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FINANCE
ASSOCIATION

1776 I Street NW., Suite 501
Washington, DC 20006
www.structuredfinance.org

July 13, 2023

Securities and Exchange Commission
100 F St., N.W.
Washington, DC 20549

Re: File No. S7-01-23 - Prohibition Against Conflicts of Interest in Certain Securitizations, SEC Rel. No. 33-11151, 88 Fed. Reg. 9678 (Feb. 14, 2023)

Ladies and Gentlemen:

The Structured Finance Association (the "SFA") appreciates the opportunity to provide additional feedback on the recently re-proposed securitization conflicts of interest rules.[1]

The SFA's mission is: "*To help its members and public policy makers grow credit availability and the real economy in a responsible manner*."

The SFA is a consensus-driven trade association with over 370 institutional members representing the entire value chain of the securitization market. By facilitating the responsible issuance and investing of loans and securities, the market provides trillions of dollars of capital to consumers and businesses in communities across the country. SFA members include issuers and investors, broker-dealers, rating agencies, data analytic firms, law firms, servicers, trustees, and accounting firms. As such, unlike many other trade associations, before we take any advocacy position our governance requires us to achieve consensus by agreement rather than majority vote, ensuring the perspectives of all our diverse membership are included. This diversity is our strength, as it builds healthy tension in arriving at our consensus position. Because of this, we are methodical and thoughtful as we analyze the pros and cons of regulatory proposals before we reach a mutually acceptable position.

On March 27, 2023, the SFA submitted a comment letter (the "First Letter"), containing our preliminary comments on the re-proposal. We described our membership, which represents the entire securitization market – including investors — and our consensus-building approach to our comments, which provides us with a full picture of market considerations and encourages a healthy tension that supports positions focused on maintaining a stable, healthy market. We noted that all our members – including our investor members—agree that the sweeping approach taken in the re-proposed rule is critically flawed, conflicts with the goals of numerous prudential regulators, relies too heavily on the Volcker Rule as a precedent, and would impose significant impediments to the continued healthy functioning of the asset-backed

[1] Prohibition Against Conflicts of Interest in Certain Securitizations, SEC Rel. No. 33-11151, 88 Fed. Reg. 9678 (Feb. 14, 2023) [hereinafter Conflicts Rule Re-Proposing Release].

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security ("ABS") and broader financial markets. We urged the Commission to strike the right balance to protect investors while maintaining the strengths of our financial markets. We refer you back to the First Letter for a detailed discussion of our market and policy concerns with the re-proposed rule.

Since the First Letter, we have engaged our market-wide membership base to assess the full scope of the impact of the re-proposal, and to build industry consensus on how to draw the line between prohibiting material conflicts of interest and assuring the continued functioning of the ABS markets. We have held many working meetings of SFA members, including separate meetings among various of our broker-dealer members, our issuer members and our investor members. We also held virtual meetings with Commission staff and each of these constituency groups of our membership, which were very helpful in refining our approach. As requested by the staff, we have produced detailed edits of the text of the re-proposed rule. We have attached our suggested revisions, marked to show changes from the re-proposal, as Exhibit A to this letter.

In this letter, we describe the reasoning behind our suggested changes, which we believe would balance the goals of Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"):[2] "to prohibit underwriters, sponsors, and others who assemble [ABS], from packaging and selling those securities and profiting from the securities' failures"[3] by "creating financial products, selling those products to customers, and betting against those same products,[4] while at the same time "protecting the healthy functioning of our capital markets"[5] by not "unnecessarily prohibiting or restricting activities routinely undertaken in connection with the securitization process, as well as routine transactions in the types of financial assets underlying covered securitizations.[6] We have listened to the concerns of the Commission regarding the use of an intent-based standard in determining what constitutes a prohibited conflict of interest, and regarding the use of disclosure or information barriers to mitigate conflicts of interest. We believe that the incorporation of our suggested changes into the re-proposed rule would result in a rule that satisfies all of these objectives, and that protects ABS investors while providing a workable compliance regime for investors, issuers and broker-dealers.

As noted in the First Letter, the re-proposed rule is complex, and its provisions are highly interdependent. Hence, our proposed changes must be viewed as a whole – the omission of or substantial changes to certain of our comments could have ripple effects that make the rule continue to be unworkable. It is crucial that the Commission eliminate the adverse impacts on vital market activities in adopting a final rule to permit the essential deployment of capital that provides important funding to American households and businesses. The SFA and its members stand ready to continue dialog with the Commission and its staff to help facilitate a workable and more tailored final rule.

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[2] Section 27B of the Securities Act of 1933, as amended (the "Securities Act"), 15 U.S.C. § 77z-2a. For convenience and consistency, we refer to this provision throughout this letter by its Dodd-Frank Act identifier, "Section 621."
[3] 56 Cong. Rec. S5899 (daily ed. July 15, 2010) (statement of Sen. Levin).
[4] 56 Cong. Rec. S5901 (daily ed. July 15, 2010) (statement of Sen. Levin).
[5] 56 Cong. Rec. S5899 (daily ed. July 15, 2010) (statement of Sen. Levin).
[6] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9679.

Our comments in this letter are designed to ensure that the final rule focuses on prohibiting the conflicts of interest that drove Congress to adopt Section 621, while protecting the ability of market participants to enter into transactions that are necessary to both their own internal business and risk management functions and the proper functioning of the capital markets. We believe this to be the intent of Section 621. Our suggested changes to the re-proposed rule, which we outline below, would accomplish that goal.

I. Definition of "Conflicted Transaction" Should Be Narrowed to Remove Unworkably Broad Approach.

A. "Conflicted transaction" revisions are a critical predicate to an operable rule.

B. Clause (iii) of "conflicted transaction" should be re-written to avoid an unnecessarily broad sweeping prohibition of critical investing and financing activities.

C. Materiality standard should be revised to protect investors by prohibiting conflicted transactions as to which a reasonable investor in the ABS would consider the securitization participant's financial interest in the transaction to be materially adverse to the investor's interests.

D. Rebuttable presumption, multi-factor indicia of separateness test, or both as alternatives, should be incorporated to safeguard inadvertent, innocent transactions.

1. *Innocent transactions and the Commission's skepticism regarding information barriers.*

2. *Rebuttable presumption alternative.*

3. *Multi-factor indicia of separateness alternative.*

E. Certain activities should be outside the scope of the "conflicted transaction" definition to eliminate severe unintended consequences.

1. *Certain transactions involving clients owed fiduciary duties.*

2. *Certain transactions related to funds independently managed by third parties.*

3. *Activities unrelated to credit risk (including interest rate, currency and other non-credit related risks).*

4. *Transactions that terminate before ABS issuance.*

II. Prohibition Should Be Clarified to Allow Securitization Participants to Conform their Activities to the Rule.

A. Commencement date of the prohibition should set clearer requirement.

B. Use of "directly or indirectly" in the prohibition should be removed in favor of straightforward anti-evasion provision.

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III. Definition of "Sponsor" Should Be Clarified to Specifically Exclude Long Investors and Certain Other Third-Party Service Providers.

A. Revisions to "sponsor" definition are critical to ensuring that important parties are not unnecessarily drawn into costly compliance regime.

B. Use of conflicting terms "participates," "significant role" and "influences" should be removed from commentary to eliminate potential ambiguity.

C. Long ABS investors – the very parties the rule is designed to protect – should be excluded to ensure they are not subjected to costly, unnecessary compliance.

D. Clarifications should be made to exclude persons performing certain routine securitization activities.

1. *Servicers.*

2. *Third-party asset sellers.*

3. *Nationally recognized statistical rating organizations.*

IV. "Synthetic Asset-Backed Security" Should Be Defined to Provide a Specific, Unambiguous Standard that Does Not Impede Critical Risk Management Tools.

A. Definition of "synthetic asset-backed security" should only include transactions with traditional ABS features.

B. Synthetic ABS should not be *per se* prohibited, and critical risk mitigating transactions should be allowed.

C. Mortgage insurance linked notes should not be considered synthetic ABS to prevent unintentionally prohibiting mortgage insurers from procuring reinsurance via the capital markets.

V. The Proposed Exceptions Should Be Clarified and Expanded to Permit Vital Risk Management Tools While Maintaining Investor Protections.

A. The Commission has the power to adopt broadened or new exceptions.

B. Risk-mitigating hedging exemption should be modified to ensure critical risk management tools are not impeded.

1. *Eliminate requirement that risk-mitigating hedging exception must be "arising out of its securitization activities."*

2. *Exclusion of "initial distribution of an ABS" should be removed to permit prudent risk transfer transactions.*

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3. *Risk mitigating hedging exemption should not require ongoing recalibration and monitoring.*

C. Exclusion of "initial distribution of an ABS" should be removed from bona fide market-making activity exception.

D. Additional limited but vital exemptions should be added to maintain a healthy functioning market.

1. *Customer facilitation transactions.*

2. *Activities before inclusion date.*

3. *Activities in connection with financing of ABS.*

4. *Riskless principal transactions.*

VI. Anti-Evasion.

VII. Narrow Safe Harbor for Foreign Transactions Should Be Included to Provide Transparent Applicability.

VIII. Provision for Exemptive Relief Should Be Added to Ensure Continued Healthy Functioning of the Securitization Market.

IX. An Appropriate Transition Period Should Be Included to Allow Adequate Time to Build Compliance Regime.

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I. Definition of "Conflicted Transaction" Should Be Narrowed to Remove Unworkably Broad Approach.

A. "Conflicted transaction" revisions are a critical predicate to an operable rule.

The Commission proposes to define a prohibited "material conflict of interest" as a "conflicted transaction." As described in the First Letter, the definition of "conflicted transaction" is too broad and could encompass countless types of transactions that have little to do with Congress' concerns in enacting Section 621. For example, the definition could be read to capture transactions only tangentially related to the ABS, such as normal course transactions that are part of the customary rights and obligations under securitization transaction documents, including:

- Transactions on behalf of a client or customer pursuant to a fiduciary duty;
- Transactions unrelated to the credit risk of the ABS, including interest rate and currency hedges, and transactions in commercially available, widely recognized indices;
- The release of the ABS collateral from a warehouse facility;
- Activities in connection with financing provided to investors in the ABS;
- Routine servicing activities;
- Risk management transactions, such as credit risk transfer transactions and mortgage insurance linked notes; and
- Sale of assets to initiate the securitization.

Because what is prohibited is identified in the re-proposed rule by potential result rather than by the type of activity or transaction, we do not know how market participants would be able to create and implement policies to assure compliance with the rule. The issues inherent in this approach are compounded because the re-proposed rule prohibits securitization participants, which includes all of their affiliates and subsidiaries, from "directly or indirectly" engaging in these very broadly defined conflicted transactions and includes an unclear materiality standard. This framework could result in a violation of law even when there is no impact on the investor, no intent to violate or circumvent the law, and no certainty as to whether a transaction is a prohibited transaction for that entity at the time it was executed. This over-breadth not only makes it exceedingly difficult for securitization participants to create effective compliance programs, but the cost of attempting to comply is likely to cause some participants to exit all or a portion of their securitization business.

We have striven to maintain the framework of the Commission's re-proposed rule. As such, our approach to addressing these problems within the definition of conflicted transaction has several components:

- First, we propose a new clause (iii) that captures the types of transactions that were the source of Congressional concern, but whose scope is tailored so as not to avoid the over-broad sweep of the re-proposal that will impede critical market activities.

- Second, we propose to modify the materiality standard to eliminate its ambiguity, by re-focusing its approach on whether a reasonable investor in the ABS would consider a securitization participant's financial interest in the transaction to be materially adverse to the investor's interests.

- Third, we propose to incorporate into the rule the ability of persons and groups within a securitization participant entity to rebut a presumption that a particular transaction was prohibited, by proving that they had no substantive role in the design of the securitization.

- Fourth, we propose to clarify that several types of activities are not considered "conflicted transactions".[7]

B. Clause (iii) of "conflicted transaction" should be re-written to avoid an unnecessarily broad sweeping prohibition of critical investing and financing activities.

Our members support clauses (i) and (ii) of the definition of "conflicted transaction" – we agree that short sales of ABS by securitization participants, and the purchase of credit default swaps or other derivatives on which the securitization participant would be paid as a result of the occurrence of adverse credit events with respect to the ABS, should be prohibited.

As we understand it, the purpose of clause (iii) was to prohibit securitization participants from finding a way around the specificity of clauses (i) and (ii) by engaging in transactions that replicate those prohibited transactions in substance, but not form. It was not intended to scope in unrelated transactions. We also understand that the Commission is reluctant to include an intent-based standard for this catch-all, due to its concern over the lack of an explicit reference to intent in Section 621 and the difficulty of proving intent in the staff's enforcement efforts.

Our proposed revision would clarify that clause (iii) prohibits transactions that substantially replicate a prohibited short sale or credit derivative by means of referencing the relevant ABS or the underlying or referenced asset pool. This approach makes it clear that, to be prohibited, a transaction must be directed at the ABS in question, or its underlying or referenced asset pool, so unrelated transactions are scoped out. It also clearly defines the type of conflict that is prohibited – thereby eliminating ambiguity. Finally, our proposed change still avoids the need for the SEC staff to prove the intent of the securitization participant in order to enforce the prohibition.

While we are suggesting other crucial changes to the re-proposed rule, including other changes to the definition of "conflicted transaction," our proposed change to clause (iii) is the most important. Were the

[7] In addition, as described below, we propose to ensure to eliminate any potential ambiguity on whether certain other specific types of ordinary-course transactions could be captured by the definition of "conflicted transaction."

Commission to adopt clause (iii) exactly as it has been re-proposed, it is likely that some securitization industry participants – including investors—would simply exit some or all of their securitization business. **A significant refocusing of clause (iii) is a critical predicate to the adoption of a rule that is workable in its entirety.**

C. Materiality standard should be revised to protect investors by prohibiting conflicted transactions as to which a reasonable investor in the ABS would consider the securitization participant's financial interest in the transaction to be materially adverse to the investor's interests.

The materiality qualifier in Section 621 was included to provide a reasonable limit to the types of conflicted transactions that would violate the rule. As described in the First Letter, the Commission's proposed standard – which looks to whether "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 asset-backed security" – is not clear enough to be workable. There is no market precedent for being required to determine whether a particular fact is "important" to an investor's investment decision in connection with anything other than the purchase of a security, much less on an ongoing basis as to an investor's decision whether to retain a security. And most importantly, this materiality standard, which was derived from Rule 10b-5 jurisprudence, was crafted by the courts specifically to identify when disclosures are inadequate. Market participants have no basis upon which to judge whether a potentially conflicted transaction would be substantially likely to be "important" to an investor's investment decision, particularly if an investor is fully aware of the potentially conflicted transaction. This makes compliance with the Commission's proposed materiality standard, difficult, if not wholly impossible, to apply, because the required determination cannot be divorced from the context of the disclosures that have been made. In sum, the Commission's reluctance to consider disclosure as a factor in assessing the importance of a particular transaction to a reasonable investor makes its proposed materiality standard exceedingly difficult to apply.

Our proposal would hone the materiality standard directly in response to its function, by asking whether there is a substantial likelihood that a reasonable investor would consider the securitization participant's financial interest in the transaction to be materially adverse to the interests of the investor in the ABS. If the transaction does not involve the actual or potential receipt of payments, or those payments are immaterial in amount, or those payments are not material in contravention to the interests of investors in the ABS, they would not be materially adverse to the interests of investors. Under our proposal, securitization participants would not be faced with the ongoing need to determine a hypothetical investor's view of the importance of a particular transaction in relation to a potential decision whether or not to retain the ABS. Our proposal would also avoid the tension between a materiality standard that demands the ability to mitigate with disclosure and the Commission's reluctance to permit disclosure to fulfill that function.

D. **Rebuttable presumption, multi-factor indicia of separateness test, or both as alternatives, should be incorporated to safeguard inadvertent, innocent transactions.**

1. *Innocent transactions and the Commission's skepticism regarding information barriers.*

Given the breadth of the application of the re-proposed rule to many large global entities and all of their affiliate and subsidiaries, it is possible that persons or groups with a securitization participant that have no connection to a securitization may innocently enter into a transaction that is deemed conflicted under the rule. However, if the transaction is disconnected to the securitization, it does not present the risks that Section 621 was intended to address. Such a transaction does not present the risk that the transaction would incentivize the transaction to be "designed to fail."

One means of addressing this issue would be to exclude from the prohibition of the rule transactions on the other side of an information barrier. However, the Commission did not include information barriers in its re-proposal, because it believes they present a potential avenue for evading the prohibition of conflicted transactions, and concerns that they are permeable and difficult to enforce.

We suggest two approaches that would have benefits similar to those of information barriers, but without the drawbacks perceived by the Commission. Either or both[8] of these approaches should be used to supplement, not replace, our suggested refinement of clause (iii) of the definition of "conflicted transaction."

2. *Rebuttable presumption alternative.*

Our first alternative approach is a presumption that a transaction of the type specified in the rule that is entered into by any employee, group or business unit within a sponsor, underwriter, initial purchaser, or placement agent (or any of its affiliates and subsidiaries) is a prohibited conflict of interest. However, if such an employee, group or business unit did not participate in the securitization transaction (which we call a "related person"), then we believe that the related person should be able to rebut the initial presumption by proving, by a preponderance of the evidence, that it had no substantive role in structuring, marketing or selling the ABS or in selection of the related asset pool. A person with no substantive role in the design of a securitization cannot, by definition, design a securitization to fail. Because the related person would bear the burden of proof, its successful rebuttal of the presumption means that whatever compliance procedures were implemented by the related securitization participant were effective in that circumstance.

In our view, this rebuttable presumption would be a safeguard against inadvertent, innocent transactions from triggering a rule that was not meant for them. Because a related person would have to prove that it had no role in the transaction, the rule would not require the Commission to prove intent. Rather, the related person would bear the burden of proving that its transaction was unrelated to the securitization.

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[8] In our view, both approaches are valid, but each may be more appropriate for different securitization participants.

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3. *Multi-factor indicia of separateness alternative.*

Another potential approach to address innocent and disconnected transactions is the "separate accounts" paradigm under Rule 105 of Regulation M.[9] This rule, which governs short sales of securities during the restricted period prior to a secondary offering, provides:

> 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.[10]

For purposes of this alternative, we would define a "non-participating entity" as 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 ABS, or in selecting the assets backing the ABS. In contrast, a "participating entity" would be defined as any business unit, group, affiliate, or subsidiary of a securitization participant that has a substantive role in structuring, creating, marketing, or selling the ABS, or in selecting the assets backing the ABS. A non-participating entity would not be considered a securitization participant with respect to any transaction if:

- The investment decision regarding the 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

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

We would then codify the Commission's guidance under Regulation M as to whether a transaction in a separate account was made separately and without coordination of trading or cooperation ,[11] as indicia of separateness to determine whether a particular transaction was made by a non-participating entity separately and without coordination with a participating entity. Under this alternative, this determination would be a facts and circumstances determination, under which indicia of separateness and lack of coordination would include (but not be limited to) the following:

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

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[9] 17 C.F.R. §242.105.
[10] *Id.*
[11] *See* Short Selling in Connection with a Public Offering: Amendments to Rule 105 of Regulation M: A Small Entity Compliance Guide, available at https://www.sec.gov/divisionsmarketregtmcomplianceregmrule105-secg.htm (last modified May 21, 2008). This guide restates the indicia of separate accounts described in Short Selling in Connection with a Public Offering, SEC Release No. 34–56206, 72 Fed. Reg. 45094, 45098 (Aug. 10, 2007) [hereinafter Short Selling Release].

- 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:

- Information barriers separate the non-participating entity and the participating entity;

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

- 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.

We believe that this framework would work well for the re-proposed rule due to the similarity of circumstances and policy between the Regulation M prohibition on short selling and Section 621's prohibition on conflicted transactions in securitizations. The Commission noted that the "separate accounts" exception was appropriate "if decisions regarding securities transactions for each account are made separately and without coordination . . . even though the accounts may be affiliated or otherwise related, [because] the incentive that motivates the Rule 105 violation is not present."[12] The Commission further noted that the exception was a "carefully honed response to the comments" it received on the matter, and that structures and entities with safeguards that are not in line with the indicia could still fall within the exception as determined by the Commission on a case-by-case basis.[13]

In our view, these indicia of separateness and lack of coordination are objective and fact-based, not subjective or intent based. Further, while information barriers may serve as one of several such indicia, this alternative would not automatically exempt any transaction on the other side of an information barrier, avoiding the Commission's expressed concerns regarding potential evasion and permeability.

E. Certain activities should be outside the scope of the "conflicted transaction" definition to eliminate severe unintended consequences.

We are proposing that the final rule clarify that several specific types of transactions that do not pose the types of concerns that impelled Congress to enact Section 621 are outside the scope of the prohibition. These types of transactions are integral to securitization market participants, especially the very investors the rule is intended to protect.

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[12] Short Selling Release, 72 Fed. Reg. 45094,45098.
[13] *Id*. at 45100.

1. Certain transactions involving clients owed fiduciary duties.

As we discussed in our First Letter, asset managers and investment advisers typically have fiduciary duties to multiple clients. A transaction that is considered a "conflicted transaction" with respect to an ABS issuance could be beneficial to a separate client to whom a securitization participant also owes a fiduciary duty. Not allowing a securitization participant to execute such a transaction on behalf of its separate client could cause it to fail to serve the best interests of that client, thereby violating its fiduciary duties imposed by law. Where fiduciary duties are owed to multiple clients, those duties will mitigate the adversity of any potential conflicts of interest by requiring the securitization participant to act in the best interests of each party separately. This contrasts with the types of transactions that motivated Congress to enact Section 621, in which a securitization participant with no fiduciary duty to the securitization had an incentive to design the securitization to fail.

In sum, where a securitization participant has fiduciary duties to both sides of a possible conflict and acts in accordance with those fiduciary duties, any transaction entered into by that securitization participant should not be considered to be motivated by a desire to profit from designing the transaction to fail. Each of these clients is protected by the securitization participant's fiduciary duty.

Therefore, we are proposing to clarify that the rule does not apply to any transaction with respect to any securitization participant with a fiduciary duty to the issuer of the ABS pursuant to the Investment Advisers Act of 1940, as amended (the "Advisers Act"), when the transaction is entered into by that securitization participant on behalf of another client, fund or account managed by that securitization participant and conducted in accordance with that securitization participant's fiduciary duty to that client, fund or account under the Advisers Act.

2. Certain transactions related to funds independently managed by third parties.

Often asset managers and other market participants use third parties to independently manage and invest their own funds. Therefore, we are proposing to clarify that the rule does not apply to any transaction involving an account owned by a securitization participant that is managed by a third party with investment discretion or advised by a securitization participant and sub-advised by a third party with investment discretion, where the transaction-specific investment decision was not directed by the securitization participant. Under these circumstances, the securitization participant has no role in the conflicting transaction, so it cannot be motivated by that transaction to design the securitization to fail. Any other interpretation would be counter to one of the key benefits of using an independent third-party manager and extend the rule well beyond a securitization participant's affiliates and subsidiaries resulting in an unnecessary and very costly, if not inoperable, compliance regime.

3. Activities unrelated to credit risk (including interest rate, currency and other non-credit related risks).

As discussed in our First Letter, our members are very concerned about any potential restrictions placed upon their ability to hedge interest rate and currency exchange risks. These types of transactions that are unrelated to the credit risk of the ABS do not pose the problems that Section 621 was intended to address. It is not clear why these uncontroversial activities should be scoped into the re-proposed rules,

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or alternatively, why they should be burdened by the extensive requirements for the proposed risk-mitigating hedging activities exception.[14]

Therefore, we are proposing to clarify that any transaction with respect to any securitization participant that is not related to the credit risk of an asset-backed security, including transactions related to overall market movements (such as movements of market interest rates, currency exchange rates or home prices), is not within the scope of the definition of "conflicted transaction."

4. Transactions that terminate before ABS issuance

If a particular transaction has been fully performed before the ABS are issued, then the securitization participant cannot logically profit at the expense of investors in the ABS, who do not even exist at the time of the transaction. Therefore, we are proposing to clarify that transactions that terminate on or prior to the closing date with respect to the ABS in question are not within the scope of the definition of "conflicted transaction."

II. Prohibition Should Be Clarified to Allow Securitization Participants to Conform their Activities to the Rule.

A. Commencement date of the prohibition should set clearer requirement.

As proposed by the Commission, the prohibition on a securitization participant's entry into a transaction that would involve a material conflict of interest (*i.e.*, a conflicted transaction) would begin when a person has reached agreement to become a securitization participant or taken substantial steps to reach such an agreement. To be able to comply with the requirements of the rule, securitization participants need a definitive starting point for the application of the rule. We think that the Commission's proposed standard can and should be refined in certain circumstances to eliminate some of the vagueness of the proposed starting point.

For this reason, we suggest that the prohibition of the rule begin on a defined "commencement date" for that securitization participant.

For a securitization participant (or a person that becomes a securitization participant) in an ABS transaction that is rated by one or more nationally recognized statistical rating organizations ("NRSROs"), we propose that the commencement date be:

- The date on which an engagement letter with an NRSRO with respect to the transaction is signed by that person; or

[14] The agencies that adopted the risk retention rules – including the Commission – recognized that these types of transactions do not misalign a risk retention holder's obligation to maintain skin-in-the-game by using them as hedges. Therefore, the agencies excepted these types of transactions from the prohibition on hedging ABS interests required to be retained under the credit risk retention rule. *See* 17 CFR § 246.12(d)(2).

- With respect to any other such person that is not a signatory to that engagement letter, the date that person has reached, or has taken substantial steps to reach, an agreement to become a securitization participant.

For a securitization participant (or a person that becomes a securitization participant) in an ABS transaction that is not rated by any NRSRO and for which an engagement letter is signed by an underwriter, placement agent or initial purchaser, we propose that the commencement date be the earlier of:

- The date on which that engagement letter is signed by that person, but no later than 30 days prior to the first sale of any of the ABS; or

- With respect to any other such person that is not a signatory to that engagement letter, the date that person has reached, or has taken substantial steps to reach, an agreement to become a securitization participant.

For a securitization participant (or a person that becomes a securitization participant) in an ABS transaction that is not rated by any NRSRO and for which there is no engagement letter signed by an underwriter, placement agent or initial purchaser, the date that is the later of:

- The date on which such person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant, and

- 30 days prior to the date of the first sale of any of the ABS.

In our view, this formulation sets a reasonable starting point for the prohibition for various types of securitization participants, considering the way in which each becomes a securitization participant and the manner and timing in which securitization transactions are normally organized and structured. The prohibition would begin at the time a particular securitization participant could possibly have an incentive to design the transaction to fail. The starting point for many securitization participants would be clearer, which should help institutions to better implement effective procedures to govern their compliance with the rule.

B. Use of "directly or indirectly" in the prohibition should be removed in favor of straightforward anti-evasion provision.

The Commission has proposed that the main prohibition of the rule apply to any transaction involving a material conflict of interest (*i.e.*, a conflicted transaction) undertaken directly or indirectly by a securitization participant. While we understand the Commission's concern with the potential for evasion of the rule, the Commission has proposed a separate anti-circumvention provision, which we propose to refine into an anti-evasion provision as described below. There should not be overlapping and potentially inconsistent anti-evasion provisions. The application of the rule must be clear, in order to enable market participants to properly conform their activities to the requirements of the rule. Therefore, we ask that the Commission delete the modifier "directly or indirectly" from the prohibition of the rule.

III. Definition of "Sponsor" Should Be Clarified to Specifically Exclude Long Investors and Certain Other Third-Party Service Providers.

A. Revisions to "sponsor" definition are critical to ensuring that important parties are not unnecessarily drawn into costly compliance regime.

As noted in the First Letter, we have significant concerns surrounding the practical effect of the proposed definition of "sponsor." Clause (i) of the definition of "sponsor" includes a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.[15] This is consistent with the definition of "sponsor" in Item 1101(l) of Regulation AB, with clause (ii) of the definition of "securitizer" in Section 941(b) of the Dodd-Frank Act,[16] and with the correlative definition of "sponsor" in the credit risk retention rules.[17]

Clause (iii), however, would add a broad universe of other securitization participants to the definition of "sponsor," including any person 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 (referred to by the Commission as a "directing sponsor"), and any person with a contractual right to do so (referred to by the Commission as a "contractual rights sponsor"). This could scope in almost anyone with any role in the structuring of a securitization, including non-bank broker-dealers, asset managers, insurance companies, third-party servicers, commercial banks, and investors in all types of ABS, residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS") and collateralized loan obligations ("CLOs"). The Commission goes on to include all affiliates and subsidiaries of any entity that falls within the definition of "securitization participant," which further exacerbates the problem posed by the breadth of the definition. The breadth of the proposed definition of "sponsor" would contribute substantially to the inability of market participants to know whether they are subject to the re-proposed rule at any given point in time.

While some of our members continue to question the legal basis for the Commission's assertion that the use of the term "sponsor" in Section 621 should be expanded beyond the definition commonly used in the markets, in Regulation AB, and in Section 941(b) of the Dodd-Frank Act and the risk retention rules adopted thereunder, we recognize the Commission's practical constraints, including the desire to scope in managers of collateralized loan obligation ("CLO") transactions that are not sponsors for purposes of the credit risk retention rules.[18] Therefore, we are not suggesting that the Commission limit the definition of "sponsor" to clause (i). But we do ask that the Commission clarify its proposed exception for certain persons that perform routine securitization activities, include servicers and third-party asset sellers within

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[15] Reg. AB Item 1101(l) uses the term "issuing entity" and the credit risk retention definition uses the term "issuer," but this difference is immaterial.
[16] As codified at 15 U.S.C. § 78o-11.
[17] The Department of the Treasury, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Department of Housing and Urban Development. *See*, *e.g.*, 12 C.F.R. § 246.2 (Commission version of risk retention rules). We cite to the Commission version of these rules in this letter for convenience.
[18] *See Loan Syndications & Trading Ass'n v. Sec. & Exch. Comm'n*, 882 F.3d 220 (D.C. Cir. 2018).

that exception, and add a new exception for long investors. Further, we request that the Commission retract certain statements in the commentary contradicting the "directs" language in the text of the re-proposed rule.

B. Use of conflicting terms "participates," "significant role" and "influences" should be removed from commentary to eliminate potential ambiguity.

Clauses (ii)(A) and (B) of the proposed definition of "sponsor" are clear. Clause (ii)(B) sponsors, which the Commission even refers to as "directing sponsors," direct or cause the direction of the structure, design or assembly of an ABS or the composition of the asset pool. Clause (ii)(A) sponsors, which the Commission calls "contractual rights" sponsors, have the contractual right to direct the structure, design or assembly of an ABS or the composition of the asset pool.

The word "directs" is clear and appropriate, and we do not object to either of these clauses as proposed. Section 621 was aimed at those who can direct the structuring of an ABS or composition of the asset pool, to prohibit them from misusing that power by entering into a short position, CDS or equivalent transaction in conflict with the interests of long investors.

Unfortunately, the Commission uses several other formulations of this test in the commentary, which may be inconsistent with the language of the proposed rule and even with each other. According to the Commission, the proposed term "sponsor" could include: parties "participating in asset selection,"[19] "with a significant role in asset selection,"[20] with "a significant role in determining the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS,"[21] having a "significant influence in the structure, composition, and management of an ABS,"[22] or even "influenc[ing] the structure of the relevant ABS."[23]

We ask that the Commission retract these and any other similar statements, which only serve to confuse. The term "directs" does not need further clarification. None of "participates," "significant role" or "influences" is the same as "directs," nor are they equivalent to each other. The use of these alternative characterizations would cause the scope of the rule to become unclear, posing problems for both compliance and enforcement.

C. Long ABS investors – the very parties the rule is designed to protect – should be excluded to ensure they are not subjected to costly, unnecessary compliance.

Long investors are frequently involved in structuring the ABS and in reviewing the underlying asset pool. Long investors may receive loan data, diligence results, and ABS informational and computational materials. Investors may specify a certain rating, yield or maturity, or require subordination, collateral

[19] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9686.
[20] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9685.
[21] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9694.
[22] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9685 n.66.
[23] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9684.

enhancement, or a specific structure. Some securities are created and structured specifically in accordance with investor requests, for example, targeted maturity term. Securitizations are often structured through an iterative negotiation process between deal participants and long investors. These are normal and beneficial market functions, yet the re-proposed rule is not clear that long investors undertaking these routine activities are not sponsors subject to the prohibition of the rule.

Were long investors to be deemed sponsors, they would be forced into implementing Volcker Rule-type compliance programs, in order to execute normal due diligence, risk mitigation and investing functions.[24] As a result, the re-proposed rule could perversely discourage long investors from actively participating in discussions regarding the deal structure and asset pools underlying an ABS, and consequently force them to be less involved and less informed about the transaction.

In its commentary, the Commission states that:

> [A]n ABS investor that is acquiring a long position in the relevant ABS would be expected to provide input with respect to the structure of the ABS investment or the underlying pool of assets for the purpose of maximizing the expected value of its ABS investment. For example, investors in certain ABS markets may have stipulations regarding general characteristics of the composition of the underlying pool of an ABS that must be satisfied in order for that investor to agree to acquire the relevant securities, including to ensure that the ABS investment would comply with its investment guidelines. Therefore, an ABS investor that is interested in acquiring a long position in an ABS would not be considered to direct the composition of assets merely because such investor expresses its preferences regarding the assets that would collateralize its ABS investment.[25]

This commentary is helpful, but the treatment of long investors should be addressed in the text of the rule.

Therefore, we propose that the Commission adopt a clear exception from the definition of "sponsor" for long investors. We propose to define "long investor" as an actual or prospective investor that directs or causes the direction of, the structure, design, or assembly of any ABS or the composition of the pool of assets underlying the ABS security solely in connection with its acquisition of a long position in the asset-backed security.

An actual or potential investor that directs, or causes the direction of, the structure, design or assembly on an ABS transaction, but in some capacity other than in connection with its acquisition of a long position, would not be covered by our proposed exclusion. For example, an investor that ultimately takes a short position in the ABS or the underlying asset pool would not be able to rely on our proposed exclusion for long investors.

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[24] Our further concerns with these requirements are described in detail below.
[25] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9686.

D. Clarifications should be made to exclude persons performing certain routine securitization activities.

The Commission has proposed an exclusion for a person that performs "only" administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of the ABS or the composition of the pool of assets underlying the ABS. However, the use of "only" undercuts this exemption because the typical "administrative, legal, due diligence, custodial, or ministerial acts" of these parties can also be viewed as causing the "direction of the structure, design or assembly of an ABS or the composition of the pool of assets underlying the ABS." For example, trustees, custodians, paying agents, calculation agents, administrators, accountants, lawyers, rating agencies and other contractual service providers also have key input into the creation of an ABS. These entities may be involved in (i) the drafting and negotiation of the operating and disclosure documents, (ii) setting fees, (iii) reviewing the asset pool, (iv) in some cases, negotiating the priority of payments within an ABS transaction, and (v) potentially advising on how to structure an ABS to meet the objectives of the deal parties, including investors.

Therefore, we propose to replace the qualifier "only" with "primarily." We acknowledge the possibility that such a party could improperly evade the rule by including within its duties the types of sponsorship functions that should subject it to the prohibition of the rule. To address this concern, we suggest that persons performing primarily these routine securitization functions should only be able to take advantage of the exception if any activities that otherwise would bring them within the definition of "sponsor" be limited to those routinely performed by persons acting in those capacities with respect to ABS transactions.

We also believe that persons who perform other specific functions should be added to this exclusion, as described below.

1. Servicers.

As noted in the First Letter, many of the roles played by servicers are ministerial in the same manner as the lawyers, accountants, rating agencies, trustees, custodians, paying agents and calculation agents that the re-proposed rule excludes. For example, a primary servicer is typically only responsible for billing and collections services. Hence, our membership does not believe that primary third-party servicers should be scoped into the prohibitions of the rule, with all that entails. This is especially important as primary servicers play a critical role in the mortgage, consumer loan and small business loan sector. As such, unnecessarily raising their regulatory risk and the associated costs should be carefully considered.

Therefore, in addition to persons performing primarily administrative, legal, due diligence, custodial, or ministerial functions, we suggest that this exception should specifically include servicers. We would define "servicer" by cross-referencing the definition of "servicer" in the credit risk retention rules: a person responsible for the management or collection of the securitized assets or making allocations or distributions to holders, but not including a trustee that makes allocations or distributions to holders if the trustee receives such allocations or distributions from a servicer and the trustee does not otherwise perform the functions of a servicer.[26] A sponsor that is also a servicer would not be captured by our

[26] 17 C.F.R. § 246.2.

exception, because its activities that would otherwise subject it the definition of "sponsor" are not limited to those routinely performed by servicers.

Our members have divergent views as to whether special servicers in CMBS transactions should be included within our proposed exemption for servicers. As defined in the credit risk retention rules, a special servicer is, in any securitization of commercial real estate loans, a servicer that, upon the occurrence of one or more specified conditions in the servicing agreement, has the right to service one or more assets in the transaction.[27]

2. Third-party asset sellers.

As noted in the First Letter, the underlying financial assets in a securitization transaction must come from somewhere. When the sponsor of an ABS transaction is also the originator, the assets usually are sold to a depositor and then by that depositor into the issuing entity. However, pool assets may also be purchased from a third-party originator or owner before they are sold into the securitization structure. These third-party asset sales are routine, necessary capital markets functions, and used extensively in consumer and business finance markets including the $9.2 trillion RMBS sector. These asset sales are also critical to corporations seeking to divest assets to raise capital or exit businesses since many potential purchasers use securitization to finance all or a portion of their acquisition of the assets. Therefore, these capital markets activities logically cannot be prohibited by the rule since the intent of Section 621 was not to prohibit securitization altogether.

Someone could argue that a third-party asset seller directs the composition of the asset pool, simply because it has agreed with the buyer on which receivables it is willing to sell. However, in most cases third-party sellers have no control over the securitization process. For example, a third-party seller does not own the equity of the depositor, does not form the issuing entity, does not select the underwriter, initial purchaser or placement agent, does not structure the securitization, does not engage issuer's counsel or accountants, does not engage the rating agency(ies), and does not negotiate the terms of the engagement of the transaction parties such as the trustee, custodian and servicers. The buyer chooses to purchase the particular group of assets, and even more importantly, whether to securitize some, all or none of those purchased assets. Thus, in all significant respects, the buyer controls whether to securitize, the assets that are to be securitized, and the structuring of the securitization.

For this reason, we propose removing any potential ambiguity by adding third-party asset sellers to the exception for persons performing primarily administrative, legal, due diligence, custodial, or ministerial functions. We propose to define "third-party asset seller" as a person that sells a financial asset or assets that become all or part of the asset pool underlying an asset-backed securities transaction that is neither the sponsor (within the meaning of paragraph (i) of the definition of sponsor) of that transaction nor a subsidiary or affiliate of that sponsor.

[27] 17 C.F.R. § 246.7.

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3. Nationally recognized statistical rating organizations.

In connection with its discussion of the exclusion of persons that perform only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of the ABS or the composition of the asset pool, the Commission states its belief that "the activities customarily performed by . . . credit rating agencies with respect to the creation and sale of an ABS, . . . are [among] the sorts of activities that would typically fall within the exclusion."[28] While this commentary is helpful, in our view the exception for NRSROs should be made explicit in the language of the rule.[29]

IV. "Synthetic Asset-Backed Security" Should Be Defined to Provide a Specific, Unambiguous Standard that Does Not Impede Critical Risk Management Tools.

While the proposed rule includes synthetic securitizations in the definition of asset backed security, the term "synthetic asset-backed security" is not separately defined. However, in its commentary the Commission described a "synthetic securitization" as "securitizations that are designed to create exposure to an asset that is not transferred to or otherwise part the asset pool." [30] The Commission states that no definition in the rule is necessary since the Commission's "descriptions of synthetic securitizations are well understood by market participants . . . that market participants have been able to readily distinguish synthetic ABS from other types of transactions." [31] The Commission also states that it is "concerned that any particular definition of 'synthetic ABS' that we might propose would be susceptible to potential over-inclusiveness or under-inclusiveness" and "that a securitization participant might attempt to evade the re-proposed rule's prohibition by structuring such transactions around any particular definition . . . , which would weaken the re-proposed rule's conflict of interest protection for investors." [32]

While we appreciate these stated concerns of the Commission, we believe that what constitutes a synthetic securitization subject to the re-proposed rule is unclear, and there is no commonly understood meaning of the term among market participants. The current construct likely leaves many questions over what is allowable, hindering the ability of market participants – including banks and insurance companies –to use synthetic ABS transactions to conduct *bona fide* risk mitigating activities. We believe there is a

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[28] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9686.
[29] NRSROs are already subject to an extensive regulatory regime that prohibits a number of conflicts, including permitting persons within the NRSRO to directly own securities of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the NRSRO, or to have business relationships that are more than arm's length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the NRSRO. 17 CFR § 240.17g-5(b)(6)-(7).
[30] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9681.
[31] *Id*.
[32] *Id.*

combined approach that can remove this ambiguity while mitigating any bad actors' attempts to evade the rule.

A. Definition of "synthetic asset-backed security" should only include transactions with traditional ABS features.

The Commission rejects the idea of a "a catch-all provision to cover any product that functions as the economic equivalent of a cash ABS, synthetic ABS, or hybrid ABS" since "[a] security that functions as the economic equivalent of a cash ABS, synthetic ABS, or hybrid ABS, as contemplated by these comments, should already meet the re-proposed rule's definition of ABS." [33] According to the Commission, "synthetic transactions are generally effectuated through the use of derivatives such as a CDS or a total return swap, or an ABS structure that replicates the terms of such a swap," and describes a synthetic securitization as a lender "purchasing a CDS contract from the special purpose entity that issues a synthetic ABS." [34]

Based on these statements, we believe that the Commission intended to scope into synthetic ABS only those transactions involving traditional ABS features such as asset remoteness and special purpose vehicles issuing securities backed by credit derivatives, not other forms of credit risk transfers ("CRT") involving insurance-, corporate-, or bank-issued securities or instruments (e.g., bank-issued credit-linked notes), insurance contracts, security based swaps, or guarantees, or unguaranteed debt obligations issued by Fannie Mae and Freddie Mac (the "Enterprises"). But without an explicit definition of "synthetic," the scope of the re-proposed rule itself is unclear.

Our proposed definition of "synthetic asset-backed security" would encompass a fixed-income or other security that is:

- Issued by a special purpose entity (an "SPE"); and
- Secured by
    - One or more credit derivatives or similar instruments ("risk transfer instruments") that reference self-liquidating financial assets (including bonds, loans, leases, mortgages, secured or unsecured receivables, or asset-backed securities) ("reference pools"), and
    - Financial assets acquired by the SPE using the proceeds of the securities to collateralize the issuer's obligations to make payments to the counterparty to the risk transfer instruments and to the investors on the securities, where the issuer's payment obligation on the securities is reduced as a result of credit events on the referenced financial exposures.

The definition would go on to clarify that it excludes any corporate debt, insurance policy, reinsurance policy, swap or security-based swap where the counterparty is not an SPE that issues a security to

[33] *Id.*
[34] *Id.*

investors, whether or not payments thereunder are contingent on the performance of referenced financial assets. As described further below, the definition also would clarify that insurance and reinsurance policies are not self-liquidating financial assets.

B. Synthetic ABS should not be *per se* prohibited, and critical risk mitigating transactions should be allowed.

According to the Commission, the re-proposed rule "prohibits a securitization participant from creating and/or selling a new synthetic ABS to hedge a position or holding."[35] It appears from this statement that the Commission intends for the re-proposed rule to ban most synthetic securitizations, which since the financial crisis have been issued primarily for the purpose of risk mitigation. If this is the case, we disagree strongly, as discussed further in connection with the Commission's proposed exceptions for risk-mitigating hedging activities and market-making activities.

C. Mortgage insurance-linked notes should not be considered synthetic ABS to prevent unintentionally prohibiting mortgage insurers from procuring reinsurance via the capital markets.

As described in detail in the First Letter, private mortgage insurance performs a crucial role in benefiting the Enterprises – and therefore taxpayers – because it absorbs potential losses before the Enterprises. Most mortgage insurance companies purchase reinsurance from a combination of "traditional reinsurers" (i.e., in direct counterparty transactions with rated reinsurers) and through capital markets structures (such as mortgage insurance-linked notes, or "MILNs") as a way to manage concentrated risk aggregations, provide protection against elevated losses, and to enhance their capital position. MILNs are structured so that the insurer is only entitled to recover its actual loss above a pre-defined point, similar to a deductible in an insurance policy. Because of the significant retained risk exposure and the requirement to maintain an insurable interest, the mortgage insurer maintains a strong alignment of interest with MILN investors to underwrite insurance on high quality loans and mitigate losses through a robust claims process. The mortgage insurer never benefits from the adverse performance of a mortgage insurance pool. Rather, the MILN is a prudent risk management tool that helps to mitigate losses under more extreme actuarial loss scenarios affecting the insurer's policies.

In order to clearly avoid scoping MILNs into the definition of "synthetic asset-backed security," we propose to clarify that the definition of self-liquidating financial assets that may be referenced in a synthetic ABS does not include insurance or reinsurance contracts (or insurance or reinsurance risks). For clarity, we also support the inclusion of text in the adopting release stating:

> We have received comments on the proposed rule from private mortgage insurance companies seeking clarification that mortgage insurance-linked notes are not synthetic asset-backed securities. We understand that payments on mortgage insurance-linked notes are dependent upon a reinsurance contract reinsuring private mortgage insurance policies that are, in each case, issued by a licensed insurance company domiciled in the United States. We do not view mortgage

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[35] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9700.

> insurance-linked note transactions with the foregoing characteristics as synthetic asset-backed securities within the meaning of Rule 192."

V. The Proposed Exceptions Should Be Clarified and Expanded to Permit Vital Risk Management Tools While Maintaining Investor Protections.

The Commission has proposed three narrow transactional exceptions to the definition of "conflicted transaction," including liquidity commitments, market-making activities, and risk-mitigating hedging activities. In our view, these exceptions need to be broadened, and even considering our proposed revisions to clause (iii) of the definition of "conflicted transaction," a number of additional narrow exceptions are needed to avoid "unnecessarily prohibiting or restricting activities routinely undertaken in connection with the securitization process, as well as routine transactions in the types of financial assets underlying covered securitizations.[36]

A. The Commission has the power to adopt broadened or new exceptions.

Because we are asking for the Commission to add new exemptions to the re-proposed rule, we have considered the Commission's authority to do so.

Congress' mandate for the Commission to adopt the re-proposed rule is explicit in Section 621, which requires the Commission to "issue rules for the purpose of implementing" the prohibition on securitization conflicts of interest, and that the prohibition shall not be effective until those rules are adopted. Section 621 was codified at Section 27B of the Securities Act of 1933, as amended (the "Securities Act").[37] As acknowledged by the Commission,[38] its rulemaking authority for the re-proposed rule derives not only from Section 621 itself, but also from several other provisions of the Securities Act, including Section 28.[39] That section empowers the Commission:

> [B]y rule or regulation, [to] conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation issued under this title, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

B. Risk-mitigating hedging exemption should be modified to ensure critical risk management tools are not impeded.

In the First Letter, we objected to the narrow scope of, and extensive compliance requirements imposed by, the proposed exception for risk-mitigating hedging activities. Financial institutions, corporations and investors utilize hedging as a protective strategy to manage risk. As demonstrated by recent events in the

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[36] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9694.
[37] 15 U.S.C. § 77z-2a.
[38] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9726.
[39] 15 U.S.C. § 77z–3.

banking sector, the failure to hedge against interest rate exposure amid an unpredictable and fluctuating market can have disastrous consequences. Overall, SFA members are concerned about the three restrictive conditions placed on their ability to enter into risk-mitigating hedges to limit credit, interest rate, and other risks for themselves and their clients.

We have several comments geared towards making this exception more workable, while remaining appropriate in the public interest and consistent with the protection of investors.

1. *Eliminate requirement that risk-mitigating hedging exception must be "arising out of its securitization activities."*

The re-proposed rule would require that any permitted risk-mitigating hedging activities be undertaken by a securitization participant in connection with positions, contracts, or holdings "arising out of its securitization activities." We propose that the Commission broaden the exception for risk-mitigating hedging activities by deleting this qualification.

Risk mitigating hedging is an imperative business function, and the unavailability of the exception for assets other than ABS would unduly limit the ability of securitization market participants to properly manage their risks. Given the broad scope of the definitions of "conflicted transaction" and "sponsor" – even considering our comments – the limited scope of the proposed exception would unnecessarily burden an important corporate function. It is crucial to the stability of securitization participants – and the interests of investors in those entities – that they be able to appropriately manage their risks, whether or not those risks are related to their securitization activities.[40] Without the deletion of the requirement that risk-mitigating hedging activity arise out of a financial institution's securitization activity, the prohibition would be even more restrictive overall than even the Volcker Rule, which contains an exemption that is not limited by the type of transaction to be hedged.

As an example, consider a broker-dealer within a diversified financial institution that acts as an underwriter for ABS issues. An affiliated bank invests in, among other things, ABS. The bank, even though it is wholly uninvolved in any securitization activity of its broker-dealer affiliate, could purchase ABS in the secondary market that were underwritten by its broker-dealer affiliate. It would be wholly appropriate – and in the public interest and consistent with the protection of investors in the financial institution – for the bank to hedge its risks arising from that purchase. As proposed, the exception for risk-mitigating hedging activities would not cover this activity.

Finally, a note about the interconnectedness of the provisions of the re-proposed rule. We hope that the Commission will agree with our proposed refinement of clause (iii) of the definition of "conflicted transaction." However, if it remains broad enough to encompass a wide swath of transactions only loosely correlated with ABS, the lack of an exception for risk-mitigating hedging activities for those loosely-correlated transactions could have far-reaching and unintended adverse consequences and may

[40] This concern would be even more heighted if the Commission were not to adopt our proposed changes to clause (iii) of the definition of "conflicted transaction."

force institutions to cease engaging in those transactions altogether. Prudent business practices will not allow the continuation of activities that cannot be hedged appropriately.

2. *Exclusion of "initial distribution of an ABS" should be removed to permit prudent risk transfer transactions.*

The re-proposed rule would require that permitted risk-mitigating hedging activities not include "the initial distribution of an asset-backed security." We propose that the Commission broaden the exception for risk-mitigating hedging activities by deleting this qualification.

According to the Commission, 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." Thus, it appears as though the prohibition of the rule would prohibit all CRT transactions[41] and other synthetic securitizations. Further, "[u]nder the re-proposed exception [for risk-mitigating hedging activities], the initial issuance of an ABS, such as a synthetic ABS, would not a be risk-mitigating hedging activity," suggesting that no exception would be available.

In our meetings with the Commission's staff, we were asked why CRT transactions would not fit within the exception for risk-mitigating hedging activities. We think they should, but if the qualification in question is not removed from the exception, they would appear to be prohibited in at least two ways. First, the rule would prohibit a sponsor of an ABS transaction from creating a separate synthetic CRT transaction to hedge its retained risk,[42] because it would be a prohibited conflict of interest regarding the investors in the initial ABS. Second, the rule would prohibit the CRT transaction considered on its own, because the CDS or other position inside the CRT transaction would be a prohibited conflict of interest with respect to the CRT investors. Due to the exclusion from "the initial distribution of an asset-backed security" from the exception for risk-mitigating hedging activities, neither prohibition would fall within the exception.

As we stated in the First Letter, we do not understand the policy rationale behind a prohibition of synthetic securitizations that are used for mitigating balance sheet risk. Synthetic securitizations are one form of CRT that banks, insurance companies, and corporations use to manage risk. Economically, synthetic securitizations used for risk mitigating purposes are the same as the other forms of CRT but have the added benefit of not subjecting investor principal repayment to the credit risk of a sponsor. Therefore, we believe that the risk-mitigating hedging activities exception should apply to synthetic securitizations that base payments to investors on the performance of a reference pool to cash assets

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[41] Except for CRT transactions sponsored by the Enterprises, which would continue to be permitted for so long as the Enterprises are operating under federal conservatorship or receivership. We also support the clarifying language proposed by the Enterprises in footnote 31 to their comment letter dated March 27, 2023.

[42] Aside from any risk position that is required to be retained (and not transferred or hedged) pursuant to the credit risk retention rules.

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held on a securitization participant's balance sheet should be included as a valid risk mitigating hedge and not *per se* prohibited as a conflicted transaction.

Preserving risk mitigation activities – which is encouraged, if not mandated, by many prudential regulators – should take precedence over the remote risk that a bad actor can find a means to circumvent an otherwise tightly structured regulatory regime. Importantly, nefarious actions will be captured by the anti-evasion rule and other enforcement tools the Commission has available to it.

We also urge the Commission to consider the legal basis for a ban on all synthetic securitizations. Had Congress meant to ban synthetic ABS, it could easily have said so, but it did not. If the Commission intends to limit or eliminate synthetic securitizations, then its rulemaking should address this directly, including an analysis of the costs and impact on capital formation and on the goals of prudential regulators. A cursory statement, solely in connection with the Enterprises, that the rule "may increase frictions in . . . the Enterprise ABS or CRT processes, perhaps increasing costs for U.S. mortgage borrowers or limiting the transfer of credit risk to investors,"[43] is insufficient to justify such a sweeping change.

3. Risk mitigating hedging exemption should not require ongoing recalibration and monitoring.

The proposed exception for risk mitigating hedging activities would be available to the extent that market participants comply with several stringent conditions, including compliance requirements modeled after the Volcker Rule proprietary trading exemption as it applies to the largest prudentially regulated banking entities.[44] We believe these conditions should be refined to make them workable for all market participants and workable for the unique purpose of the re-proposed rule.

The first condition is that "the activity must be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant arising out of its securitization activities." Second, all hedging activity would be subject to "ongoing recalibration to ensure that the hedging activity satisfies the requirements" and "does not facilitate or create an opportunity to benefit from a conflicted transaction other than through risk-reduction." Third, the securitization participant would have to implement a compliance program to ensure it is abiding by the standards of permitted risk mitigating hedging activities, including "reasonably designed written policies and procedures . . .that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored." These qualifications would significantly restrict how a market participant can, and currently do, manage risks for itself and its clients. The conditions seemingly imply that market participants may need to use a single hedge and single hedging strategy for each asset, may need to reduce their hedges over time and across

[43] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9720.

[44] "[C]ertain of the proposed conditions to the proposed risk-mitigating hedging activities exception are similar to those that are applicable to the equivalent exception to the Volcker Rule's proprietary trading prohibition." Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9703.

all entities and may need to limit hedging activities to only those *arising out of its securitization activities.* These conditions simply do not accurately reflect how institutions manage risk.

As noted in the First Letter, both the design and recalibration requirements included in the re-proposed rule are similar to requirements that apply to all banking entities under the Volcker Rule,[45] while only banking entities with "significant trading assets and liabilities" are subject to the compliance program requirement. However, under the re-proposed, rule, all securitization participants, banking entities or not, and regardless of their size, including investors as well as affiliates and subsidiaries that have no connection to securitizations, will need to institute similar internal compliance programs.[46] We note the conceptual difficulty of applying Volcker Rule concepts to non-banks. The analogous exceptions from the Volcker Rule apply to its prohibition on proprietary trading, as it was Congress' goal to limit banking entities' involvement in proprietary trading activity. However, limiting market participants' ability to engage in routine risk-mitigating activities – especially given the for broad range of transactions that the Commission proposes to scope into the conflicts of interest rule – was not what Congress intended in adopting Section 621. To the contrary, investing in ABS and other investment opportunities is the primary focus of the business of asset managers and other investors who may be subject to the rule. Requiring them to comply with a set of conditions that is designed to limit their hedging activities as a condition to allowing them to participate in a significant manner in ABS offerings is a non-sequitur and is not supportable under Section 621. **Ultimately, these burdensome conditions have the potential to create adverse unintended consequences for financial stability in the market at large.**

Our proposed changes focus on the recalibration and compliance requirements. We would remove the requirement for ongoing calibration of the risk-mitigating hedging activity and replace it with a requirement that the primary benefit of the risk-mitigating hedging activity is risk reduction and not the facilitation or creation of an opportunity to realize some other benefit from a conflicted transaction. Many securitization participants are less equipped than large, regulated financial institutions to establish the extensive compliance programs that would be required to continually recalibrate their hedge positions. Similarly, we would revise the compliance program requirement to remove the requirement that the required policies and procedures provide for ongoing monitoring of risk-mitigating hedging activities, which would pose similar issues for many market participants. Finally, we would revise the compliance program requirement to state that it is reasonably designed to "result in" compliance with the requirements of the exception, not to "ensure" compliance. We believe the word "ensure" is inconsistent with the requirement that the compliance program be "reasonably designed." Compliance is always the goal, but no procedures – no matter how well designed—can guarantee that. Put another way, a securitization participant that creates a prohibited conflict of interest may be subject to Commission enforcement for that failure however should not be subject to separate enforcement for

[45] *See* 17 C.F.R. §§ 255.5(b)(1)(ii)(B) and (D)(3) (banking entities with significant trading assets and liabilities), 255.5(b)(2)(i) and (ii) (banking entities without significant trading assets and liabilities).
[46] The practical problem would be even worse if the Commission does not revise clause (iii) of the definition of "conflicted transaction," since securitization participants might not easily be able to identify the conflicted transactions that are supposed to be the subject of these compliance programs.

failing to ensure that its compliance program worked despite being reasonably designed to accomplish its goal.

C. Exclusion of "initial distribution of an ABS" should be removed from bona fide market-making activity exception.

As with the proposed exception for risk-mitigating hedging activity, the exception for bona-fide market-making activity would not include "the initial distribution of an asset-backed security." We proposed deleting the exclusion there, and we also propose deleting it here.

According to the Commission, this language "would mean that a securitization participant would not be able to rely on the re-proposed exception for bona fide market-making activities in ABS for primary market activities, such as issuing a new synthetic ABS."[47] We do not understand precisely what the Commission intends here. In any event, for all the reasons described above, we strongly object to the use of the re-proposed rule as a means to ban synthetic ABS, or to prohibit them from being used for routine and necessary corporate or market functions.

D. Additional limited but vital exemptions should be added to maintain a healthy functioning market.

1. Customer facilitation transactions.

Sometimes financial assets are transformed into ABS solely for risk capital management or other balance sheet reasons. In these transactions, which may be facilitated by a broker-dealer, the customer both selects the pool assets and retains all of the ABS that are issued. These transactions do not implicate the policy concerns of Section 621, because the customer is the sole investor in the ABS that are structured to its specifications.

To accommodate these transactions, we propose adding an exception for any ABS transaction that is structured for an investor, where the investor selects the collateral and where that same investor (or its affiliates) purchases all of the ABS issued, with a view toward investment and not distribution.

2. Activities before inclusion date.

As described in the First Letter, assets—whether they are originated by the sponsor or acquired from third parties—usually must be temporarily financed in a "warehouse" facility until they can be accumulated in sufficient size and sold, or more permanently financed in a securitization. We think the Commission should make it clear that the payoff of the warehouse facility from the proceeds of the securitization, and the release of the assets from the facility, would not be considered conflicted transactions.

Similarly, the pool assets need to be sold or otherwise transferred into the securitization vehicle for a securitization to occur. There may be multiple steps in these transfers that involve securitization

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[47] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9706.

participants – for example, from the warehouse lender to the sponsor to the depositor to the issuing entity.

The release by a warehouse lender of assets to be securitized from the facility, and the transfer of assets into the securitization structure, are routine and vital securitization activities that are not a source of concern behind Section 621, and as to which the legislative history mandates non-interference. Moreover, this perspective is consistent with the position the Commission expressed in the 2011 proposing release regarding these types of transactions. The rule should be clear that these activities are not within the scope of the prohibition.

> We believe that activities associated with the typical structuring of a non-synthetic ABS would not be prohibited by the proposed rule. For example, the basic transfer of risk in a non-synthetic ABS in which a securitization participant who is long the underlying assets sells them to an SPV is typical of most ABS structures and would not constitute a prohibited transaction, because after such sale the securitization participant would not benefit from the subsequent decline in the value of the ABS or the underlying assets.[48]

If there is any possibility that such activities could be scoped into the definition of "conflicted transaction," it is crucial that there also be a clear exception. Therefore, we propose an exception for any of the following transactions relating to all or a portion of the pool of assets underlying or referenced by the ABS that terminates on or prior to the date on which such assets are included in as part of that asset pool (which we refer to as the "inclusion date"):

- Activities undertaken in connection with the release of any of the pool assets from any financing thereof on or prior to the inclusion date; and

- The sale or other transfer of any of the pool assets to the issuing entity (or to any intermediate party to the transaction), and any related activities.

3. *Activities in connection with financing of ABS.*

As described in the First Letter, investors often finance the ABS they acquire. In many instances, institutions involved in the securitization are best suited to provide that financing, because of their detailed understanding of the structure and the pool assets. Such financing transactions are usually structured as repurchase agreements, although they may also take other forms such as secured loans or total return swaps. Numerous routine activities that may take place as part of the financing could be considered conflicted transactions. For example, in a repurchase agreement, the repurchase buyer (lender) has the right to protect its level of collateralization through "borrowing base" mechanics by marking the ABS to market. When it does so in a declining market, it often will make a "margin call" on the repurchase seller (borrower) for additional cash or collateral. This activity clearly is related to the decline in the value of the ABS and is intended for the lender to avoid a loss. This type of activity is

[48] Prohibition Against Conflicts of Interest in Certain Securitizations, SEC Release No. Release No. 34–65355, 76 Fed. Reg. 60320, 60340 (Sept. 28, 2011).

inherent to routine securities financing activity and does not serve as any kind of incentive for the lender or repurchase buyer to design the transaction to fail.

If there is any possibility that these financing transactions could be scoped into the definition of "conflicted transaction," it is crucial that there be a clear exception. Therefore, we propose an exception for activities undertaken by a securitization participant in connection with any financing of the asset-backed securities provided to holders thereof by a securitization participant, regardless of whether the financing takes the form of a loan, a repurchase agreement, total return swap, or otherwise.

4. Riskless principal transactions.

A riskless principal transaction is a transaction in which a broker-dealer intermediates between the buyer and seller of a security. For the intermediary such riskless principal transactions do not pose the conflicts of interest that Section 621 was intended to address. Therefore, we propose an exception for a securitization participant that, after receiving an order from a customer to enter into a transaction, enters into a separate and contemporaneous transaction with another person for its own account, to offset the transaction with its customer.

VI. Anti-Evasion.

The proposed anti-circumvention provision states simply that a securitization participant may not engage in a transaction that circumvents the prohibition of the rule. We believe that this formulation is unclear and over-inclusive, potentially prohibiting any number of innocent, ordinary course transactions that would be otherwise permitted by the rule. We suggest refocusing this provision specifically on evasion of the rule, as opposed to circumvention. We believe this to be a clearer standard.

It is not clear to us why the Commission used the word "circumvent" in the rule, when it states that what it intended to do was to avoid "an attempt to evade the prohibition on material conflicts of interest."[49] The rule should mean what it says, say what it means, and be consistent with the commentary.

The Commission seeks comment on an alternative provision that would instead prohibit a securitization participant from engaging in a transaction or a series of related transactions as part of a plan or scheme to evade the prohibition of the rule, asking whether this addresses any concerns about potential over-inclusiveness.[50] We believe that this formulation is superior. It would be helpful to mitigate potential over-inclusiveness, but just as importantly would more clearly identify within the text of the rule exactly what is prohibited.

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[49] Conflicts Rule Re-Proposing Release, 88 Fed. Reg. 9678, 9699.
[50] *Id*.

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VII. Narrow Safe Harbor for Foreign Transactions Should Be Included to Provide Transparent Applicability.

At present, the re-proposed rule gives no indication of the Commission's views as to its extraterritorial application. Financial markets are global and many participants in the U.S. ABS markets are parts of large institutions with affiliates and subsidiaries worldwide. In order for them to effectively comply effectively with the rule, there needs to be a clear safe harbor for activities and transactions that do not fall within the jurisdictional limit of the United States – or at least, as noted by the Commission and the other agencies that adopted the risk retention rules, "to provide clarity that the agencies will not apply the requirements of the final rule to transactions that meet all of the conditions of the safe harbor."[51]

We are proposing a simple safe harbor for foreign-related ABS transactions, that would apply if:

- The offer and sale of the ABS was or is not required to be and was or is not registered under the Securities Act;
- The offer and sale of all of the ABS is or was made outside the United States within the meaning of Rule 901 of Regulation S;[52] and.
- The issuing entity of the ABS is a foreign issuer within the meaning of Rule 902(e) of Regulation S.[53]

VIII. Provision for Exemptive Relief Should Be Added to Ensure Continued Healthy Functioning of the Securitization Market.

As described in the First Letter, the re-proposed rule is like a giant Venn diagram – in order to determine if an activity or transaction is permissible, a market participant must carefully examine numerous different aspects of the rule to ensure that it is in one of the areas of the diagram that does not prohibit either the transaction, its participation in the transaction and whether the transaction qualifies for an exemption. It is likely that even the more tailored formulation of the rule that we have proposed would leave several unanswered questions and "grey areas." As a result, we believe that the final rule should include a provision expressly authorizing exemptive relief.

First, we suggest a provision that empowers the Commission to provide a total or partial exemption of any transaction as the Commission determines may be appropriate in the public interest while maintaining the commitment to investor protection.

Second, we suggest a provision empowering the Commission to adopt or issue exemptions, exceptions, or adjustments to the requirements of the rule, including exemptions, exceptions or adjustments for:

[51] Risk Retention Adopting Release, 79 Fed. Reg. 77601, 77668 n. 215.
[52] 17 CFR § 230.901.
[53] 17 CFR § 230.902(e).

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- The types of entities that constitute securitization participants;
- The types of transactions that constitute conflicted transactions;
- The types of securities that constitute synthetic asset-backed securities;
- 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.

IX. An Appropriate Transition Period Should Be Included to Allow Adequate Time to Build Compliance Regime.

As re-proposed, the rule would affect many market participants, all of their affiliates and subsidiaries, and apply to many types of transactions, with only limited and complex exceptions. Even if all of our proposed changes were adopted, the rule would require sweeping changes in the way many institutions do business, and market participants will need to take the time to "get it right" internally. Therefore, we urge the Commission to provide an extended effective date, a long compliance period, or both, when adopting the final rule. We believe that 18-24 months would be appropriate.

Conclusion

As re-proposed, the rule is so far-reaching that it would have severe unintended consequences for the capital markets, the participants in those markets (including investors) and the consumers and businesses whose financing needs are provided for by those markets. Our detailed comments on the text of the re-proposed rule, which were specifically requested by the staff, represent the consensus of our issuer, broker-dealer and investor members as to the best ways to mitigate these consequences and permit routine securitization activity to continue unabated, while still providing an effective rule that addresses the concerns that lay behind Congress' enactment of Section 621.

We would be happy to continue our dialog with the Commission about these matters. In the meantime, should you have any questions, please do not hesitate to call.

Regards,

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Michael Bright
CEO, Structured Finance Association

§ 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 commencement 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 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 that 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,] [FOR REBUTTABLE PRESUMPTION ALTERNATIVE] 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 securitization participant's financial interest in the transaction ~~important to~~being materially adverse to the interests of the investor~~'s investment decision, including a decision whether to retain the~~ in the relevant asset- backed security:

(i) A short sale of the relevant asset- backed security by a securitization participant;

(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 the securitization participant would benefit from the actual, anticipated or potential:~~that substantially replicates one or both of the types of transactions set forth in clause (i) or (ii) above by means of referencing the relevant asset-backed security or the asset pool underlying or referenced by the relevant asset-backed security;

~~(A) Adverse performance~~

provided that, for the avoidance of doubt, none of the following shall constitute a conflicted transaction:

(i) Any such transaction with respect to any securitization participant with a fiduciary duty to the issuer of the asset-backed security pursuant to the Investment Advisers Act of 1940, which transaction is entered into by that securitization participant on behalf of another client, fund or account managed by that securitization participant and conducted in accordance with that securitization participant's fiduciary duty to that client, fund or account under the Investment Advisers Act of 1940;

(ii) Any such transaction involving an account owned by a securitization participant that is managed by a third party with investment discretion, or advised by a securitization participant and sub-advised by a third party with investment discretion, and the transaction-specific investment decision was not directed by the securitization participant; or

(iii) Any such transaction with respect to any securitization participant that is not related to the credit risk of an asset-backed security or the underlying assets thereof, including without limitation transactions related to overall market movements (such as movements of market interest rates, currency exchange rates or home prices).

(4) [Alternative 1*: Rebuttable presumption*. For purposes of this rule, a transaction described in clause (a)(3)(i), (ii) or (iii) that is entered into at the direction of a related person will be presumed to be a conflicted transaction unless the related person demonstrates, by a preponderance of the evidence, that the related person had no substantive role in structuring, marketing or selling the asset backed security or in the selection 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.~~. The related person seeking to rebut the presumption will bear the burden of proof.]

[Alternative 2: *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.]

(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 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 primary benefit of such 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~~risk reduction and~~ does~~ not ~~facilitate~~the facilitation or ~~create~~creation of an opportunity to realize some other benefit from ~~a conflicted transaction other than through risk-reduction~~such activity; and

(C) ~~The~~Any securitization participant relying on 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 described in paragraph (b)(3) of this section ~~in accordance with~~if and to the extent required by applicable law and applicable self-regulatory organization rules; and

(E) ~~The~~Any securitization participant relying on 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) *Customer facilitation transactions*. Any transaction related to an asset-backed securities transaction that is 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 asset-backed securities transaction with a view toward investment and not distribution.

(5) *Activities in connection with the asset pool before the inclusion date*. Any of the following transactions relating to all or a portion of the pool of assets underlying or referenced by the asset-backed security that terminates on or prior to the date on which such assets are included in as part of that asset pool (the "inclusion date"):

(i) Activities undertaken in connection with the release of any of the pool assets from any financing thereof on or prior to the inclusion date; and

(ii) The sale or other transfer of any of the pool assets to the issuing entity of the asset-backed securities (or to any intermediate party to the transaction), and any related activities.

(6) *Activities in connection with financing asset-backed securities on behalf of holders*. Activities undertaken by a securitization participant in connection with any financing of the asset-backed securities provided to holders thereof by a securitization participant, regardless of whether the financing takes the form of a loan, a repurchase transaction, total return swap, or otherwise.

(7) *Riskless principal transactions*. Any transaction by a securitization participant in which the securitization participant, after receiving an order from a customer to enter into a transaction, enters into a separate and contemporaneous transaction with another person for its own account, to offset the transaction with its customer.

(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.

Commencement date means:

(i) With respect to a securitization participant (or a person that becomes a securitization participant) in an asset-backed securities transaction that is rated by one or more nationally recognized statistical rating organizations, (A) the date on which an engagement letter with a nationally recognized statistical rating organization with respect to that transaction is signed by such person, or (B) with respect to any other such person that is not a signatory to that engagement letter, the date on which such person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant;

(ii) With respect to a securitization participant (or a person that becomes a securitization participant) in an asset-backed securities transaction that is not rated by any nationally recognized statistical rating organization and for which an engagement letter is signed by an underwriter, placement agent or initial purchaser with respect to that transaction, (A) the date on which that engagement letter is signed by that person, but no later than 30 days prior to the date of first sale of any of the asset-backed securities issued in that transaction, or (B) with respect to any other such person that is not a signatory to that engagement letter, the date on which such person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant; and

(iii) With respect to a securitization participant (or a person that becomes a securitization participant) in an asset-backed securities transaction that is not rated by any nationally recognized statistical rating organization and for which there is no engagement letter signed by an underwriter, placement agent or initial purchaser with respect to that transaction, the date that is the later of (A) the date on which such person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant, and (B) 30 days prior to the date of first sale of any of the asset-backed securities issued in that transaction.

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, other than a non-participating manager, 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]

Non-participating manager means a person that would be an underwriter, placement agent or initial purchaser of an asset-backed security, except that it does not participate substantially in the structure, design, or assembly of an asset-backed security or the selection of the pool of assets underlying or referenced by the asset-backed security.

Placement agent and underwriter each mean a person, other than a non-participating manager, 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 transaction, an employee, group or business unit within the securitization participant or within an affiliate or subsidiary of the securitization participant, in each case that does not participate in the securitization transaction on behalf of the securitization participant in its role as underwriter, placement agent, initial purchaser or sponsor.] [FOR REBUTTABLE PRESUMPTION ALTERNATIVE]

Securitization participant means[, in case subject to the exclusion set forth in clause (a)(4) above] [FOR MULTI FACTOR INDICIA OF SEPARATENESS ALTERNATIVE]:

(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.

Servicer has the same meaning as in 17 CFR 246.2, but does not include a special servicer. [1]

Special servicer has the same meaning as in 17 CFR 246.7.

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 or referenced by 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 or referenced by the asset-backed security.

(~~C~~iii) Notwithstanding paragraphs (ii)(A) and (ii)(B) of this definition, none of the following will be a sponsor for the purposes of this rule:

(A) A servicer, a third-party asset seller, or a person that performs ~~only~~primarily administrative, legal, due diligence, custodial, or ministerial acts related to (x) the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying or referenced by the asset-backed security~~ will not be a sponsor for purposes of this rule~~, or (y) the ongoing management and administration of the entity that issues the asset-backed security, in each case so long as any of that person's activities that would fall within paragraphs (ii)(A) and (ii)(B) are limited to those routinely performed by persons acting in the foregoing capacities in connection with asset-backed securities transactions; or

(B) A person that directs or causes the direction of the structure, design, or assembly of any asset-backed security or the composition of the pool of assets underlying the asset-backed security, or has the contractual right to do so, solely in connection with its acquisition of a long position in the asset-backed security.

(~~iii~~iv) 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

[1] See comment letter for an explanation of divergent views of SFA members.

Mortgage Corporation pursuant to section 1367(i) of ~~theFederal~~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 ~~fullyinsured~~fully insured or fully guaranteed as to the timely payment of principal and interest by such entity.

Synthetic asset-backed security means a fixed-income or other security (a) issued by a special purpose entity (an "SPE"), and (b) secured by (i) one or more credit derivatives or similar instruments ("risk transfer instruments") that reference self-liquidating financial assets (including bonds, loans, leases, mortgages, secured or unsecured receivables, or asset-backed securities) ("reference pools") and (ii) financial assets acquired by the SPE using the proceeds of the securities to collateralize the issuer's obligations to make payments to the counterparty to the risk transfer instruments and to the investors on the securities, where the issuer's payment obligation on the securities are reduced as a result of credit events on the reference financial exposures. The term "synthetic asset-backed security" shall not include any corporate debt, insurance or reinsurance policy, swap, or security based swap where the counterparty is not an SPE that issues a security to investors, whether or not payments thereunder are contingent on the performance of referenced financial assets. For the 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).

Third-party asset seller means a person that sells a financial asset or assets that become all or part of the asset pool underlying an asset-backed securities transaction that is neither the sponsor (within the meaning of paragraph (i) of the definition of sponsor in this part) of that transaction nor a subsidiary or affiliate of that sponsor.

(d) *Anti-~~circumvention~~evasion*. If a securitization participant engages in a transaction ~~that circumvents~~or series or related transactions as part of a plan or scheme to evade] the prohibition in paragraph (a)(1) of this section, the transaction will be deemed to violate paragraph (a)(1) of this section.

(e) *Safe harbor for certain foreign-related 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:

(1) 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. Asa et seq.);

(2) 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.

(3) 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.