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LSTA
THE LOAN SYNDICATIONS AND TRADING ASSOCIATION®

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July 30, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule on Asset-Backed Securities
File Number S7-08-10

Dear Ms. Murphy:

The Loan Syndications and Trading Association[1] (the "LSTA") welcomes the opportunity to provide the Securities and Exchange Commission (the "Commission" or "SEC") with comments regarding proposed rules (the "Proposed Rules") on asset-backed securities ("ABS") contained in the Securities Act Release Nos. 33-9117, 34-61858 (April 7, 2010); 75 Fed. Reg. 23328 (May 3, 2010) (the "Proposing Release").

At the outset, we would like to note that this comment letter is intended to address only specific aspects of the Proposed Rules that are of most interest to the LSTA and its members. This letter is not intended to be comprehensive in scope.

I. Executive Summary

As the Commission points out in the Proposing Release, the recent financial crisis highlighted a substantial failure of information and transparency within the structured finance market. In pursuing regulatory reforms in this regard, however, the Commission must recognize that not all types of transactions falling within the broad category of "structured finance" have had the same historical experience, and that regulatory requirements that may be appropriate for one segment of the market may be unnecessarily restrictive for another. The LSTA and its members have concerns about the Proposed Rule's sweeping extension of requirements largely prompted by the experience of other asset classes and market sectors to the institutional market for collateralized loan obligation ("CLOs"). There are more than $500 billion of outstanding non-investment grade term loans and existing CLOs hold roughly half of these loans. The existence of CLOs and other loan securitization vehicles allows many non-investment grade

[1] The Loan Syndications and Trading Association was founded in 1995 and is the trade association for the corporate loan market, dedicated to advancing the interests of the marketplace as a whole and promoting the highest degree of confidence for investors in corporate loans. The LSTA has is active on a wide variety of activities intended to foster the development of policies and market practices designed to promote a liquid and transparent marketplace. More information about LSTA is available on its website at www.lsta.org. This comment letter was prepared in consultation with the LSTA's CLO Committee, which includes representatives of institutions active in the CLO market as investors, investment managers and underwriters.

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companies to access the syndicated loan market, and without them this market would be far smaller and access to capital far more difficult for non-investment grade companies.

In CLOs, important market-driven features such as restrictions on asset types, independent credit analysis by investment managers, active participation of institutional investors, ongoing management of investment portfolios, the transparent nature of the loan asset class and others have given this segment of the structured finance market a 20-year track record of effective and efficient functioning. Even in the worst credit environment since the Great Depression, CLOs, while of course suffering some stress, have had few if any failures of transparency or frustration of legitimate investor expectations regarding these structures.

The Proposed Rule would unnecessarily impose requirements that are being developed to protect investors in the public market, for transactions with static pools of assets that have very distinct characteristics, to an already well functioning segment of the private institutional market that has evolved with its own distinct criteria and standards. Moreover, the Proposed Rule and the Proposing Release give little or no guidance as to exactly how the Regulation AB requirements should apply to CLO structures, even though these requirements plainly do not take account of the context of CLOs. The effect of the Proposed Rules will therefore be to create substantial uncertainties in what disclosures may be required in a privately placed CLO transaction, and expensive reporting requirements that institutional investors do not want or need.

Among other details, LSTA would propose the following changes to the Proposed Rules:

- Private placement CLO issuers should be exempted or, if exemption is not provided, afforded the opportunity to "opt-out" from prescribed disclosure requirements, as well as prescribed reporting requirements where no initial investor in the CLO transaction requests such reporting.

- The SEC should provide clarity as to the required information for a CLO structure, rather than grouping these structures with other types of transactions and giving little guidance beyond a general reference to Regulation AB and Form S-1 under the Securities Act.

- Liability under Rule 192 for a failure to provide reporting information should not be in the nature of fraud or deceit.

II. CLOs Support the Market for Corporate Loans

CLOs play an important role in providing liquidity in the loan market. CLOs purchase mainly the "institutional tranche" of secured leveraged loan facilities, which is a long-dated, senior secured term loan. CLOs purchased 60-70% of all new non-investment grade term loans between 2000 and 2006. All told, CLOs have invested in nearly $300 billion of corporate loans, and today hold almost half of all outstanding non-investment grade term loans. Even in the third-quarter of 2008, when the market disruption was severe, CLOs were the largest purchasers in the institutional loan market.[2] Liquidity provided by CLOs allowed banks to free up capital for additional corporate lending and companies to finance their businesses. New CLO issuances could play an important role in helping fuel economic recovery and an associated increase in jobs. Placing new regulatory constraints or economic burdens on 144A offerings could dampen the viability of new issuances; a robust private placements market for CLOs is key to a resurgence of the corporate loan market.

A high percentage of corporate loans mature within the next five years, creating what has been referred to as the "refinancing cliff." Securing refinancing will pose a serious challenge to borrowers in the leveraged finance market if new CLOs are not issued. According to the S&P/LSTA Leveraged Loan Index, more than $400 billion of outstanding term loans will mature (and borrowers will be seeking to refinance) between 2010 and 2015. Approximately half of these loans are currently held by CLOs, most of which will reach the end of their reinvestment period by the end of 2012 and therefore will have limited ability to purchase the refinanced loans. Many borrowers are expected to "amend and extend" the maturities on existing loans in the next couple of years to lock in financing, rather than negotiating new credit facilities which entails greater transaction costs. Unless the pace of new issuances of CLOs is able to increase, these refinancings will be much more difficult. If some companies are unable to refinance, they may face liquidity crises and even be forced to file for bankruptcy.

III. CLOs Have Distinct, Investor Driven Features that Protect Soundness and Transparency

CLOs are a distinct category of structured finance transactions due to the asset class of assets that is being securitized; i.e. corporate loans to borrowers in diverse industries and locations, which are backed by tangible assets rather than more securitized products (RMBS, ABS, etc.). The basic structure of a typical CLO involves the formation of a special purpose vehicle which finances the acquisition of corporate loans through the issuance of securities. Securities are issued in a number of classes of differing seniority in right of payment, with more junior classes reflecting leveraged exposure and greater possible returns and risk of loss. The assets securitized in a CLO consist predominantly of corporate loans originated by commercial banks. These loans are generally secured by collateral other than residential real estate, commercial real estate or other securitized paper, and are diversified based upon criteria that have developed over time with input from investors at all levels of the capital structure, rating agencies, investment managers and structurers. The criteria include diversification requirements based on industry, type of loan (e.g., first lien, second lien, senior secured, DIP), rating, country of the obligor and total assets held that have a single obligor, among others.[3] While CLOs may invest on a very limited basis in asset swap packages or similar synthetic assets, CLOs generally segregate a portion of the note proceeds to cover such investments; CLOs do not take significant

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2 Standard & Poors Leveraged Commentary & Data ("S&P/LCD").

3 These comments will relate to "cashflow" CLOs and not "market value" CLOs. Cashflow CLOs do not mark their assets to market although the financial coverage tests include some market value features. A very small fraction of CLOs are "market value" CLOs which do require marking the portfolio to market at specified intervals and selling assets in order to pay down principal of the senior class of notes if the market value of the portfolio moves below certain specified levels.

unfunded risk exposures. CLOs also do not permit significant holdings of other ABS. Most importantly, CLOs feature an investment manager who undertakes to actively select and manage the assets for the benefit of the investors in the special purpose entity and the initial collateral is typically purchased from multiple sources, including the investment bank that arranges the CLO. In most cases, however, banks do not originate bank loans for the primary purpose of selling the loans to CLOs structured by that bank or its affiliates.

The Proposing Release does not take account of the distinct features of CLOs, and incorrectly classifies CLOs with CDOs. Most of the discussion in the Proposing Release regarding CDOs, as noted above, is focused on CDOs of ABS and in particular CDOs of subprime ABS. Thus, the Commission's one and only mention of CLOs in the Proposing Release is in the following:

> Many of the problems giving rise to the financial crisis involved structured finance products, including mortgage-backed securities. Many of these mortgage-backed securities were used to collateralize other debt obligations such as collateralized debt obligations and collateralized loan obligations (CDOs or CLOs), types of asset-backed securities that are sold in private placements. As the default rate for subprime and other mortgages soared, such securities, including those with high credit ratings, lost their value. CDOs were noted, in particular, to have contributed to the collapse in liquidity during the financial crisis.

Proposing Release at page 10-11 (footnotes omitted).

This characterization of CLOs is inaccurate. CLOs did not purchase mortgage-backed securities, nor was their performance affected directly by the default rate for subprime or any other type of mortgages. CLOs share a few initials with CDOs, but they are a different asset class. CLOs have relatively simple structures and are more transparent than ABS CDOs. Investors have been drawn to CLOs because they want to have diversified exposure to the corporate loan market that has been assembled and will be monitored by an expert in the asset class. The features of CLOs described above, and the conventions within the CLO market, have led to a 20-year history of these products being well understood by investors and functioning in a manner that, taking into account the credit environment as a whole, generally has been consistent with investors' expectations. We explain further the characteristics of CLOs that have contributed to this record below.

A. CLOs Are First-Order Securitizations

An important feature of CLOs is that they are first-order securitizations, rather than re-securitizations of obligations that have already been securitized. As a result, the assets in the pool lend themselves to more accurate fundamental credit analysis by the trained personnel of the investment manager to the fund as a result of the significant credit and performance history of the middle market and larger companies in which they invest. CLOs provide an opportunity for institutions that want to invest in the corporate loan market but may not be able to participate directly in lending to a corporation, and for investors who have a history of investing directly but who seek to invest on a leveraged basis with accompanying risks and returns.

B. CLOs Have the Benefit of an Investment Manager

CLOs are managed by an investment manager who actively selects loans for purchase and sale by the CLO, subject to certain criteria, and monitors the performance of the CLO assets over time. A CLO investment manager is required to manage the portfolio in a manner, subject to the CLO investment criteria and other restrictions under the CLO's governing documents, that permits the CLO to meet its payment obligations to its debt holders, and subject to that objective in a manner that generates equity returns. This active management affords investors in CLOs access to a portfolio that is selected by experts in the loan market, and the CLO has the benefit of the ongoing attention of the investment manager who is able to take active measures to adjust the portfolio to changing market conditions. Investors select transactions based upon the identity of the investment manager, its investment strategy, and level of experience and expertise in the asset class, and based on the investment criteria that will apply to the portfolio. Investors have direct input into the investment criteria that will govern the CLO.

The investment manager for a CLO is generally not affiliated with the lead underwriter of the transaction and the initial collateral is typically purchased from multiple sources, including the investment bank that arranges the CLO. In addition, there are strict requirements (stemming from the U.S. tax code) applicable to any purchase of loans originated by the investment manager or its affiliates. This minimizes potential conflicts of interest. During the marketing of the transaction, investors typically have an opportunity to meet with the investment manager to discuss the strategies that will be applied to the portfolio and the type of assets that will be included. Investors have also favored fee structures of the investment managers that provide for the majority of the fees to be paid on a subordinated basis in order to create performance incentives for the investment manager.

The investment manager also plays a key role in establishing the investment criteria applicable to the CLO transaction. Due to the certain operational characteristics of the loan market generally only a certain percentage of the CLO proceeds is invested at the time the CLO securities are issued (generally not less than 50%), and during a period of approximately three to six months after closing, the remainder of the proceeds of the offering are applied to the purchase of additional assets. After this "ramp-up" period, investment managers are permitted to sell assets in the portfolio and reinvest sale proceeds and prepayment proceeds during a prescribed "reinvestment period" that generally ranges three to seven years, depending upon a number of factors, including the preferences of the initial investors in the transaction.[4] Neither the bank arranging the CLO nor the banks which have originated the loans held in the CLO portfolio plays any role in making investment decisions during the ramp-up period or the reinvestment period

During the reinvestment period, the investment manager employs its investment strategies within the confines of the CLO investment criteria.[5] In addition, the governing documents generally provide authority for the investment manager to sell specified types of

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4 In the very small number of CLOs that have not permitted reinvestment after the closing of the transaction, an investment manager monitors the portfolio and has authority to sell assets, primarily in order to minimize losses.

5 We note that many CLO transactions also permit limited investment after the reinvestment period; for example, with proceeds from appreciated loans and prepayment proceeds.

assets (e.g., defaulted assets, appreciated assets, credit-risk assets) based on its professional judgment. The governing documents also grant the investment manager the discretion to sell up to specified percentage of the portfolio on an annual basis. The scope of that discretionary authority is a point of negotiation with investors when the transaction is structured.

In contrast to securitizations based on an "originate to distribute" model, CLOs thus benefit from two or three separate levels of credit analysis that have helped to preserve the standards applicable to assets in CLOs over time. There is first the credit review of the originating bank or lending syndicate for the underlying loan. Separately, the investment manager reviews the creditworthiness and investment characteristics of the loans, both at initial issuance and over the life of the CLO transaction. Finally, in connection with the initial issuance of the CLO securities investors themselves have input into the criteria that govern the CLO's investing activity. The underlying loans are broadly syndicated and the syndication agent has the ability to monitor the borrower and take active measures to help the borrower avoid defaults and restructure using a process that preserves the value of the loans. The interests of the CLOs and the loan syndicators are generally aligned.

C. Investors Have Played an Active Role in the Structuring of CLOs

As noted in a number of specific contexts above, the initial investors in CLO transaction often play a role in establishing the investment criteria, the level of discretionary sale authority of the investment manager, and other structural features of CLO. Purchasers of CLO securities are institutional investors who often have experience in investing in corporate loans directly, and a familiarity with the CLO asset class enables them to have significant input into the terms and conditions of the CLO. Investors have also played a role in the development of periodic reporting obligations of CLOs. CLOs generally provide an extensive monthly report to investors that includes a list of all assets in the portfolio and information investors have identified as important for them to confirm that the investment criteria are being adhered to.

Investors in the private CLO market have been active participants in the development of the investment criteria and reporting requirements for CLOs. As a result they have access to the information that they have determined to be important in making their investment decision and monitoring their investments. The type of information investors have wanted has varied from time to time, as have their specific concerns regarding investment criteria. The market has responded to those changes and the information provided to investors and the investment criteria have been modified over time based on input from investors at all levels of the capital structure.

The CLO market is a positive example of the strength of the private placement market and the ability of sophisticated investors to negotiate terms and obtain access to the types of information that is important to them.

D. CLOs Have Performed Relatively Well During the Market Disruption

In the recent market disruption, CLO structures performed predictably. CLOs have long featured financial coverage tests which protect the rights of senior investors by diverting cash from, and deferring interest and distributions to, the junior debt and equity investors in the CLO when the CLO asset pool experiences higher defaults or credit deterioration demonstrated by ratings downgrades. In a period when defaults increased on loans in the CLO portfolio, the financial coverage tests performed the function for which they were designed and afforded protection to the senior investors. As defaults have stabilized and decreased, CLOs that had been out of compliance with their coverage tests have stabilized and recovered. The structures of CLOs have been able to weather the stresses of this difficult period as they were designed to, with performance that was foreseeable and understandable.

During their twenty-year history, cashflow CLOs have performed well. Relatively few CLOs have defaulted and returns to investors have been generally reflective of the performance of the underlying loan asset class during that same period. For example, although there have been downgrades of ratings on CLOs, approximately 80% of CLO senior tranches that were assigned a "Aaa/AAA" rating at issuance have remained rated "Aa/AA" or better. And *none* of the true cash flow CLOs suffered an uncured event of default during the recent market disruption. Performance of CLOs has varied based on the specific loans in the portfolio, the overall investment strategies and skill of the investment managers, the investment criteria of the specific CLO and other structural features. But all of these factors were evaluated by investors when they determined whether to invest in a particular CLO.

IV. Privately Placed CLOs Should be Permitted to Continue to Provide Disclosure and Reporting Based on Current Investor-Driven Practices

A. Investors in CLOs are Sophisticated Investors

CLOs have relied on private placements in the issuance of their securities, primarily Rule 144A.[6] In the original proposing release for Rule 144A, the SEC noted that the Securities Act has, from its inception, exempted private placements from its registration requirements.[7] The rationale for the exemption is that the size and sophistication of the institutions involved in private placements makes registration protection unnecessary.[8]

The SEC noted the legislative history of the addition of section 4(6) to the Securities Act in 1980, which states that the "accredited investor" concept was "based on the assumption that

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6 CLOs may also sells certain classes of securities to "accredited investors" pursuant to the exemption provided by Regulation D. In addition, essentially all CLOs have relied upon the exemption from registration under the Investment Company Act of 1940, as amended provided under Section 3(c)7; hence with a few exceptions U.S. investors in the initial sale and in all transfers are required to "qualified purchasers" (as defined for purposes of Section 3(c)(7).

7 Resale of Restricted Securities, 53 Fed. Reg. 44016, 44028 (proposed Oct. 31, 1988) ("Rule 144A Original Proposing Release."

8 *See* James Landis, The Legislative History of the Securities Act of 1933, 28 Geo. Wash. L.Rev. 29, 37 (1959) (recalling that the draftsmen of the Securities Act believed that "[t]he sale of an issue of securities to insurance companies or to a limited group of experienced investors, was certainly not a matter of concern to the Federal Government); Manuel Cohen, Federal Legislation Affecting the Public Offering of Securities, 28 Geo. Wash. L.Rev. 119, 142 n. 64 (1959) (noting that private placements had their beginning in the negotiated sale of tailored debt securities to large institutional investors who were in a position to demand and receive more information than provided by registration and to insist upon protection and supervise their investments to the point that the registration provisions were unnecessary).

accredited investors are sophisticated and able enough to protect their own financial interests without regulatory assistance."[9] Following this line of logic, the SEC noted that it similarly chose to define "qualified institutional buyers" would "identify a class of investors that can conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act's registration provisions."[10]

The rationale supporting Rule 144A continues to be valid in respect of CLO investors. The Commission states in the Proposing Release "that the events of the financial crisis have demonstrated a lack of understanding of CDOs and other privately offered structured finance products by investors" and that such lack of understanding indicates that the Rule 144A exemption needs to be reconsidered.[11] We respectfully submit that this is not the case in respect of CLOs. CLOs have performed as designed during several economic and credit cycles, from periods of economic growth and low defaults to the latest financial crisis in a manner that was predictable based on the increase in defaulted loans and other factors. The stresses on the market were clearly more extreme than anticipated at the time the CLO transactions were structured, but cash flow CLO structures withstood these circumstances with negligible defaults even during this time of extreme stress.[12]

B. The Amendments to Rule 144A and Regulation D Should Either Exempt CLOs or Permit an Opt Out

Investors have shown that they have been able to determine the information upon which they select CLO transactions and tranches of securities within those CLO transactions. Investors in CLOs are specifically choosing a primary securitization of this asset class because they seek exposure to the loan market within specified parameters, and they are interested in exposure to a portfolio of loans that will have the benefit of the expertise of the investment manager. Investors (together with rating agencies, sponsors and investment managers) have been directly involved in developing the type and scope of reporting on the performance and assets of the CLO. The resulting reports provide CLO investors with detailed information on the performance of the portfolio presented in various ways that have been developed to provide the investors with the information that have considered to be important to them.[13] Such reports are provided to investors on a monthly basis through access to the CLO trustee's website.

Against this background, the Commission's proposal that a privately placed CLO issuer must stand ready to prepare 'registered-equivalent' disclosure and reporting, such that "any security holder and a prospective purchaser designated by a security holder" will have "the right

9 Rule 144A Original Proposing Release, at 44024.

10 Rule 144A Original Proposing Release at 44028.

11 Proposing Release at 20-21.

12 Jeremy Gluck, Moody's Investors Service, CLOs versus CDOs: It's the 'L' That Matters, in CLO Interest at 12 (July 2007).

13 Investors have access to certain terms of the underlying loans held in a CLO portfolio through the Trustee reports.

to obtain from the issuer promptly, upon request of the purchaser or holder, information as would be required if the offering were registered on Form S-1 or Form SF-1 under the Securities Act and any ongoing information regarding the securities that would be required by Section 15(d) of the Exchange Act if the issuer were required to report under that section," will only introduce confusion and unnecessary cost to the CLO market. As the Commission recognizes in the Proposing Release, structures such as CLOs have never been registered under existing Regulation AB. There is little or no experience adapting the requirements of Regulation AB, which emphasize disclosures based on a *static* pool of specific assets generally originated by a single institution and primarily for securitization, to the context of a CLO, which features investment criteria applied to a managed portfolio of assets over time by an investment manager who purchases loans in the secondary market from a variety of originating banks, and is often not much more than 50% invested at closing. Moreover, the investment manager typically has the ability to sell, at its discretion, 20-25% of the portfolio, in addition to loans that satisfy specific criteria. A CLO is obviously a dramatically different product from typical ABS. The Commission should not create a mandate for disclosure, even upon request by investors, with little more guidance than the statement that "the requirements of Form S-1 would apply" and "the issuer would be required to provide information required under Regulation AB regarding the assets and parties as well as additional information required under Regulation S-K."[14]

Given the well developed conventions regarding disclosure and reporting in the institutional CLO market, LSTA submits that CLOs having the features described above should be excluded from the list of "structured finance products" for which 'registered-equivalent' disclosure and reporting must be available upon request. Disclosure involves substantial costs, and the bill for the possibly far-reaching additional disclosures proposed by the Commission will be paid by investors. Investors in the CLO market have already struck a healthy balance in terms of the costs and benefits of available information. CLOs should be exempt from the new conditions on Rule 144A and Regulation D. But if an exemption is not considered workable, CLO investors should be permitted to "opt out" of the additional requirements and the cost to the transaction associated with those requirements.

When one moves beyond the context of disclosure in connection with the initial marketing of a CLO – where CLO issuers generally disclose information requested by investors anyway – the provision of disclosure upon request becomes a much more significant issue and potential burden. The Proposed Rules would have the ironic result that even where all the initial investors in a CLO transaction are comfortable with existing market conventions as to reporting, and do not want to pay for registered-equivalent reports, a CLO transaction would still have to provide for such reporting. This is because under the Proposed Rule any "prospective purchaser" has the right to request such reporting upon resale, even if the initial holder did not want it. The only way a CLO issuer can ensure its ability to produce reports upon request of future holders of its securities– failing which it faces Rule 192 liability – is to put in place an infrastructure for such reporting from the beginning. Again, the initial investors in a CLO should have the right to decide whether they want to bear the cost of providing the additional reports required by the Proposed Rules. They should not be forced to bear such costs based on the possible requests of unknown future prospective purchasers. Accordingly, the amendments to

14 Proposing Release at 278.

Rule 144A in the Proposed Rules should be adjusted to provide that a CLO can, with the consent of its initial holders, "opt out" of registered-equivalent reporting, so that a future prospective purchaser will be able to request only the same ongoing reporting information as is being obtained by the initial holders of the CLO securities themselves.

The LSTA supports the suggestion of Commissioner Paredes that "a more targeted regulatory response...that tempers the required disclosures under these safe harbors to account for the wherewithal of investors participating in private offerings to safeguard their own interests — may better facilitate securitization."[15] This is certainly true in the case of CLOs, where well-established market conventions as to disclosure and reporting have already produced satisfactory results. Especially given the uncertainties CLO issuers would face in adapting and applying the requirements of Regulation AB, participants in the CLO market should be entitled to retain their current practices.

V. If the Commission Applies Regulation AB Requirements to Privately Placed CLOs, It Should Clarify Their Meaning.

A. Disclosure and Reporting Requirements Should Be Clear and Appropriate for the Asset Class

As noted above, under the Proposed Rules a 144A structured finance transaction must contain a provision requiring the issuer, promptly upon request, to provide to purchasers or holders of the securities (and to prospective purchasers designated by a holder) any information that would be required to be filed with the SEC if the transaction were registered on Form S-1 or Form SF-1 under the Securities Act. The issuer must further undertake to provide any ongoing information regarding the securities that would be required by Section 15(d) of the Exchange Act if the issuer were required to report under that section. The issuer must also represent that it will comply with the foregoing information requirements. Similar requirements would apply to Regulation D transactions in connection with the initial distribution. These requirements were not written with CLOs in mind and their applicability is, in many respects, highly uncertain.

Regulation AB as originally adopted in 2005 codified a set of interpretive practices and guidance under the Securities Act and the Exchange Act that emerged generally in the context of mortgage, credit card, auto loan and other types of securitizations closely connected to credit origination activity. The registrants under Regulation AB generally have been either affiliates of originators of loans and other receivables or underwriters sponsoring securitizations as part of a "pipeline" relationship with third party financial institutions. Regulation AB therefore evolved in the context of static pools and contemplates direct involvement by the registrant in the selection of the assets in the pool, such that the registrant has access to information about and from originators and sponsors that is relevant to the credit characteristics of the securitized assets, including performance information as to similar asset pools.

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[15] Troy A. Paredes, Commissioner, SEC, Statement at Open Meeting Regarding Proposed Rules Concerning Asset-Backed Securities (Apr. 7, 2010).

CLOs are a different asset type and they invest in a different asset class than the classic ABS security. CLOs invest in new loans (following a seasoning period) being brought to market or syndication, as well as existing loans that they purchase through secondary market transactions. In many cases, and particularly with respect to purchases in the secondary market, the investment manager may not have access to information about the origination process or the types of information for which the Proposed Rules would require disclosure. Moreover, this information is not of particular importance in analyzing the credit quality of an individual loan in the same way as it might be in analyzing pools of assets that are being securitized in a more traditional way. The investment manager is capable of performing credit analysis without considering the origination standards of an originating bank. Investors in a CLO are not buying the CLO based upon the underwriting standards of a particular originator of the underlying corporate loans; rather, the investor is buying based upon the terms and features of the CLO and the management skill of the investment manager. A requirement to provide originator information would be difficult to comply with, impose additional costs on the transaction and provide no real benefit to the management process or investors.

Indeed, most CLO loans may not even have an "originator" as such. CLOs invest primarily in syndicated loans, which often have many lead banks, underwriters and agents. It is not clear what would be meant by the "originator" of the loan facility in this context for purposes of the Item 1110(a) requirement to identify originators. If the requirement is to be imposed, its application to the syndicated loan market should be clarified and requirements in the Proposing Release should be more tailored to CLOs. For example, to the extent required at all, the identity of the originator should only be required for non-syndicated loans, and only where the CLO owns more that 20% of loans originated by that party. Information regarding the identity of intermediate holders is not relevant to investors or the investment criteria of CLOs, and in many cases will not be available. It should not be required to be reported. Item 1110(b) disclosure as to loan underwriting standards employed by the originator, as well, would be much less meaningful in the case of corporate loans, as corporate loans generally have more individually negotiated terms and diverse types of collateral security. Finally, disclosure of origination information for assets purchased in the secondary market would be of little utility as data will be available to the investment manager regarding the performance of the loan.

Providing other specified information for the loan asset class also raises practical concerns and, is in some respects, not workable. Many borrowers and guarantors of loans in the loan market are not reporting companies. The scope of required reporting does not adequately take into account the differences in available information between public and non-public companies. Information regarding non-reporting companies is generally strictly confidential and there are thus practical constraints on the investment manager in disseminating information that is available to it under the loan documents. Further, some institutions invest in CLOs, rather than directly investing in loans, in order to screen themselves from confidential, non-public information that could raise concerns in respect of their other trading activities. Investors expect that the investment manager- not the investor- will monitor loans in the portfolio and that they will not duplicate those efforts. Thus, reporting such information raises a number of practical problems and is simply not required for a portfolio of assets with an investment manager.

If the SEC determines that, nonetheless, information regarding borrowers and/or guarantors is required to be reported, financial statement disclosure for obligors in the context of a Rule 144A or Regulation D transaction should be limited to Rule 144A(d)(4)(i) information for non-reporting companies (and only required with respect to borrowers or guarantors that are present in the portfolio at a concentration of 10% or greater at the time of purchase of the respective obligation). Similarly, where hedge counterparty or credit enhancement providers are not reporting companies, financial information requirements should also be limited to 144A(d)(4)(i) information. It makes little sense to require, in the context of a securitization, greater credit-related information about an obligor than would be required for a direct transfer of that obligor's own securities under Rule 144A.

B. The SEC Should Clarify That Certain Regulation AB Disclosures Should Not Apply

1. Static pool information. The existing "static pool" requirements of Item 1105 of Regulation AB do not contemplate managed transactions. A static pool envisioned by Regulation AB has been chosen by the sponsor or arranger of the transaction without the benefit of an investment manager who will be involved in the transaction on an ongoing basis. Item 1105 information regarding "delinquencies, cumulative losses and prepayments for prior securitized pools of the sponsor" of the same asset type does not have the same relevance in a CLO as in static pools selected by the arranger. Transactions arranged by the same institution will have a range of investment managers who will, subject to constraints in the CLO governing documents, select, monitor and sell assets both before the securitization closing and after. These investment managers will have different investment strategies that will influence their selection of the initial pool. Accordingly, past performance information regarding other CLO transaction involving the same arranger does not have the same relevance in the CLO market.

2. Servicer disclosures. CLOs do not have a function comparable to that of a securitization "servicer." A CLO's trustee performs certain duties with respect to the CLO that are non-discretionary in nature. Any decisions that are required to be made with respect to the assets, including how to proceed if an asset defaults, are made by the investment manager, not the trustee. Accordingly, disclosure requirements applicable to the transaction "servicer" in the Proposing Release are not relevant to the trustee in a CLO.

3. Waterfall program. The waterfall modeling provisions in the proposal should not apply to CLOs. Institutional investors in the CLO market have long had their own capacity to model CLO waterfalls, and do not depend on the availability of a particular computer program format to facilitate this review. For those investors that do not prepare their own cash flow models, there are subscription services that are used extensively in the secondary market for analysis and pricing.

C. The SEC Should Modify Requirements that Will Apply with Respect to the Investment Manager Based on the Constraints on the Investment Manager under the Governing Documents

The Commission notes in the Proposing Release that as to managed structured finance products the Commission would seek disclosure regarding "objectives and strategies, any interest that they have retained in the transaction or underlying assets, and substitution, reinvestment and management parameters."[16] It is unclear on what standards such disclosure would be made under Form S-1 however. 144A disclosure documents for CLOs do already describe provisions of the CLO governing documents (including the investment criteria set forth therein) as to then "[s]ubstitution, reinvestment and management parameters."[17] Because the investment criteria set forth in the CLO governing documents constrain the discretion of the investment manager to a significant degree, however, investments objectives disclosure (similar to Form N-1A Item 9 disclosure for a registered investment company) is not relevant to investors. Eligibility criteria for CLO assets are heavily negotiated by all parties involved in the transaction, including investors and rating agencies, and establish the parameters within which the investment manager is authorized to manage the portfolio. Eligibility criteria including diversification requirements and material limitations on the sale of or reinvestment in assets are described in the CLO disclosure documents. In addition, the investment strategies of registered investment managers are described in its Form ADV filed with the SEC and available to investors.

D. Loan Asset Class Data Points Should Be Clarified

Reporting requirements for CLOs have developed over time with the involvement of investors as to the type and extent of information they believe they need to have access to. The type of asset-level information set out in CLO reporting illustrates the information that investors have determined to be important. If the SEC determines that the content of ongoing reporting should be prescribed by regulation, the data for corporate loans should be similar to that proposed for corporate debt securities in Schedule L Item 10. The following is the relevant information to be provided with respect to each loan in the portfolio.

- identity of the asset
- the identification number, if applicable
- borrower, guarantor or other obligor
- principal balance;
- annual interest rate or the spread to LIBOR (or other applicable reference index) and the reference index, as applicable
- maturity date
- country in which the issuer, borrower under an assignment of a bank loan or selling institution is organized
- public ratings, if available
- if the loan has defaulted, its market value

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[16] Proposing Release at 278.

[17] Id.

VI. Liability Under Proposed Rule 192 as Proposed in the Proposing Release Would Be Excessively Harsh

Proposed Rule 192 specifies that where information is required to be provided in accordance with a Rule 144A, Regulation D or Rule 144 undertaking, a failure to provide such information "would constitute an engagement in a transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser of the securities."[18] LSTA submits that this is not the proper standard or remedy for failure to provide information.

A failure to provide information that has been requested by an investor is plainly outside the limits of conduct that can be considered in the nature of fraud. An investor who asks for certain information at the time of its investment and does not receive it may be uncertain or dissatisfied, but the investor has not been deceived and has the obvious recourse of refusing to purchase the relevant securities. Similarly, a failure to provide ongoing reporting is simply a breach of promise, not a deceit.

Liability for violation of Rule 192 should be contractual liability to the investor and liability to the SEC that is similar in nature to a breach of an undertaking to the SEC. Such liability should be conditioned on an investor complaint and failure by the CLO to provide material information within a specified cure period.

In addition, as currently drafted, Rule 192 is unclear as to when an issuer would be deemed to have violated its provisions. The proposed rule simply states that "a failure to provide the information as required" would constitute fraud or deceit without defining what constitutes "a failure to provide." Rule 192 furthermore does not distinguish between material and non-material information and treats any failure to provide information as a violation. To rectify these current ambiguities in Rule 192 and to provide a fair and enforceable rule, we recommend that the SEC clarify that "failure to provide the information as required" means failure by the issuer to provide material information to an investor within 90 days after receipt of a complaint from such investor.

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For the reasons discussed above, we submit that the SEC should exempt CLOs from the proposed revisions to Regulation AB or allow investors to expressly opt out of receiving Regulation AB-style information and securities act reporting. If the SEC determines that notwithstanding the characteristics of the CLO market described in this letter, regulatory requirements must be imposed on CLOs, we strongly urge the SEC to adapt the proposed regulations to the CLO asset class and to make clear that requirements that have not applicability or are impractical will not apply to CLOs.

The LSTA and its members appreciate the opportunity to comment on the Proposed Rules. Should you have any questions about the comments in this letter, please do not hesitate to contact Bram Smith, Executive Director of the LSTA at (212) 880-3001.

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[18] Proposing Release at 23436.

Very truly yours,
THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION

R. Bram Smith
Executive Director