STRUCTURED FINANCE ASSOCIATION

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June 13, 2022

Via E-Mail: rule-comments@sec.gov

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

Re: File Number S7-03-22: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (Feb. 9, 2022)

Dear Madam Secretary:

This letter supplements the comment letter that the Structured Finance Association ("SFA") submitted to the Securities and Exchange Commission ("Commission") on April 25, 2022 (the "Initial SFA Letter") regarding the above-referenced proposed rulemaking (the "Proposal").[1] Because the Proposal would significantly expand the regulatory requirements applicable to investment advisers to "private funds,"[2] it would have far-reaching, and potentially adverse, ramifications for the collateralized loan obligation ("CLO") market and the U.S. corporate lending market that indirectly depends upon CLOs for financing. SFA thus appreciates that the Commission reopened the comment period for the Proposal, thereby providing SFA and our members the opportunity to more fully assess if, and how, each of the complex proposed rules put forth in the Proposal might apply to CLO transactions that rely on the Section 3(c)(7) exclusion and consequently fall within the scope of the Proposal.

As a trade association representing participants across the full spectrum of the structured finance and securitization markets – including lenders, securities issuers, institutional investors, asset managers, financial intermediaries, credit rating agencies, law firms, accounting firms, technology firms, servicers and trustees – SFA plays a vital role in the development of market-

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[1] *See* 87 Fed. Reg. 16886 *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (the "Proposing Release").

[2] The term "private fund" is defined in the Investment Advisers Act of 1940, as amended (the "Advisers Act"), by reference to an entity's reliance upon the exclusions from "investment company" status contained in Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended (the "Investment Company Act").

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consensus solutions that support efficient and stable markets.[3] Unlike some 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 positions.

Our regulatory analysis supporting our members' consensus building regarding the Proposal has been made more challenging by the fact that CLOs are asset securitizations that constitute asset-backed securities ("ABS") for purposes of Section 3(a)(79) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and thus differ significantly from the hedge funds, private equity funds and venture capital funds on which the Proposing Release focused.

Because the Proposing Release focuses almost exclusively on private funds that are **not** ABS issuers, SFA is deeply concerned that adoption of the Proposal, in its current form, could have significant unintended and adverse consequences in the CLO and syndicated loan markets.

SFA accordingly requests that the Commission proceed cautiously and conservatively, to avoid adopting any rules that might hamper the efficient functioning of those markets and reduce the flow of capital to a wide spectrum of American businesses. Likewise, we urge the Commission to carefully consider our market consensus viewpoints and recommendations, detailed below, on how the Proposal could be modified to accommodate the unique characteristics of the CLO market while effectively furthering the Commission's enhanced investor transparency objectives.

I. Overarching SFA Consensus Positions

As a result of the extensive review and consensus building process that SFA conducted, this letter reflects the views of the full spectrum of our membership. Our members are united in their desire to ensure that the securitization market contains a strong disclosure regime, designed to provide investors with transparency and instill confidence in their ability to fully evaluate investment opportunities.

This objective was balanced with an overarching concern among SFA members that certain aspects of the Proposal could have negative consequences for the CLO market that have not been appropriately considered and that certain of the proposed rules would afford no regulatory benefit in this market.

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[3] SFA is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization markets. SFA provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, to be advocates for the securitization community, to share best practices and innovative ideas and to educate industry members through conferences and other programs. Further information can be found at www.structuredfinance.org.

- **Enhanced disclosure, tailored for CLO investors, is worthwhile.** Because there is strong consensus among our members on this point, SFA is supportive of the aspects of the Proposal that enhance disclosure in ways that would be relevant and meaningful to CLO investors. In each case, SFA members – including CLO investors and managers – carefully considered any modification to the Proposal that would be beneficial to current CLO disclosure practices; and they support modifications that are consistent with this goal. However, as many of the Proposal's added disclosure requirements are designed to address the market practices of hedge funds, private equity funds and venture capital funds, many are not relevant to the CLO market. We are not supportive of requirements that are not a good fit for the CLO market and that would merely make CLO management more costly and cumbersome, thereby potentially altering CLO economics and impairing the important economic function that CLOs provide to American companies.

- **Scope and purpose of Proposal are not apparently intended for the CLO market.** In certain instances, the Proposal is written so broadly that it could capture common CLO market practices that we believe are not intended to fall within the scope of the Proposal.

- **The Commission should not prohibit institutional investors from negotiating contractual terms.** While the vast majority of the private fund structural features and terms that the Proposal would ban are generally not present in the CLO market, we have deep concerns that the Proposal represents a drastic departure from the Commission's traditional regulatory approach of providing investors, including sophisticated private investors, with a transparent, fulsome disclosure regime so they can make educated investment decisions. Instead, the Proposal, in part, introduces an approach of imposing or banning specific contractual terms on market participants. Our CLO investors and managers alike desire to retain their right to negotiate such transaction terms as they deem appropriate, rather than to have those terms imposed by regulation.

Based upon the overarching positions outlined above, we provide detailed feedback and recommendations on each component of the Proposal in the following Sections II and III. Section II outlines our consensus positions on the portions of the Proposal that seek to enhance disclosure for private funds. Section III addresses SFA consensus positions and concerns developed in our review of the portions of the Proposal's relating to prohibitions on certain activities and practices. Additionally, in Appendix I we recap the overview of CLOs and the structural and operational differences between CLOs and other private funds that we presented in the Initial SFA Letter.

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II. Our Recommendations Regarding the Proposal's Enhanced Disclosure Provisions

A. Proposal Is Inoperable for Existing CLO Transactions:
Drives Necessity for "Grandfathering"

Because CLOs are structured as securitizations, subject to the rigid provisions of their indentures – including onerous investor consent requirements for certain types of amendments – the Initial SFA Letter emphasized that any material changes to the regulatory framework applicable to CLO managers could only be implemented prospectively. That letter stressed that it likely would not be feasible for CLO managers to comply on any other basis, given the extreme difficulty of amending a CLO's governing documents and the near impossibility of altering economics that already have been agreed upon by the parties.

In this regard, CLO indentures typically require that 100% of the affected noteholders consent before certain key types of amendments can be made to the indenture, including amendments that change the economics of the notes. Other types of amendments require the consent of a majority of each tranche that would be materially and adversely affected by a proposed change. The difficulty of obtaining these consents would be increased by the fact that, unlike most other private fund interests, CLO notes are book-entry securities that often are actively traded in the secondary market; and identifying the entirety of the relevant securities holders at a given point in time would be extremely challenging, if not impossible. The difficulty of obtaining these consents would be further complicated by the fact that equity investors would have no incentive to consent to changes that could reduce the value of their investment. Moreover, compliance with certain provisions of the Proposal could necessitate that collateral management agreements be amended, a process that also might require the consent of certain investors.

If CLO managers cannot obtain the requisite consents in the case of all CLOs they manage, they would be unable to comply with many aspects of the Proposal and would thus be forced to choose between incurring potential regulatory exposure due to circumstances beyond their control or resigning from their role once a suitable replacement is engaged.

The Initial SFA Letter also noted that, in addition to the inability to retroactively implement significant transactional changes, grandfathering would be supported by the fact that, unlike the equity securities relating to traditional private funds, the bonds issued in CLO transactions have specific, relatively short maturity dates. Moreover, the bonds are often called well before their stated maturity dates, including in connection with "reset" and "refinancing" transactions where less than all of a CLO's tranches are called.

Because "resets" and "refinancings" involve the redemption of **less than all** of a CLO's tranches, SFA further notes that those transactions should not be deemed "new transactions" for purposes of any "grandfathering" provisions included in the final rules. (See Section II, D. below for a description of those transactions.)

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B. Issuer's Audited Financial Statements Are Not Meaningful for CLO Investment Analysis:
Extensive Monthly and Quarterly Disclosures Relevant to CLOs Are Already Provided

The Initial SFA Letter emphasized that the Commission has never deemed GAAP financial statements regarding ABS issuers to be meaningful or necessary because the performance of ABS depends primarily upon the cash flows generated by the underlying assets. Instead, ABS issuers, including CLO issuers, provide extensive monthly and quarterly information regarding their assets, portfolio performance and cash flow distributions to investors (and potential investors) on the trustees' websites. Because audited financials have little or no value in a cash flow transaction, CLO investors are not seeking to receive them. It is telling that SFA so quickly reached consensus among our members on this point.

The Initial SFA Letter also noted that because CLO managers do not have "custody" of a CLO's assets, they have had no need to rely upon the annual audit provision of Advisers Act Rule 206(4)-2. An annual GAAP audit requirement would therefore introduce a potentially significant "sea change" cost to the CLO market, reducing the cash flows available to CLO investors under the payment waterfall and increasing the cost barriers to capital formation via CLO issuance, without affording any corresponding regulatory benefits.

Indeed, the Proposing Release acknowledged that the costs of obtaining an annual GAAP audit would disproportionately affect "securitized asset funds" without: (1) discussing the fact that imposing an annual audit requirement in the ABS context would be inconsistent with the Commission's decades-long approach in the Securities Act and Exchange Act contexts; (2) considering whether this departure from its longtime approach might have implications for the broader ABS market; (3) identifying any regulatory need for this departure and (4) considering whether imposing this substantial additional cost might have negative repercussions for both the CLO and syndicated loan markets, as well as for the companies that rely on those markets for vital funding.[4]

SFA accordingly recommends that, in the event the Commission determines to adopt Rule 206(4)-10 (Issuer's Annual Financial Audit), that rule should include an exemption for special purpose vehicles that issue ABS.

C. CLOs Provide Robust, Tailored Monthly and Quarterly Disclosure Reports:
Proposal's Quarterly Statements Are Unnecessary and Irrelevant to CLOs

The Initial SFA Letter also emphasized that the need to provide CLO investors with quarterly investment statements containing, among other things, prescribed performance information, would provide CLO investors with no meaningful benefit, while unnecessarily increasing CLO operating costs and jeopardizing capital formation.

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[4] *See* Proposing Release at 16954.

CLO Investors Already Receive Monthly and Quarterly Reports Containing Extensive Cash Flow, Performance and Expense Information

The Initial SFA Letter emphasized that it is market practice to equip CLO investors with monthly and quarterly reports containing cash flow, performance and expense information germane to those investors. As part of the negotiation process that customarily precedes the issuance of a CLO, the sophisticated institutional investors that constitute the CLO market have requested such information as they deem material to their CLO investments; and CLO issuers routinely furnish that information on the trustee websites. Of important note, SFA quickly reached consensus among our members regarding the fact that the information that is currently contained in CLO investor reports is sufficient to satisfy the needs of those investors.

This information includes:

1) in the case of each CLO asset, the then-current principal balance, industry, obligor name, rating and certain rating agency data, such as recovery rates;

2) in the case of the pool, compliance with overcollateralization and interest coverage tests, weighted average spread and weighted average life tests, and other indenture-imposed tests; and

3) information regarding cash flows from the underlying assets to the CLO distributions, capturing both interest and principal payments to investors and payments to various service providers, including the manager.

To eliminate the adverse, unintended consequences that would flow from applying Rule 211(h)(1)-2 (Quarterly Statements Disclosing Performance, Fees and Expenses) to the CLO market, SFA recommends that, in the event the Commission determines to adopt this rule, it include an exemption for special purpose vehicles that issue ABS.

D. Clarify that Standard Redemption, Refinancing or Similar Rights Provided in CLOs Are Not "Adviser-Led Secondaries"

Proposed Rule 211(h)(2)-2 (Adviser-led Secondaries) would require a fairness opinion to be obtained with respect to "adviser-led secondaries"; *i.e.*, transactions initiated by an investment adviser (or a related person), in which investors are afforded the option to sell their interests in a private fund, or to exchange them for interests in another vehicle advised by the adviser (or a related person). SFA's members believe that it would be inappropriate to apply this rule, the stated purpose of which is to "provide an important check against an adviser's conflicts of

interest in structuring and leading a transaction from which it may stand to profit at the expense of fund investors," to CLOs.[5]

In particular, SFA believes the proposed rule should not be deemed to apply to redemption, refinancing or similar rights permitted by the applicable transaction documents and disclosed to investors, including: (1) reissuances (so-called "call and roll" transactions)[6]; (2) redemptions by liquidation; and (3) refinancings or resets.[7] SFA notes that the Commission clearly did not have these sorts of CLO transactions in mind when it proposed this rule; and these transactions do not implicate the regulatory concerns animating the proposed rule. Among other things, most refinancings, resets and reissuances are directed by the holder of the majority of the equity, rather than by the CLO manager. Furthermore, refinancings, resets and reissuances are designed to primarily benefit the holder of the equity tranches by allowing them to lower the financing costs of the rated debt and consequently increase returns to the equity tranche.

Although the equity tranche of a CLO is sometimes held by entities affiliated with the CLO manager, in the case of any of the transactions described in the previous paragraph, the holders of all non-equity tranches must be fully paid at par after the end of an agreed-upon non-call period and all equity holders of a given tranche - including any holders of a minority equity position – must be paid on a *pro rata* basis. As the overwhelming majority of these transactions occur at the direction of a majority of the equity tranche, requiring a fairness opinion would only introduce unnecessary costs to the CLO, which would be borne by the equity tranche. This is especially true in the case of refinancings and resets, as no CLO assets are sold. With respect to redemptions by liquidation and reissuances, SFA members believe any regulatory concerns would be addressed by requiring a CLO manager to provide investors with the proposed prices at which the CLO's assets would be sold, including in connection with a reissuance, from the existing CLO to the new CLO. In this regard, before these transactions can occur, the CLO

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[5] *See* Proposing Release at 16917.

[6] A "reissuance" or "call and roll" transaction is a transaction where, after the end of a non-call period and typically at the direction of a majority of the equity tranche, the CLO redeems all of its outstanding debt tranches through a liquidation of all of its assets. The purchaser of the assets in the liquidation is a new CLO vehicle which finances the acquisition by issuing new CLO debt. The assets of the old CLO are typically settled through a merger of the existing CLO vehicle with the new CLO vehicle, with the equity tranche of the old CLO becoming the equity tranche of the new CLO vehicle.

[7] "Refinancings" are transactions where, after the end of a non-call period and typically at the direction of a majority of the equity tranche or with their consent, one or more outstanding tranches of a CLO's **rated debt** are redeemed at par from the proceeds of the issuance or incurrence of replacement debt. Where less than all of the debt tranches of a CLO are refinanced, the replacement debt is required to have a lower weighted interest rate than the redeemed debt and, typically match the principal amount of the redeemed debt. "Resets" are refinancings where all of a CLO's **debt tranches** (but not the equity) are replaced with new debt tranches and additional changes are made to extend the stated maturity of the debt, adjust certain tests and update other terms to reflect market terms.

manager must determine that the proceeds from the asset sales will be sufficient to pay the rated debt and expenses in full.

There is thus consensus among SFA's members that fairness opinions regarding the activity described in this section are neither helpful nor necessary in the CLO context.

E. Clarify Scope of Preferential Treatment Disclosure:
Confirm Materiality Threshold Should Apply

Proposed Rule 211(h)(2)-3(b) (Provision of "Specific Information" regarding Non-Prohibited Forms of "Preferential Treatment") would require that a CLO manager furnish each prospective CLO investor with a written notice providing "specific information" regarding any "preferential treatment" that the manager or its related persons provide to other investors in the CLO. Following the closing of the CLO, the manager would need to provide an annual notice to investors if any "preferential treatment" has been provided since the most recent prior notice. Although our members are supportive of the Commission's desire to furnish CLO investors with information that may be deemed helpful to them, SFA believes the Commission should clarify the scope of the "specific information" an investment adviser would be expected to provide, as well as the contexts that might be deemed to involve "preferential treatment."

SFA supports the disclosure of information related to side letters and other arrangements that could have a *material* impact on other current or prospective investors. For example, some CLOs provide certain equity or debt investors a rebate of a portion of the management fees. Under this circumstance our members believe the existence of the side letter and its terms should be disclosed – to the extent they are *material* to other investors. Our investor members noted that the existence of this type of side letter and a relevant range of the amount of any rebate – if either is material to other investors – is important for them to know.

Rule 10b-5 under the Exchange Act prohibits the omission of material information in connection with all sales and purchases of securities. Given CLOs are subject to Rule 10b-5, if a side letter or other arrangement exists that provides preferential treatment to an investor, it currently must be disclosed to the extent it is deemed material information to other investors. Further, when CLO offerings occur, legal counsel routinely render "negative assurance letters," expressing the view that the applicable offering memoranda do not contain any material misstatements or omissions for purposes of Rule 10b-5. In the process of rendering these negative assurance letters, counsel reviews any side letters or other arrangements that the collateral manager may

have entered into with specific investors, to determine whether any terms of those arrangements that may be material to other investors have been adequately disclosed.

SFA believes the Rule 10b-5 "materiality" analysis associated with the issuance of negative assurance letters and any related disclosures should be deemed sufficient to satisfy the "specific information" requirement.

The Proposing Release notes that side letters can be used to meet the needs of investors subject to specific regulatory requirements (*e.g.*, ERISA or the Bank Holding Company Act) and that these arrangements (*e.g.*, arrangements with large early-stage investors) also can benefit the private fund.[8] SFA's members believe this proposed rule should not be interpreted to require the disclosure of non-material details regarding side letters, as this could discourage managers from entering into arrangements that investors deem beneficial. However, if adopted as proposed without such clarification, SFA would be concerned that the current proposal unnecessarily introduces regulatory compliance uncertainty and liability risk.

F. CLOs Comply with Existing Prohibition of Selective Disclosure of Material Information: *Clarify "Material, Negative Effect" Isn't A Higher Standard and Eliminate "Substantially Similar Pool of Assets" for CLOs*

Proposed Rule 211(h)(2)-3(a)(2) (Proposed Prohibition on Provision of Certain Portfolio Holdings Information) would prohibit a CLO manager from providing certain investors with information regarding the portfolio holdings or exposures of the CLO – or a "substantially similar pool of assets" – if the manager "reasonably expects" that doing so would have a "material, negative effect" on other investors in that CLO or in a "substantially similar pool of assets."

CLO managers are already subject to overarching legal standards regarding the selective provision of material information and therefore either disallow investor requests that would implicate that standard, enter into confidentiality agreements or post the requested information to the trustee's website. SFA's members have had difficulty in determining whether or how Proposed Rule 211(h)(2)-3(a)(2) differs from existing securities law standards. Accordingly, SFA is concerned that the vagueness of the terms "material, negative effect" and "substantially similar pool of assets" could have a disruptive effect on the provision of information that does not implicate an existing legal standard and could, counterproductively, result in **less** transparency for investors.

As the Commission has itself acknowledged, some investors require specialized information to satisfy their specific regulatory or tax needs; and the provision of this type of information has typically been deemed appropriate, provided it does not run afoul of existing legal standards regarding selective disclosure. We further note that the term "substantially similar pool of assets"

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[8] *See* Proposing Release at 16928.

potentially could be read to encompass **any** CLO a manager or its affiliate advises, despite the fact that each such CLO would have a different loan pool, different maturity date and, in most cases, different structural nuances. SFA accordingly requests that the Commission provide clarity regarding the manner in which "material, negative effect" relates to existing legal standards of materiality and regarding the scope of "substantially similar pool of assets."

III. Our Recommendations Regarding Certain Provisions of the Proposal Prohibiting Certain Activities

A. Restrictions on Ability to Limit Liability Is Inappropriate

Proposed Rule 211(h)(2)-1(a)(5) (Indemnification for Ordinary Negligence) would prohibit a CLO manager from seeking indemnification, or limitation of its liability, for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the CLO. Although CLO management agreements typically do **not** indemnify CLO managers against, or limit a manager's liability with respect to, actions or omissions that constitute willful misfeasance, bad faith or recklessness, it is customary to indemnify managers for actions or omissions that constitute ordinary negligence, as opposed to gross negligence. These standards are subject to negotiation prior to the issuance of the CLO securities and are fully disclosed to investors.

Consistent with the overarching principles underlying our comments, SFA's members believe that the sophisticated institutional investors that constitute the CLO market should have the freedom to negotiate the specific indemnification standard with which they are comfortable – whether that be gross negligence or ordinary negligence. SFA therefore believes that it is inappropriate for the Commission to upset well-established CLO market practice by dictating the negligence indemnification standard that should apply.

Increased Threat of Litigation Will Have Sweeping Effects and Change Activities CLO Manager May Be Willing to Perform

We note that, because a CLO manager must attempt to assure compliance with both the complex restrictions of the applicable indenture and the limitations of the collateral management agreement – and may also be required to make sensitive decisions regarding asset dispositions and work-outs – the imposition of an ordinary negligence standard could dramatically heighten the liability risk associated with managing a CLO. We further note that a gross negligence standard is customary in the case of asset servicers.

If the established standard of indemnification were altered, the economics of CLO transactions and the efficient functioning of the market could be adversely affected because CLO managers could be required to increase their management fees to offset the substantial increase in legal

liability associated with an ordinary negligence standard. These additional costs would be borne by the equity tranches or discourage CLO managers from entering into new transactions.

In the event that the Commission determines to impose an ordinary negligence standard in the private fund context, SFA recommends that it include an exemption for special purpose vehicles that issue ABS.

B. Preferential Redemption Rights Are Not Applicable to CLOs:
Confirm That Standard Call Option Is Exempted

Proposed Rule 211(h)(2)-3(a)(1) (Proposed Prohibition on Preferential Redemption Rights) would prohibit an investment adviser from providing an investor in a private fund (or a substantially similar pool of assets) with the ability to redeem its interest on terms that the adviser reasonably expects to have a "material, negative effect" on other investors in that private fund (or substantially similar pool of assets). SFA believes this proposed prohibition does not have any applicability in the CLO context.

In this regard, CLO indentures do not permit any investor in a CLO debt tranche to receive payment ahead of any other investor in that tranche. Rather, all CLO noteholders simply receive principal and interest payments in accordance with the applicable indenture-prescribed waterfall, with all holders of a given tranche paid together on a *pro rata* basis. Additionally, although the transaction documents typically do give the holders of a majority of the equity tranche the ability to direct the refinancing or redemption of the CLO, as described above, those rights also do not constitute preferential "redemption" rights because, as required by the applicable indenture and as fully disclosed in the applicable offering memoranda: (1) all debt holders being redeemed must be repaid at par; and (2) all equity investors – including any holders of a minority equity position – must be paid on a *pro rata* basis. Unlike certain types of private funds, CLOs do not give any investor the ability to exit the fund ahead of other investors. Therefore, our members would ask the Commission to confirm that a standard "call option" where all investors are repaid in full would not be captured by the final rule.

C. Borrowings by Adviser from CLO Trust is Not Applicable:
Clarify Other Common CLO Practices Are Not Unintentionally Captured

Proposed Rule 211(h)(2)-1(a)(2) and (a)(3) (Proposed Prohibition on Borrowings by an Adviser from a Private Fund) would prohibit an investment adviser from directly or indirectly borrowing money, securities, or other fund assets from a private fund it manages or from receiving a loan or an extension of credit from such a fund. SFA believes this proposed prohibition has no applicability in the CLO context. However, we request Commission confirmation that it would not be deemed to apply in the context of a lender that obtains term financing for the middle

market corporate loans it originates by pooling those loans and sponsoring CLO issuances, if the lender or an affiliate of the lender serves as CLO manager.

In response to questions raised by certain member industry participants, we also wish to note that this provision should not be deemed to apply in the case of a voluntary cash contribution made by an equity investor. Such contributions are intended to allow equity investors to inject additional equity capital to support the CLO or to allow the CLO to acquire assets that would otherwise be ineligible for acquisition in connection with a workout or restructuring of an asset held by the CLO. Because funds are contributed as equity, rather than debt, any obligation of the CLO to make a "repayment" of such contribution to the applicable investor is subordinate to any amounts due on the debt tranches and there is no guarantee that such contribution amounts would be returned. Consequently, any benefit to the contributor would derive solely from any excess distributions available to be paid after payment of all amounts due on the debt tranches.

D. Prohibition on Certain Fees and Expenses Is Not Required:
All Fees and Expenses Paid From The Trust Must Be Disclosed With Supporting Detail

Proposed Rule 211(h)(2)-1(a)(2) and (3) (Proposed Prohibition on Certain Fees and Expenses) would prohibit an investment adviser from charging investors any fees and expenses related to an examination or investigation of the adviser by any governmental or regulatory authority, including the amount of any settlements or fines paid in connection therewith. There is general agreement among CLO investors that such fees should not be passed through as line-item fees. Accordingly, the charging of such fees is *not* a typical practice in the context of the CLO market.

Even so, SFA believes the Commission should *not* prohibit negotiable terms. Our members believe that qualified, sophisticated investors presented with full and fair disclosure of all expenses and fees that can be paid from the securitization assets – and ongoing, timely supporting detail of actual expenses and fees paid – can assess the suitability of the investment.

E. Quarterly Statement and Financial Audit Requirements Should Not Apply to ABS Investment Vehicles that Rely Upon "Investment Company" Exclusions Other than Sections 3(c)(1) or 3(c)(7)

The Proposing Release requests comment as to whether the proposed annual audit and quarterly statements requirements should be expanded to encompass advisers to pooled investment vehicles that are not "private funds" because those vehicles rely upon the exclusion from "investment company" status contained in Section 3(c)(5)(C) of the Investment Company Act or upon another Section 3 exclusion (other than Sections 3(c)(1) or 3(c)(7)).[9] For the reasons set forth in Section II.B. and C. above, SFA believes it would be unnecessary and counter-productive to apply the proposed quarterly statement and annual financial audit requirements to **any** type of special purpose vehicle that issues asset-backed securities. Hence, the exemptions

[9] *See* Proposing Release at 16891 and 16951.

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we are proposing for special purpose vehicles that issue ABS would apply equally to entities that rely upon Section 3(c)(5) or another exclusion from investment company status.

Given the extensive consideration the Commission and its staff have given these issues over the years – including in the context of promulgating and subsequently expanding Regulation AB – it would seem to be both anomalous and potentially damaging to the ABS markets to chart a dramatically different course in the context of rules promulgated under the Advisers Act.

IV. Conclusion

Given that the Proposing Release does not identify any regulatory problems in the CLO markets to which the Proposal is responding – and given that SFA members are unaware of any such problems – we believe the need to proceed with regulatory restraint is particularly compelling. If the Commission determines to adopt some or all of the new rules comprising the Proposal, SFA strongly recommends that the Commission include the exemptions and clarifications requested herein. In the case of any such adoption, SFA further believes any transition period should provide affected CLO managers with a realistic timeframe for compliance, which we believe for many of the proposed requirements and prohibitions should be 18-24 months.

We thank the Commission for its consideration of our feedback, and we stand ready to provide further input regarding this important topic. If you have any questions about this matter, please contact Kristi Leo, SFA President, at 917.415.8999 or kristi.leo@structuredfinance.org.

Sincerely,

Kristi Leo
President, Structured Finance Association

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Appendix I: Brief Recap of CLOs and Key Differences Between CLOs and Other Section 3(c)(7) Vehicles

Brief CLO Recap

As detailed in Appendix I of the Initial SFA Letter, CLOs are fixed-income bonds issued by special purpose vehicles that are structured to include debt and equity tranches and hold a diversified pool of senior secured corporate loans as the primary collateral for repayment of these tranches. The debt tranches are typically rated by at least one rating agency, with credit ratings from triple-A for the most senior tranche, through double-B or single-B for the most junior tranche. The senior debt tranches are sold exclusively to "qualified institutional buyers", as defined in Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), and non-U.S. persons pursuant to Regulation S under the Securities Act.

As of the end of Q1 2022, more than $800 billion of U.S. CLOs collateralized by broadly syndicated loans to U.S. companies were outstanding. Those CLOs thus serve as an essential financing source for U.S. businesses, making credit more available and affordable to thousands of corporate borrowers with high levels of debt or that are rated below investment grade (BBB; Baa). CLOs provide approximately 60-70% of the funding for these companies and represent a significant portion of the market for sub-investment grade corporate loans. The obligors on these corporate loans use the proceeds to finance mergers and acquisitions, refinance existing debt, manage their capital structures and expand their businesses, as well as for general operating purposes. CLOs thus play a crucial role in maintaining credit availability to U.S. companies and supporting American economic growth and job creation. Many drivers of today's business and economic expansion succeed because funds for classic American risk-taking ingenuity are more available, at better rates, because the loans made to these businesses can be packaged into, and financed by, CLOs.

Recap of Key Differences Between CLOs and Other Section 3(c)(7) Vehicles

As emphasized in the Initial SFA Letter, CLOs differ significantly, both structurally and operationally, from the hedge funds, private equity funds and venture capital funds on which the Commission focused in the Proposing Release. The Initial SFA Letter emphasized that ignoring the fundamental differences between CLOs and other Section 3(c)(7) private funds is both inappropriate and potentially perilous for capital formation.

Those differences include the following:

- CLOs predominantly issue debt, rather than equity securities, with roughly 90% of their capital structures attributable to debt.

- The debt tranches, predominantly issued by CLOs as securities, are typically rated by at least one nationally recognized rating agency. CLO structures and assets are thus carefully reviewed prior to issuance, and on an ongoing basis, by the applicable rating agencies; and CLOs must meet stringent criteria to maintain their ratings.

- CLOs are structured with distinct tranches, each with their own risk profile and payment prioritization within the structure.

- Repayment of CLO securities depends primarily on the cash flows from the CLO's collateral loan pool, rather than from an effort by the manager to capture increases in the market value of those loans. CLOs consequently are ABS for purposes of the Exchange Act, a status that entails, in certain cases, the need to file reports under Rule 15Ga-1 of the Exchange Act relating to asset repurchase requests and the need to comply with the credit risk requirements contained in Regulation RR under the Exchange Act.

- Because they predominantly issue debt securities, CLOs operate pursuant to the very strict requirements of bond indentures and have independent indenture trustees that serve as custodians for the loans and other assets collateralizing a CLO. Those trustees, typically in tandem with an independent Collateral Administrator, are responsible for preparing detailed monthly and quarterly reports to investors with respect to a CLO's assets and expenses. The role of CLO managers in the preparation of these reports is limited to reviewing them and providing certain information to the Collateral Administrator.

- A CLO manager's authority is circumscribed not only by a collateral management agreement but also by the provisions of the indenture, which include negotiated standards of care, impose rigid constraints on the manager's ability to acquire and dispose of assets and afford very limited ability to influence the valuation of the CLO's assets.