants. Requirements such as the recalibration of a hedge, for instance, are relevant for Volcker but don't really have the same relevance for securitization market participants.

As noted above in connection with the proposed revision to the definition of "conflicted transaction," the vast majority of participants in the securitization markets, including those sponsoring synthetic ABS, do so to monetize or manage the risk of assets that the participants hold. To the extent that the participants securitize to mitigate the risks of assets they hold—even if not perfectly or precisely—the participants are not betting against the securitization or the assets. And they should be able to do so without risking violations of the conflict of interest rule because of small mismatches, or failure to recalibrate, or not having the sort of robust policies and procedures that are appropriate for banks. Volcker again still applies, so banking entities will continue to be held to a higher standard for risk mitigating hedging. But market participants that are not banking entities should not be held to a Volcker-level standard to utilize the exception.

Although it seems unusual to refer to the Paperwork Reduction Act (the "PRA") analysis of a Proposed Rule, one important aspect of that analysis is the Commission's working assumption for risk-mitigating hedging activities exceptions that there are only 1,265 securitization participants. (PRA Table 1, referred to in the analysis of the precondition and costs of risk mitigation in page 168 of the re-proposed rule.) However, because the proposed definition of securitization participant includes sponsors and all those that even indirectly sell or transfer assets or have a contractual right to direct the structure or assembly or the composition of the assets included in a securitization, as well as all of those sponsors' affiliates, it seems that the basis for the limited number of 1,265 (fn1 to PRA Table 1) excludes the great majority of the entities that are within the scope of securitization participant. Moreover, because the proposed definition of "conflicted transactions" includes a garden-variety monetary default, an early amortization event, or a decline in asset value, the impact on sponsors in particular means that a default or other misstep that otherwise might be a matter of contract is, by the scope of Section (a)(1) of the re-proposed regulation, rendered unlawful. Accordingly, the exception for risk-mitigation hedging is extremely important; failure by the Commission to narrow the scope of the Proposed Rule may have the effect of excluding from the securitization markets considerable numbers of enterprises, the ultimate customers and consumers of which would have benefitted from securitizations.

As a result of the structure of the Proposed Rule, both the proposed prohibitions under Section (a)(1) and the exemptions under Section (b) impact non-institutional sponsors of securitizations (that is, the enterprises that are

closest to the intersection between the borrowing public and consumers) in ways that are unintentional and could have materially adverse effects on those sponsors, the public and consumers. In the event of financial difficulty of a sponsor or an affiliate, the prohibition appears on its face to create a legal violation if a sponsor (or affiliate of a sponsor) faces financial challenges and undertakes common, otherwise entirely legal, and necessary steps to protect itself and its non-securitized assets and non-institutional business and affairs from actions taken by or on behalf of investors. Even though the exception, as proposed, contemplates origination and acquisitions of assets for proposed securitizations, imposing a specific compliance system to this activity is challenging to manage and would create a *de novo* undertaking by many types of sponsor, leading to considerable room for misunderstanding, possible ineffectiveness, and excessive limitation of participation in securitizations. As written, the mandatory preconditions to the hedging exception effectively make it significantly more likely that a sponsor will not be able to achieve the protections that Congress identified in the statute.

In the context of the hedging exception the precondition of maintaining robust formal compliance programs that work as intended creates limitations and considerable confusion for securitization participants (inasmuch as institutional participants will necessarily have overlapping compliance programs because of the requirements of the Volcker Rule and other rules of the Commission, the CFTC and the CPFB). It is not clear that the imposition of such precondition is within the scope of congressional intent in Section 621. The same can be said for the imposition of those programs as preconditions to market-making activities. Even though the requirement contains the requirement that compliance programs be reasonably designed to ensure compliance with the limitations in the exceptions, the prospect of confusion significantly undercuts the ability of securitization participants to rely on the exceptions.

VI. The anti-circumvention standard should be rejected in favor of an anti-evasion standard to prevent the inadvertent restriction of legitimate and necessary transactions.

In general, the federal securities laws include anti-evasion provisions and not anti-circumvention provisions.[38] An anti-evasion standard in the Proposed Rule would be more workable than an anti-circumvention standard because "evasion" includes an intent standard whereas "circumvention" implies that an unintentional violation of the Proposed Rule would make a transaction violate the Proposed Rule.

[38] See Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 1851 (2010).

In addition, an anti-evasion provision should be tied to the intent of the securitization participant and not the effect of the transaction. Similar language appears in the security based swap regulation, which refers to actions that "willfully evade or attempt to evade any provision." Such a standard is more reasonable than evaluating only the effect of a transaction because, under such a standard, a violation would only be based on the actions of the securitization participant that sought to evade the rule.

A standard that looks to the actions of the securitization participant is also important to create an understanding that the actions of one participant do not necessarily affect the transaction as a whole. The current drafting of paragraph (d) of the Proposed Rule implies that an entire transaction can be deemed to be a conflicted transaction if the actions of one participant in the transaction have the effect of circumventing paragraph (a) of the Proposed Rule.

An anti-evasion standard coupled with the changes suggested above in this letter would restrict the behavior that the statute is intended to address without inadvertently causing legitimate and necessary transactions to be swept up in the scope of the Proposed Rule.

VII. Conclusion.

We understand that the Commission is fulfilling a statutory mandate in proposing these rules on conflicts of interest, and we recognize that there continues to be room for abuse in the ABS markets. However, we believe that regulatory developments since the adoption of the Dodd-Frank Act have effectively addressed many of these concerns, and we are concerned that the reach of the Proposed Rule is both too vast, in terms of the entities that may be subject to it and the types of arrangements it would prohibit, and too vague, in ways that will make compliance difficult if not impossible for a wide swath of securitization participants and their affiliates. We believe that one of the Commission's guiding tenets as a regulator should be first to do no harm, and we fear that the Proposed Rule, as drafted, may have far-reaching implications that will cause real harm to the entities the Proposed Rule purports to regulate and to the economy as a whole, without significantly enhancing the Commission's ability to constrain the sort of bad acts at which the Proposed Rule was aimed. We have tried to provide concrete guidance on approaches to tailor the Proposed Rule to the sort of harms it was intended to prevent, and we would be happy to work with the Staff to redraft as much of the Proposed Rule as the Staff would find helpful.

Although these proposals are based on the feedback and guidance of our members, we do not believe that this committee or market participants as a whole have had sufficient time to evaluate the implications of the Proposed Rule, because of the short timeline the Commission gave to submit comments. We

therefore recommend that the Commission re-propose a rule to address these comments with sufficient time to comment prior to issuing a final rule.

We would be happy to speak with the Commission Staff to discuss anything in this letter. Please feel free to contact Stuart Litwin at [redacted] or [redacted], Jay Knight at [redacted] [redacted] or [redacted], Ellen Marks at [redacted] or [redacted], or Matthew Hays at [redacted] or [redacted], if we can be of assistance in this regard.

Respectfully submitted,

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Jay H. Knight
Chair, ABA Federal Regulation of Securities Committee

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