June 27, 2023

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: Request for Public Comment Regarding Proposed Rule 192
"Conflicts of Interest Relating to Certain Securitizations"
File Number S7-01-23

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA"),[1] the Asset Management Group of SIFMA ("SIFMA AMG")[2] and the Bank Policy Institute ("BPI")[3] (collectively, the "Associations") submit this letter to provide additional comments on proposed Rule 192 (the "Proposed Rule") under the Securities Act of 1933 (the "Securities Act"). When adopted in its final form by the Securities and Exchange Commission (the "Commission"), Rule 192 will implement Section 27B of the Securities Act ("Section 27B"),[4] which prohibits certain material conflicts of interest in securitizations, subject to the exceptions set forth therein.

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[3] The Bank Policy Institute is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks, and the major foreign banks doing business in the U.S. Collectively, they employ almost two million Americans, make nearly half of the nation's bank-originated small business loans, and are an engine for financial innovation and economic growth.

[4] Section 27B was added to the Securities Act by Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

On March 27, 2023, the Associations submitted a comment letter (the "First Associations Letter") in response to the Proposed Rule which provided, among other things, the views of the Associations on the breadth and scope of the Proposed Rule as well as recommendations for limiting the scope of the Proposed Rule so that it is more narrowly tailored to prohibit material conflicts of interest between securitization participants and investors without unintentionally prohibiting transactions that are necessary to the functioning of the asset-backed securities market and do not constitute such a material conflict of interest. On the same date, SIFMA submitted a comment letter detailing specific concerns and recommendations for tender option bond ("TOB") transactions (the "SIFMA TOB Letter").

While we will not repeat the bulk of what was said in either of the First Associations Letter or the SIFMA TOB letter here, we restate the views expressed in those letters. This comment letter is not intended to replace or retract anything in the First Associations Letter or the SIFMA TOB letter. This letter is intended to provide mark-ups of the Proposed Rule on specific points requested orally by the Commission's staff, and examples of how such revisions would work in practice. In this letter, we hope to present a mark-up of the Proposed Rule in a way that reflects our agreement with the Commission's view and Congressional intent that (i) a securitization participant should not be able to "short" an asset-backed security that it helped create and (ii) the Proposed Rule should not prohibit transactions that are necessary to the functioning of the asset-backed securities market. We also recognize the Commission's concerns of using information barriers, disclosure or requiring the Division of Enforcement to prove intent to achieve those objectives. Our mark-up of the Proposed Rule is reflective of and seeks to balance the above objectives and concerns.

It is vital to note that the provisions of the Proposed Rule are extremely interdependent. Changing or not changing one provision impacts changes to other provisions. Our mark-up reflects a holistic approach, and adopting one provision and not adopting another could potentially result in the above stated objective not being achieved. We have tried to highlight where such interdependencies exist. We encourage the Commission to raise any questions they may have on the mark-up of the Proposed Rule and encourage the Commission to consider re-proposal, rather than adoption, as the next step to avoid any unintended consequences.

EXECUTIVE SUMMARY

Our suggested changes to the regulatory text may be summarized as follows:

- We recommend setting a definitive start date of the prohibition;
- We recommend deleting the phrase "directly or indirectly" from section (a)(1) of the Proposed Rule;
- We recommend changing the "reasonable investor" test to a test that looks at whether a securitization participant is entering into a transaction that would benefit such securitization participant in a way that is materially adverse to the interests of an investor in the relevant asset-backed security;
- We propose two alternatives for the Commission to consider to address issues that arise with the inclusion of "affiliates and subsidiaries" in the definition of securitization participant;

- We recommend deleting the requirement that the risk-mitigating hedging exemption only applies to activities "arising out of" the securitization participant's "securitization activities";
- We suggest that synthetic securitizations should fall under the risk mitigating hedging exemption under most circumstances;
- We recommend changing the ongoing recalibration requirement of the risk-mitigating hedging exemption to a principles-based requirement that such activity is focused on risk reduction;
- We believe the initial distribution language should be deleted from the bona fide market-making activities exemption;
- We suggest an exemption of certain securitization formation activities;
- We suggest codifying that the long-standing practice of financing investors' purchase of asset-backed securities is not a conflicted transaction;
- We suggest an exemption for transactions where long investor buys all securities (e.g., repacks);
- We suggest an exemption for TOBs;
- We suggest that the rules should exclude passive co-managers and other parties who have not had any influence over the composition of the asset pool or structure of the transaction from placement agent and sponsor definitions;
- We suggest that the rules should carve out long investors from "sponsor" definition;
- We suggest a definition of "synthetic asset-backed security".

PRESENTATION OF COMMENTS IN THIS LETTER

In Part I, we have provided a mark-up of the Proposed Rule, with removed text in ~~strikethrough~~ and added text in double-underline. In Part II, we have provided examples of how such mark-ups would work in practice to prohibit material conflicts of interest without chilling the market by prohibiting routine securitization activity.

PART I - SUGGESTED CHANGES TO PROPOSED RULE 192

§ 230.192 Conflicts of interest relating to certain securitizations.

(a) *Unlawful activity*.

(1) *Prohibition*. A securitization participant shall not, for a period commencing on the date ~~on which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to~~ which is 30 days prior to the first closing of an asset-backed security, and ending on the date that is one year after the date of the first closing of the sale of such asset-backed security, ~~directly or indirectly~~ engage in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such asset-backed security.

(2) *Material conflict of interest*. For purposes of this section, engaging in any transaction would involve or result in a material conflict of interest between a securitization participant for an asset-backed security and an investor in such asset-backed security if such a transaction is a conflicted transaction.

(3) *Conflicted transaction*. For purposes of this section, and subject to the rebuttable presumption described in clause (4) below, a conflicted transaction means any of the following transactions ~~with respect to which there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the~~ that would involve or result in the securitization participant's interests being materially adverse to the interests of investors in the relevant asset-backed security:

(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; or

(iii) The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction ~~through which~~that substantially replicates one or both of the types of transactions set forth in clause (i) or (ii) above by means of the securitization ~~participant would benefit from the actual, anticipated or potential:~~

~~(A)~~ participant's shorting or buying protection on ~~Adverse performance of~~ the asset pool ~~supporting~~ underlying or referenced by the relevant asset-backed security~~;~~.

~~(B) Loss of principal, monetary default, or early amortization event on the relevant asset-backed security; or~~

~~(C) Decline in the market value of the relevant asset-backed security.~~

(4) Alternative 1 – *Multi Factor Indicia of Separateness*.

(i) A non-participating entity will not be considered a securitization participant with respect to any transaction if:

(A) the investment decision regarding such transaction was made for the account of the non-participating entity and was made separately and without coordination of trading or cooperation between that entity and the related participating entity; and

(B) the related participating entity implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure compliance with the rule.

(ii) Whether the investment decision regarding such transaction was made for the account of the non-participating entity and was made separately and without coordination of trading or cooperation between the non-participating entity and the related participating entity is a facts and circumstances determination. Indications of separateness and lack of coordination include (but are not limited to) the following:

(A) The accounts of the non-participating entity and the participating entity have separate and distinct investment and trading strategies and objectives;

(B) Personnel for the non-participating entity and the participating entity do not coordinate trading between the accounts of the non-participating entity and the participating entity:

(C) Information barriers separate the non-participating entity and the participating entity;

(D) The non-participating entity and the participating entity maintain separate profit and loss statements; or

(E) Personnel with oversight or managerial responsibility over the accounts of both the non-participating entity and the participating entity do not have authority to execute trading in individual securities in the accounts and in fact do not execute trades in the accounts, and do not have the authority to pre-approve trading decisions for the accounts and in fact do not pre-approve trading decisions for the accounts.

(iii) Depending on the facts and circumstances, non-participating entities and participating entities that do not satisfy each of the conditions set forth in paragraph (a)(4)(ii) of this section may nonetheless be considered to be acting separately and without coordination.

(4) Alternative 2 - *Rebuttable presumption*. For purposes of this rule, a transaction described in clause (a)(3) that is entered into at the direction of a related person will be presumed to be a conflicted transaction unless such related person demonstrates that such related person had no substantive role in the structuring, marketing or

selling the asset backed security or in the selection of the asset pool underlying or referenced by the relevant asset-backed security and did not otherwise coordinate with a party who did have a substantive role in the structuring, marketing or selling the asset backed security or in the selection of the asset pool underlying or referenced by the relevant asset-backed security. The related person seeking to rebut the presumption will bear the burden of proof.

(b) *Excepted activity*. The following activities are not prohibited by paragraph (a) of this section:

(1) *Risk-mitigating hedging activities*.

(i) *Permitted risk-mitigating hedging activities*. Risk-mitigating hedging activities, of a securitization participant conducted in accordance with this paragraph (b)(1) in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant ~~arising out of its securitization activities, including the origination or acquisition of assets that it securitizes, except that the initial distribution of an asset-backed security is not risk-mitigating hedging activity for purposes of paragraph (b)(1) of this section~~.

(ii) *Conditions*. Risk-mitigating hedging activities are permitted under paragraph (b)(1)(i) of this section only if:

(A) At the inception of the hedging activity and at the time of any adjustments to the hedging activity, the risk-mitigating hedging activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified current or future positions, contracts, or other holdings of the securitization participant, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

~~(B) The risk-mitigating hedging activity is subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1) of this section and does not facilitate or create an opportunity to benefit from a conflicted transaction other than through risk-reduction; and~~

(B) The primary benefit of such risk-mitigating hedging activity is risk reduction; and

(C) ~~The~~ Any securitization participant utilizing this exemption has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ~~ensure the~~ result in such securitization participant's compliance with the requirements set out in paragraph (b)(1) of this section, including reasonably designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified~~,~~ and documented~~, and monitored~~.

(2) *Liquidity commitments*. Purchases or sales of the asset-backed security made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for the asset-backed security.

(3) *Bona fide market-making activities*.

(i) *Permitted bona fide market-making activities*. Bona fide market-making activities, including market-making related hedging, of the securitization participant conducted in accordance with this paragraph (b)(3) in connection with and related to asset-backed securities with respect to which the prohibition in paragraph (a)(1) of this section applies, the assets underlying such asset-backed securities, or financial instruments that reference such asset-backed securities or underlying assets~~, except that the initial distribution of an asset-backed security is not bona fide market-making activity for purposes of paragraph (b)(3) of this section~~.

(ii) *Conditions*. Bona fide market-making activities are permitted under paragraph (b)(3) of this section only if:

(A) The securitization participant routinely stands ready to purchase and sell one or more types of the financial instruments described in paragraph (b)(3)(i) of this section as a part of its market-making related activities in such financial instruments, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(B) The securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments described in paragraph (b)(3)(i) of this section;

(C) The compensation arrangements of persons performing the foregoing activity are designed not to reward or incentivize conflicted transactions;

(D) The securitization participant is licensed or registered to engage in the activity, if required, described in paragraph (b)(3) of this section in accordance with applicable law and self-regulatory organization rules; and

(E) ~~The~~ Any securitization participant utilizing this exemption has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure ~~the~~ such securitization participant's compliance with the requirements of paragraph (b)(3) of this section, including reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its market-making positions and holdings.

(4) *Securitization Formation Activities*. For purposes of clarity, those customary transactions necessary for the formation and creation of an asset-backed security are not conflicted transactions:

(i) *Pre-securitization hedging transactions*. Any interest rate hedge, credit hedge, index hedge, TBA market hedge or other hedge with respect to all or any portion of the pool of assets underlying an asset-backed security entered into prior to the date on which such assets are included in the securitization (the "inclusion date") and terminating with respect to the pool of assets or portion thereof on or prior to the inclusion date.

(ii) *Pre-securitization financing transactions*. Any financing (including warehouse financing, repo financing or other form of financing) of all or any portion of the pool of assets underlying the asset-backed security entered into prior to the related inclusion date for such assets and terminating with respect to the pool of assets or portion thereof on or prior to the related inclusion date for such assets;

(iii) *Pre-securitization transfers*. Any purchase, sale, assignment, contribution or other transfer of all or any portion of the pool of assets underlying the asset-backed security prior to the first closing of the related inclusion date for such assets; and

(iv) *Other pre-securitization transactions*. Any other transaction relating to all or a portion of the pool of assets underlying the asset-backed security that terminates on or prior to the related inclusion date of such assets.

(5) *Financing of ABS Securities*. Any transaction related to the financing of asset backed securities, which transaction may take the form of repurchase agreement, financing total return swap or secured loan.

(6) *Customer Facilitation Transaction*. Any transaction related to a securitization or synthetic securitization, structured for an investor, where the investor selects the collateral and where such investor (or its affiliates) purchases all of the asset backed securities issued in such securitization or synthetic securitization with a view toward investment and not distribution.

(7) *Municipal Securities Underlying a Tender Option Bond Transaction*. Any hedges with respect to the municipal securities underlying a tender option bond transaction to the extent the tender option bond sponsor either provides credit enhancement on the underlying asset or the floater certificates or assigns, subordinates its right of payment on, or otherwise provides the benefit of, any hedge to the floater certificate investors ahead of the tender option bond sponsor's benefit therefrom

(c) *Definitions*. For purposes of this section:

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.

Bona fide long investor means an investor or prospective investor in a long position in an asset-backed security who does not select the collateral backing such asset-backed security. For the avoidance of doubt, specifying preferences or requirements regarding the composition of the underlying assets or the structure, features and design of the asset-backed security does not constitute selecting the collateral.

Distribution means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

Initial purchaser means a person who has agreed with an issuer to purchase a security from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon 17 CFR 230.144A or that are otherwise not required to be registered because they do not involve any public offering.

Non-participating entity means any business unit, group, affiliate, or subsidiary of a securitization participant that does not have a substantive role in structuring, creating, marketing or selling the asset-backed security, or in selecting the assets backing the asset-backed security. [FOR MULTI FACTOR INDICIA OF SEPARATENESS ALTERNATIVE]

Participating entity means any business unit, group, affiliate, or subsidiary of a securitization participant that has a substantive role in structuring, creating, marketing or selling the asset-backed security, or in selecting the assets backing the asset-backed security. [FOR MULTI FACTOR INDICIA OF SEPARATENESS ALTERNATIVE]

Placement agent and *underwriter* each mean a person who directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security and who has agreed with an issuer or selling security holder to:

(i) Purchase securities from the issuer or selling security holder for distribution;

(ii) Engage in a distribution for or on behalf of such issuer or selling security holder; or

(iii) Manage or supervise a distribution for or on behalf of such issuer or selling security holder.

Related person means, with respect to a securitization participant in connection with an asset-backed security, an employee, group or business unit within the securitization participant other than the employees of the securitization participant that act as the underwriter, placement agent, initial purchaser or sponsor of the asset-backed security. [FOR REBUTTABLE PRESUMPTION ALTERNATIVE]

Securitization participant means:

(i) An underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security; or

(ii) Any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of this definition.

Sponsor means:

(i) Any person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the entity that issues the asset-backed security; or

(ii) Any person:

(A) with a contractual right to direct or cause the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security; or

(B) that directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security.

(C) Notwithstanding paragraphs (ii)(A) and (ii)(B) of this definition, a person ~~that~~will not be a sponsor for purposes of this rule who (x) performs ~~only~~ primarily administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security ~~will not be a sponsor for purposes of this rule~~ or (y) is a bona fide long investor.

(iii) Notwithstanding paragraphs (i) and (ii) of this definition:

(A) The United States or an agency of the United States will not be a sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States.

(B) The Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617) with capital support from the United States; or any limited-life regulated entity succeeding to the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that the entity is operating with capital support from the United States; will not be a sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity.

Synthetic asset-backed security mean a fixed-income or other security (a) issued by a special purpose entity, and (b) secured by (i) one or more credit derivatives or similar instruments

that reference self-liquidating financial assets (including bonds, loans, leases, mortgages, secured or unsecured receivables, or asset-backed securities) ("reference pool") and (ii) financial collateral held by the SPV where performance on the note is primarily linked to the performance of the reference pool and the repayment of principal is dependent on the financial collateral held by the SPV. The term "synthetic asset-backed security" shall not include any insurance or reinsurance policy, corporate debt, or swap or security based swap where the counterparty is not a special purpose entity that issues a security to investors, whether or not payments thereunder are contingent on the performance of referenced financial assets. For avoidance of doubt, the term "self-liquidating financial asset" (as used in this definition) shall not include any insurance or reinsurance contracts (or insurance or reinsurance risks).

(d) *Anti-circumvention*. If a securitization participant engages in a transaction that circumvents the prohibition in paragraph (a)(1) of this section, the transaction will be deemed to violate paragraph (a)(1) of this section.[5]

(e) *Safe harbor for foreign transactions*. The prohibition in paragraph (a)(1) of this section shall not apply to any asset-backed securities if all the following conditions are met:

(i) The offer and sale of the asset-backed securities was or is not required to be and was or is not registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.);

(ii) The offer and sale of all of the asset-backed securities is or was made outside the United States within the meaning of 17 CFR § 230.901; and

(iii) The issuing entity of the asset-backed securities is a foreign issuer within the meaning of 17 CFR § 230.902(e).

(f) *Exemptive relief*.

(i) *Exempted transactions*. The Commission may provide a total or partial exemption of any transaction as the Commission determines may be appropriate in the public interest and for the protection of investors.

(ii) *Exceptions, exemptions, and adjustments*. The Commission may adopt or issue exemptions, exceptions or adjustments to the requirements of this rule, including exemptions, exceptions or adjustments for the types of entities that constitute securitization participants, the types of transactions that constitute conflicted transactions, the requirements of the rule pertaining to exceptions from the rule, and other matters as the Commission determines may be appropriate in the public interest and for the protection of investors.

[5] We wish to reiterate our comment in the First Associations Letter than the anti-circumvention provision should be removed and replaced with an anti-evasion provision that applies to the exceptions and safe harbors. *See* First Associations Letter, pp. 57-60.

PART II – SECTION-BY-SECTION DISCUSSION OF SUGGESTED CHANGES TO PROPOSED RULE 192

Commencement of Prohibition

We recommend setting a definitive start date of the prohibition, at 30 days prior to the first closing of an asset-backed security, rather than requiring all securitization participants to make a facts-and-circumstances determination of when they have taken substantial steps to reach an agreement to become a securitization participant. We believe that this allows securitization participants to be able to construct a more rigorous compliance program while posing no risk that a bad actor could use this definitive start to evade the prohibition.

"Directly or Indirectly" Engaging in a Transaction

We recommend deleting the phrase "directly or indirectly" from section (a)(1) of the Proposed Rule. We believe such reference to be unnecessary because an underwriter, placement agent, initial purchaser or sponsor's entire universe of affiliates and subsidiaries is already captured under the definition of *securitization participant*, leaving no room for a securitization participant to engage in such a transaction indirectly. The use of "directly or indirectly" creates an intractable issue in the application and interpretation of the Proposed Rule because it creates a significant misalignment between (1) a prohibition that applies broadly to transactions entered into "directly or indirectly" by any securitization participant and (2) exemptions that apply narrowly only to specific securitization participants. For example, with respect to a risk mitigating hedging or market-making transaction, a particular securitization participant may directly satisfy the technical requirements of the applicable exemption; however, there will be other securitization participants (such as affiliates or subsidiaries of the securitization participant or unrelated securitization participants) who do not satisfy the technical requirements of the applicable exemption and could consequently be viewed as indirectly participating in a transaction they could not participate in directly. This misalignment could result in violations of the Proposed Rule by securitization participants who should not be captured by the Proposed Rule.

Furthermore, we believe that the anticircumvention language in clause (d) of the Proposed Rule would help to address concerns about attempts to evade the reproposed rule's prohibition if a securitization participant were to route payments through multiple transactions or recharacterize payments so as to obscure the economics of a conflicted transaction.

Materiality Standard

We recommend changing the "reasonable investor" test, which is generally used as a test for disclosure, to a test that looks at whether a securitization participant is entering into a transaction that would benefit such securitization participant in a way that is materially adverse to the interests of an investor in the relevant asset-backed security.[6] Under the "reasonable investor" standard, there are many non-adverse transactions that a securitization participant enters into which

[6] See First Associations Letter, pp. 46-47.

a reasonable investor would want to figure into their investment decision (and which are also generally disclosed, per other securities laws, rules and regulations).

For example, a reasonable investor may consider a securitization participant's interest rate hedge transaction important to such investor's investment decision (noting that the original formation of the "reasonable investor" test in the Proposed Rule does not require that a "reasonable investor" consider such transaction to be negative). But we do not believe that these are the types of "material" transactions that either Congress or the Commission intended to capture. Instead, our proposed test would capture transactions where a securitization participant is materially benefiting at the expense of an investor in the relevant asset-backed security, which we agree should be prohibited. This test also sets much clearer parameters for the industry, making it possible to develop an effective compliance program.

Further, altering the "reasonable investor" standard to the "materially adverse" standard would more closely align Section 621 of the Dodd-Frank Act with Section 619, fulfilling Congress' intentions.[7] As "Sections 619 and 621 were intended to work in tandem, and [] should cross-reference"[8] each other, the "materially adverse" standard is more appropriate to the Proposed Rule than the "reasonable investor" standard. While courts have not directly addressed the scope or meaning of the "materially adverse" standard in the context of the securities laws, the Commission has previously used the "materially adverse" standard in the Volcker Rule.[9] The Commission, therefore, has recently, and in a closely-related Dodd-Frank Act provision, used the "materially adverse" standard and should do so again here.

Although without judicial or academic interpretation of the "materially adverse" standard, the Commission and the industry are not without interpretive tools. First, as noted above, Section 621 of the Dodd-Frank Act was intended to be closely linked with Section 619. As industry professionals are already familiar with Volcker Rule compliance, and therefore have an expectation of the standard's parameters, maintaining the same "materially adverse" standard would help ensure orderly and efficient markets. Second, several dictionaries help define both "material" and "adverse." Black's Law Dictionary defines "material" to mean "[o]f such a nature that knowledge of the item would affect a person's decision-making."[10] The dictionary also defines "adverse" to mean "[h]aving an opposing or contrary interest."[11] Together, these definitions form a commonly-understood meaning of "materially adverse" as having an opposing or contrary interest that would affect a person's decision-making, a definition that satisfies the goals of the Proposed Rule to prevent conflicts of interest in securitization. Accordingly, far from increasing confusion around the Proposed Rule's parameters, using the "materially adverse" standard would promote consistency in the industry while simultaneously capturing problematic

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[7] *See* Senators Jeff Merkley & Carl Levin, Comment Letter on Proposed Rule to Implement Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Feb. 13, 2012), https://www.sec.gov/comments/s7-41-11/s74111-362.pdf.

[8] *Id.*

[9] *Compare* 17 C.F.R. 255.7(b), 255.15(b) (defining a "material conflict of interest" as "any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty") *with* 12 U.S.C. § 1851 (lacking a "materially adverse" standard).

[10] *Material*, BLACK'S LAW DICTIONARY (11th ed. 2019).

[11] *Adverse*, BLACK'S LAW DICTIONARY, *supra* note [].

conflicts of interest in securitization. The Commission, therefore should use the "materially adverse" standard in the Final Rule, as opposed to the disclosure-focused "reasonable investor" standard.

Prong (iii) of Conflicted Transaction

The current formulation of prong (iii) of the definition of *conflicted transaction* in the Proposed Rule is not workable and would drastically reduce the use of securitization as a viable source of funding for the economy. As currently drafted, it would prohibit securitization participants' ordinary business activities that are not related to any specific asset-backed security, and would create a regime under which a diversified financial institution could never comply. This could cause issuers, investors, asset managers and diversified financial institutions to move away from the securitization market and into forms of financing which are less efficient for businesses and consumers. For example, current prong (iii) in the Proposed Rule potentially prohibits a securitization participant from entering into an interest rate or currency swap or from entering into even a potentially correlated transaction (i.e., a securitization participant in one particular auto asset-backed security who takes an unrelated short position against an auto manufacturer or the auto industry in general). Our understanding, after speaking with Commission staff and reviewing the commentary in the Proposed Rule, is that such unrelated transactions were not intended to be prohibited.[12] Our mark-up of the Proposed Rule would prohibit transactions that short or buy protection on the asset-backed security or otherwise attempt to replicate such transactions by shorting or purchasing protection on the underlying assets,[13] while allowing for normal course activities to occur that are not related to the underlying asset-backed security. This, along with the anti-evasion provision in the Proposed Rule, adequately addresses the Commission's concerns while preserving the viability of the securitization market.

Moreover, securitization professionals know what the transactions in prongs (i) and (ii) look like and are able to monitor for and stop transactions which would produce their economic equivalent with respect to the relevant asset-backed security. This kind of compliance could not be undertaken by industry under the formulation of prong (iii) in the Proposed Rule. Under our proposed formulation, the Commission would have the power to stop the functional equivalent of short sales and credit default swaps, even if it is done via a financial instrument that has not yet been conceived at the time of this writing. Refining the scope of prong (iii) of the definition of *conflicted transaction* to something the industry can scope and comply with is among the most

[12] "Because 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, the re-proposed rule would not apply to transactions that are wholly independent of, and not in connection to, the relevant securitization." *See* Prohibition Against Conflicts of Interest in Certain Securitizations, 88 Fed. Reg. 9678 at 9696f (Feb. 14, 2023) (to be codified at 17 C.F.R. pt. 192) (the "Proposing Release"). However, the Proposed Rule as drafted does not clearly reflect that stated intention.

[13] We believe this addresses Commission concerns stopping "any attempted evasion of the rule that is premised on the form of the transaction rather than its substance" including instances where "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 [but] are structured to replicate the terms of a swap pursuant to which the special purpose entity that issues the synthetic ABS is obligated to make a payment to the securitization participant upon the occurrence of certain adverse events in respect of the ABS for which the person is a securitization participant under the reproposed rule." *See* the Proposing Release at 9695.

pressing changes that need to be made to the Proposed Rule. This reproposed formulation also makes it clear that non-credit related ancillary or imbedded derivatives, such as interest rate or currency swaps, are not implicated by the Proposed Rule.

Non-Participating Entities; Multi-Factor Indicia of Separateness and Rebuttable Presumption Alternatives

Here and in the mark-up, we have proposed two alternatives for the Commission to consider to address issues that arise with the inclusion of "affiliates and subsidiaries" in the definition of *securitization participant*

Multi Factor Indicia of Separateness Alternative

In the First Associations Letter, we urged the Commission to consider the "separate accounts" paradigm under Rule 105 of Regulation M as a model for addressing transactions entered into by "non-participating entities".[14] Rule 105, which governs short sales of securities during the restricted period prior to a secondary offering, provides that:

> "Separate accounts. Paragraph (a) of this section shall not prohibit the purchase of the offered security in an account of a person where such person sold short during the Rule 105 restricted period in a separate account, *if decisions regarding securities transactions for each account are made* ***separately and without coordination*** *of trading or cooperation among or between the accounts*."[15]

As explained in the First Associations Letter, we are of the view that a transaction entered into by a non-participating entity ***separately and without coordination*** with the underwriter, placement agent, initial purchaser or sponsor, should not be prohibited under the rule.[16] As is the case with Rule 105 under Regulation M, whether a non-participating entity acts separately and without coordination with an underwriter, placement agent, initial purchaser or sponsor is a facts and circumstances determination. As also noted in the First Associations Letter, the Commission has already issued guidance as to the various factual indicia such separateness and lack of coordination.[17] Importantly, those indicia of separateness and lack of coordination:

- are objective and fact-based, *not* subjective or intent-based,[18] and
- *do not* specify information barriers as the means of compliance, but *do* recognize information barriers as only one of several indicia of separateness and lack of coordination.

[14] See First Associations Letter, pp. 29-32.

[15] See 17 C.F.R. §242.105 (2023). *Emphasis added*.

[16] See First Associations Letter, pp. 29-37.

[17] See First Associations Letter, at p. 31.

[18] See footnote 65 and related text of the First Associations Letter, at p. 31 (describing the Commission's guidance as to the indications of separate accounts).

Rebuttable Presumption Alternative

The attached markup contains the rebuttable presumption alternative that was discussed with Commission staff. The rebuttable presumption we have proposed is intended to address a situation where, due to the breadth of the definition of *securitization participant*, a party that had no ability to influence the structure or composition of the asset pool of the underlying asset-backed security innocently engages in a conflicted transaction. If a conflicted transaction occurred, the rebuttable presumption merely gives such a party (defined as a *related person* in our mark-up) the opportunity to prove that it had no substantive role in the structuring, marketing or selling the asset-backed security or in the selection of the assets backing asset-backed security. The burden is on the related party to prove it was not involved in such activity and not on the Commission to prove intent. Properly functioning information walls could be evidence presented in such related person's favor, but would not in and of themselves be a complete defense to an enforcement action brought by the Commission under the Proposed Rule. We view this addition as a safeguard where someone has, without coordinating with one of their affiliates that was involved in structuring an asset-backed security, entered into a conflicted transaction. We also note that the Volcker Rule has a comparable safeguard for transactions entered in error.[19]

As noted above, the various provisions of the Proposed Rule are extremely interdependent, and this rebuttable presumption is not intended to be the full, stand-alone solution to the industry concerns. Rather, this should be implemented in concert with our other suggested revisions, including, most importantly, the revisions to prong (iii) of the definition of *conflicted transaction.*

Risk-mitigating hedging activities

Deletion of "arising out of its securitization activities"

Although the language is in the statute, we recommend deleting the requirement that the risk-mitigating hedging exemption only applies to activities "arising out of" the securitization participant's "securitization activities." We believe that the important distinction should be between (i) hedging a long position on a security or receivables actually owned by the securitization participant and (ii) entering into a short position where the securitization participant does not own the security or the related assets, rather than whether the long position arises under a securitization participant's securitization activities or other activities. We also believe the proposed formulation also unintentionally limits important business activity. Financial institutions engage in hedging activities across business units, legal entities and offices which may be transacted for purposes other than hedging against losses with respect to a specific asset-backed security. Curtailing such hedging activities – which are unrelated to the relevant asset-backed security and are entered into as part of a securitization participant's risk management practices and not as a bet against a relevant asset-backed security – could have adverse and unintended effects on everyday operations and risk management practices of financial institutions and their affiliates. We don't believe it was the intention of Congress or the Commission to prevent banks and other

[19] *See* 17 CFR 255.3(d)(10) (providing that "Proprietary trading does not include… [a]ny purchase or sale of one or more financial instruments that was made in error by a banking

entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error.")

financial entities from managing their risks, whether or not those risks arise out of the securitization activities of those entities. The Commission has ample room under Section 27B, as well as under its general exemptive authority, to craft a rule that prohibits transactions that create material conflicts of interests between securitization participants and investors without creating significant turmoil whose economic costs threaten to outweigh any foreseeable benefit.

For instance, a large diversified financial intermediary may fall under the Proposed Rule's definition of *underwriter* of many asset-backed securities and therefore would be a securitization participant. The chief investment office ("CIO") of the bank invests the bank's deposits, and traditionally those CIOs are large investors in asset-backed securities. The CIO, which is not involved in the creation of an asset-backed security, could, in the secondary market, purchase such asset-backed security. Subsequent to that, the CIO may hedge that purchase by buying credit protection on such asset-backed security. Given the literal language, the hedge would not be a good risk mitigating hedge under the rule since it did not "arise out of the securitization participant's securitization activities." Even if prong (iii) were to be narrowed, it would not solve this situation. If prong (iii) of the definition of *conflicted transaction* is not revised, such entities would not be able to hedge loosely correlated assets that were not acquired in connection with the securitization participant's securitization activities. Furthermore, it would be more restrictive than the Volcker Rule, under which entities are allowed to hedge and act as market makers. It would also be more restrictive than the Bank Push Out Rule, which allows credit default swaps on asset-backed securities to be done out of a banking entity for risk mitigating hedging purposes. Such an interpretation would prevent banks and other entities from effectively managing their risk exposures in the most efficient manner. A large diversified financial institution could not be a securitization participant and operate its business if the rule were interpreted that way.

Moreover, a risk mitigating hedge is hedging an existing exposure – a securitization participant is not necessarily profiting from a future decline in performance of an asset-backed security by merely hedging an existing exposure. Therefore, it should be irrelevant whether such hedging "arises out of securitization activities" or not. The phrase "arising out of its securitization activities," for example, could be read as prohibiting risk mitigating hedging activity on an auto finance company's entire origination portfolio.

Deletion of "the initial distribution of an asset-backed security is not risk-mitigating hedging activity"

In our discussion with Commission staff, they inquired whether synthetic securitizations are able to fit under the risk-mitigating hedging exemption to the Proposed Rule as currently drafted. We analyzed this position, and two elements of the Proposed Rule, read in connection with the Proposing Release, give us pause in making a determination that a synthetic securitization would currently be considered a risk mitigating hedge under the Proposed Rule.

First, the phrase in (b)(i) of the risk-mitigating hedging exemption that says "including the origination or acquisition of assets that it securitizes, except that the initial distribution of an asset-backed security is not risk-mitigating hedging activity for purposes of paragraph (b)(1) of this section" is unclear. Particularly, it is not clear what the Commission's intent was in including such phrase as a caveat to risk mitigating hedge. A potential interpretation of that clause could be that synthetic securitization and issuance of an asset-backed security would not be a good risk

mitigating hedge for a position that otherwise would be eligible for the risk mitigating hedging exemption. Second, the Commission seems to dismiss the inclusion of synthetic securitizations in several parts of the Proposing Release. In it, the Commission states that "[a]lthough we received comment that securitization participants should be permitted to enter into a synthetic ABS transaction pursuant to the risk-mitigating hedging activities exception because such transaction is the economic equivalent of a bilateral CDS transaction where the counterparty to the CDS is not an ABS issuer,[] the re-proposed rule prohibits a securitization participant from creating and/or selling a new synthetic ABS to hedge a position or holding."[20] We don't understand the reasoning behind why a transaction that was clearly and economically done solely for risk mitigation purposes is excluded in this way. The Commission should clarify what the intent of that clause is or delete it to ensure that synthetic securitizations can be done for risk mitigating hedging purposes.

We believe that synthetic securitizations *should* fall under the risk mitigating hedging exemption under most circumstances. In such a scenario, the actions of the securitization participant are entirely risk mitigation, because any benefit that such securitization participant may receive when the reference portfolio's performance declines would be directly offset by the reduced value of the assets in the reference portfolio which remain on book. As above, hedging an existing exposure is not necessarily profiting from a future decline in performance of an asset-backed security. Furthermore, as noted in the First Associations Letter, synthetic securitizations are critical tools for banks in managing their credit risks. Often, synthetic securitization is the most efficient way to achieve those objectives. Fannie Mae and Freddie Mac often use synthetic securitization in their credit risk transfer ("CRT") transactions and allowing this type of activity under the risk-mitigating hedging exemption would provide more clarity and certainty for all participants than carving those entities out of the definition of *sponsor*.

Adding "current or future" positions

This language is added to reflect that there are circumstances were future positions may be taken. For example, there could be a synthetic risk transfer that applies to future portfolios. It is intended to allow a hedge or synthetic securitization entered into in 2023 to cover (for example) auto loans or mortgages originated in 2024. This also accounts for asset-backed securities with revolving portfolios and prefunding periods.

Eliminating ongoing recalibration

We recommend changing the ongoing recalibration requirement of the risk-mitigating hedging exemption to a principles-based requirement that such activity is focused on risk reduction. While banks that are subject to the Volcker Rule have experience with calibrating[21] hedges to comply with the Volcker Rule requirements, entities not subject to the Volcker Rule, such as asset managers and issuers, do not, and establishing such compliance programs to do so could be prohibitively expensive for such entities. Furthermore, the capital rules do not recognize the transfer of credit risk if there is "credit enhancement provided by the national bank or Federal

[20] *See* the Proposing Release at 9700.

[21] Under Volcker, calibration is required at the portfolio-level.

savings association after the inception of the securitization."[22] A required recalibration would likely violate this provision.

We also question if it is really necessary to have a "perfect" hedge to get the benefit of the hedging exception. It seems unnecessarily punitive, and not necessary to achieve the regulatory purpose of Rule 192, for a securitization participant to lose the benefit of the hedging exception just because it couldn't construct a perfectly, consistently calibrated hedge for its asset-backed securities. In some instances, a perfect hedge may not be even possible. Instead, the exemption should be focused on the overall nature of the hedge, as there is a huge difference between a transaction intended as a hedge and a "short" transaction. Our suggested changes, plus the anti-evasion provision of the Proposed Rule, are sufficient to prevent securitization participants from only satisfying the requirement at the outset of a transaction and then intentionally selling the underlying position, turning the hedge into a short position. The principles-based approach set forth here achieves the goal of addressing instances that go beyond risk-mitigation.

Bona fide market-making activities

Deletion of "the initial distribution of an asset-backed security is not bona fide market-making activity"

For similar reasons to those noted above for risk-mitigating hedging, we believe the initial distribution language should be deleted from the bona fide market-making activities exemption. First, it is unclear why such activities should never be considered bona fide market-making activity. As with risk-mitigating hedging, there phrase is unclear. The brief explanation in the Proposing Release, that the Commission is concerned that a securitization participant would point to its initial recommendations and sales of a new asset-backed security in an attempt to rely on the exception for bona fide market-making activities,[23] is, we believe, already addressed by the conditions a securitization participant must comply with in order to use such exemption, plus the anti-evasion provision of the Proposed Rule. Even if that is not the case, more narrowly-tailored language in the Proposed Rule would better address such a concern.

Securitization Formation Activities

Our inclusion of an exemption of certain securitization formation activities is intended to make clear in the rule that the transactions securitizations participants must enter into to create an asset-backed security, such as any of the steps required for moving assets from a warehouse to a trust (including hedging risks during that time period), are not intended to be conflicted transactions subject to the prohibition. In most cases, and as detailed in our suggested revisions to the Proposed Rule, these transactions must terminate or otherwise conclude before the asset-backed security is issued. Our suggested revisions are also limited to the transaction enumerating therein to address the Commission's concerns about evasion. We believe this is consistent with Congressional and Commission intent; otherwise, the entire asset-backed securities market would be in jeopardy. These changes are necessary even if prong (iii) of the definition of *conflicted*

[22] *See* 12 C.F.R. Sections 3.41(b)(2)(v) and 217.41(b)(2)(v).

[23] *See* the Proposing Release at 9706.

transaction is revised as we have suggested as suggested, since the sale of the collateral needed to create an asset-backed security could potential be interpreted to fall under that provision.

Financing of ABS Securities

Here we are simply codifying that the long-standing practice of financing investors' purchase of asset-backed securities is not a conflicted transaction.

Customer Facilitation Transaction

Investors frequently request having a security that is customized for their needs. Repackaging transactions are created in circumstances, for example, where an investor wants a certain bond, but the bond is denominated in dollars and the investor wants exposure in a different currency, or where an investor wants credit derivative exposure to a certain company but needs the instrument to be issued in security form. In these situations, a dealer will enter into a swap or credit derivative with a special purpose vehicle ("SPV"), depending on the product, and the SPV will issue a security tailored to such investor's requests. The investor would buy all the asset-backed securities issued by the SPV to avoid potential conflicts with any other investor. Unlike the short transaction the Proposed Rule is designed to prevent, here the investor is expressing preferences about a security it wishes to purchase and hold. In this case, there are no other investor interests that need protecting.

Municipal Securities Underlying a TOB Transaction

As detailed more fully in the SIFMA TOB Letter and in the mark-up, we believe these types of transactions should be exempt from the prohibition under the Proposed Rule.

Placement Agent and Underwriter Definitions

Our suggestions here are intended to exclude passive co-managers and other parties who have not had any influence over the composition of the asset pool or structure of the transaction. This better aligns the definitions of *placement agent* and *underwriter* with that of *sponsor*.

Sponsor Definition

Here we are merely carving out long investors from the definition of *sponsor*, which we believes codifies statements made by the Commission in the proposing release clarifying that it did not intend to capture an investor that is acquiring a long position in the relevant asset-backed security in the definition of *sponsor*.

Synthetic Asset-Backed Security Definition

As stated in the First Associations Letter, we believe it is important to include a definition of *synthetic asset-backed securities*. The definition we have proposed here is intended to capture the market's understanding of what is, and what is not, a synthetic asset-backed security. Based on our discussions with Commission staff, we believe our suggested definition reflects the Commission's understanding of the same, and reflects that underlying self-liquidating assets are necessary for there to be a securitization. If self-liquidating asset were not used to delineate what

constitutes a synthetic securitization, the Proposed Rule could pick up equity-linked and commodity-linked products, which are clearly not securitizations. Clarifying this is critical to insurers, banks and other entities in order to manage risk exposures.

Safe Harbor for Foreign Transactions

In the First Associations Letter, we urged the Commission to include a safe harbor for foreign transactions which parallels the safe harbor for certain foreign transactions in Regulation RR. While we still believe that such a safe harbor would be preferrable to the current lack of foreign safe harbor in the Proposed Rule, we have refined our recommendations in the mark-up. If conditions of the foreign transaction safe harbor are limited to the three requirements in our mark-up, the focus is on the purchase of securities issued in an offshore transaction by a foreign issuer. The foreign issuer point is important; it means that domestic issuers cannot use the exemption as a way to get around the Proposed Rule by issuing Regulation S securities.

CONCLUSION

The Associations greatly appreciate your consideration of the views set forth in this letter. We stand ready to assist the Commission in this important rulemaking effort and we would be pleased to have the opportunity to discuss these matters with the Commission and its staff.

If you have any comments or questions, please feel free to contact Christopher B. Killian at (212) 313-1126 (ckillian@sifma.org), Lindsey Keljo at (202) 962-7312 (lkeljo@sifma.org) or Jack Stump at (202) 589-1932 (jack.stump@bpi.com), or our outside counsel, Mayer Brown LLP, attention: Stuart M. Litwin at (312) 701-7373 (slitwin@mayerbrown.com), Christopher B. Horn at (212) 506-2706 (cbhorn@mayerbrown.com) or Michelle M. Stasny at (202) 263-3341 (mstasny@mayerbrown.com).

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