THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

VIA http://www.sec.gov/rules.shtml

February 13, 2012

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

Re: Prohibition Against Conflicts of Interest in Certain Securitizations, Securities Exchange Act Release No. 65355 [File No. S7-38-11], 76 FR 60230 (Sept. 28, 2011) (the "Proposing Release")

Dear Ms. Murphy:

The Financial Services Roundtable (the "Roundtable") respectfully submits these comments in response to the Securities and Exchange Commission's (the "Commission") request for comment on proposed rule 127B under section 27B of the Securities Act of 1933[1] to implement the proscription on conflicts of interest in certain securitizations as set forth in section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Among the Roundtable's Core Values are *fairness*; *integrity*; *respect*; and *community involvement*.[3] Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic

---

1 15 U.S.C. § 77z-2a (2010).

2 Section 621 of the Dodd-Frank Act, Pub. Law No. 111-203, § 621, 124 Stat. 1631 (July 21, 2010).

3 *See Roundtable Statement of Core Values, available at* http://www.fsround.org/.

engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

Executive Summary

Proposed rule 127B under the Securities Act would prohibit any underwriter, placement agent, initial purchaser, and sponsor of an asset backed securities ("ABS") transaction (including a synthetic ABS), and their respective affiliates or subsidiaries (each, a "Covered Person" or "securitization participant"), from engaging in any transaction that would create or result in a material conflict of interest with any investor in that particular ABS transaction during the one year period after the date of the first sale of the securities. The prohibitions are intended to eliminate any opportunity for a securitization participant or third party to profit from the failure or default of an ABS transaction the securitization participant or third party designed to fail.[4]

Our comments on the proposed rule are summarized as follows:

- Traditional activities undertaken in connection with the securitization process (including servicing, underwriting, collateral management, *etc.*) should not be prohibited by the rule.

- Investors should be allowed to waive disclosed potential material conflicts of interest that are outside of the intended scope of section 621 of the Dodd-Frank Act.

- Insurance-linked securities that reinsure natural catastrophe, pandemic, or similar risks should be excluded from coverage by the rule.

- Ordinary business relationships between Covered Persons and borrowers who have loans that were securitized and between Covered Persons and third-party vendors who service securitized assets would not constitute "material conflicts of interest" under the rule.

- Covered Persons should exclude any affiliate, subsidiary, business unit, or trading desk that operates separately and independently from the ABS securitization participant, is not involved in creating, structuring, or distributing the ABS, and maintains information barriers to manage the potential for material conflicts of interest.

---

[4] *See* CONG. REC. S5899 (July 15, 2010) (Statement of Sen. Levin) ("The intent of section 621 is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures.")

- Unregistered ABS transactions made outside of the U.S. to non-U.S. persons (including Regulation S[5] transactions) are subject to regulation by the offshore jurisdiction and should be excluded from coverage by the rule.

- The Commission should provide a safe harbor from the rule's prohibitions for transactions entered into prior to the effective date of the rule.

Introduction

The Roundtable welcomes this opportunity to present its views on several issues raised by proposed rule 127B under the Securities Act, which is intended to implement the prohibitions of section 621 of the Dodd-Frank Act.[6] Our members include underwriters, placement agents, originators of assets that are securitized, and securitization sponsors.

Proposed rule 127B under the Securities Act would prohibit any underwriter, placement agent, initial purchaser, and sponsor of an asset backed securities ("ABS") transaction (including a synthetic ABS), and their respective affiliates or subsidiaries (each, a "Covered Person" or a "securitization participant"), from engaging in any transaction that would create or result in a material conflict of interest with any investor in that particular ABS transaction during the one year period after the date of the first sale of the securities. The prohibitions would apply to registered and unregistered ABS transactions. The purpose of the prohibition is to eliminate any opportunity for a Covered Person to profit (or enable a third party to profit) from a failure or default of an ABS transaction the Covered Person "help[ed] structure, offer and sell to investors."[7] As proposed, certain risk-mitigating hedging activities, liquidity commitments, and *bona fide* market making would not be subject to the prohibition.

We note that conflicts of interest are to some degree inherent in any capital markets transaction, and typically arise in the unique manner by which assets are acquired and their cash flows structured to create asset backed securities.[8] The Commission also stated its preliminary agreement that "most activities undertaken in connection with the securitization process would not be prohibited by the proposed rule."[9] We appreciate the Commission's acknowledgement "that certain

---

[5] 17 C.F.R. § 230.903.

[6] *See* Prohibition Against Conflicts of Interest in Certain Securitizations ("Proposing Release") at n. 6.

[7] *Id.* at 60330.

[8] *See id.* at nn. 33-35 and accompanying text (listing conflicts of interest that arise in asset securitization).

[9] *Id.* at 60340 (listing servicing, collateral management, underwriting, exercising remedies upon a loan default, and other traditional securitization activities). *See id.* at 60323-24 (noting 22 traditional securitization activities identified by the Securities Industry and Financial Markets Association).

conflicts of interest are inherent in the securitization process," and its desire that "Section 27B and [its] proposed rule [be] construed in a manner that does not unnecessarily prohibit or restrict the structuring and offering of an ABS."[10] Therefore, we ask the Commission to confirm that traditional activities undertaken in connection with the securitization process would not be prohibited by the final rule.

The Roundtable agrees that securitization participants should not intentionally design an ABS transaction to fail or default in order to profit—or allow third parties to profit—from that failure or default. However, the proposed rule and its interpretative guidance raise uncertainties about the scope of persons and products that would be subject to the rule, the nature of transactions that would create conflicts of interest with ABS investors, and the materiality of those conflicts. For example:

- The discussion related to synthetic ABS structures[11] that should be prohibited by rule 127B and the examples accompanying it are so broad and vague as to possibly encompass insurance-linked securities, which allow insurers to reinsure natural catastrophe, pandemic, or similar risks in the capital markets.

- The second prong of the conflicts of interest test[12] could be read to include ordinary business relationships between Covered Persons and borrowers who have loans that were securitized, and between Covered Persons and third-party vendors who service the securitized assets.

- Because the definition of Covered Persons includes any affiliate or subsidiary of an underwriter, placement agent, initial purchaser, or sponsor, the rule would unduly restrict the activities of individuals and entities that have no role in structuring or underwriting the securitization transaction.

Absent further clarification, we believe the proposed rule would inadvertently include persons and transactions that are beyond the intended scope of section 621 of the Dodd-Frank Act.

We believe properly informed investors could negate or mitigate many potential material conflicts of interest. This approach would be consistent with the role that disclosure traditionally has played in the federal regulation of securities

---

[10] Proposing Release at 60329.

[11] *Id.*, "Example 3—Synthetic ABS Transaction" at 60338.

[12] *See id.* at 60328 (noting that a covered conflict would not "be involved if the conflict in question . . . (2) did not arise as a result of or in connection with the related ABS transaction").

offerings.[13] Further, for securitization participants that have affiliates, subsidiaries, business units, or trading desks that operate separately and independently from securitization participants, information barriers would allow the parties to manage potential conflicts of interest. Finally, the revised guidance should clearly distinguish conflicts of interest arising generally in ABS transactions from abusive structures where sponsors, distribution participants, or a third party stand to profit from an ABS transaction they designed to fail or default.[14]

Our comments focus on the following aspects of the proposed rule:

I. Investors should be allowed to waive disclosed potential material conflicts of interest that are outside of the intended scope of section 621 of the Dodd-Frank Act.

The Commission seeks comment on the role of disclosure for purposes of section 27B and the proposed rule.[15] While many potential conflicts of interest (some of which may be material) are inherent in ABS transactions, section 621 was intended to eliminate a specific material conflict of interest—one that arises when securitization participants are allowed to engage in transactions from which they can improperly profit from the failure of the ABS transaction they designed and sold to clients. As Senators Jeffrey Merkley and Carl Levin noted, section 621 was not intended to curtail the "healthy functioning of our capital markets,"[16] but to prevent securitization participants "from securing handsome rewards for designing and selling malfunctioning vehicles that undermine the asset-backed securities markets."[17]

Full and fair disclosure of material information is the foundation of federal regulation of securities offerings.[18] As the Commission noted, disclosure is often

---

13 *See infra* "Section I."

14 *See* CONG. REC. S5899 (July 15, 2010) (Statement of Sen. Levin) ("The intent of section 621 is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures. . . . [The] sponsors and underwriters of the asset-backed securities are the parties who select and understand the underlying assets, and who are best positioned to design a security to succeed or fail.").

15 Proposing Release, "Section IV.B." at 60343.

16 Letter of Senators Jeffrey Merkley and Carl Levin, U.S. Senate, Re: Implementation of Merkley-Levin Provisions at 5 (Aug. 3, 2010), available at http://sec.gov/comments/df-title-vi/conflicts-of-interest/conflictsofinterest-2.pdf.

17 CONG. REC. S5899 (July 15, 2010) (Statement of Sen. Levin).

18 Securities Act of 1933, Pub. Law No. 73-22, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77a–zzz (2010)) (adopting the Securities Act "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof"). *See also* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963)

used "to manage conflicts of interest in other areas of the federal securities laws."[19] It shouldn't be that investors are precluded from investing, but that investors have the information from which to make informed decisions that serve their interests as they see them.

This reliance on full disclosure also would be consistent with the approach jointly proposed by federal banking authorities and the Commission to negate or substantially mitigate certain conflicts of interest for purposes of the restrictions on proprietary trading in section 619 of the Dodd-Frank Act.[20] As the agencies noted, "some types of conflicts may be appropriately resolved through the disclosure of clear and meaningful information to the client, customer, or counterparty that provides such party with an informed opportunity to consider and negate or substantially mitigate the conflict."[21] The Roundtable believes that investors who have the benefit of full disclosure should be allowed to determine for themselves the *significance* (if any) of potential conflicts, and make investment decisions that satisfy their particular investment goals, risk tolerance, or other objectives.

A disclosure-based approach also would allow ABS markets to function normally for innumerable transactions that raise none of the issues that section 621 was intended to address. The Commission's general exemptive authority under section 28 of the Securities Act[22] would allow it to "carve-out" the more routine conflicts for which disclosure would be an appropriate response, and focus its attention and resources on eliminating those material conflicts that section 621 was intended to prohibit.

We ask the Commission to exercise its exemptive authority to allow investors to waive certain potential material conflicts of interest that have been disclosed to them. This conditional exemption would be available for potential material conflicts of interest that are outside the intended scope of section 621 of the Dodd-Frank Act (*i.e.*, a Covered Person entering into a short transaction to profit from the poor performance of a security that it intentionally designed to fail).

(noting that federal securities laws "substitute a philosophy of full disclosure for the philosophy of *caveat emptor*").

[19] Proposing Release, "Section IV" at 60341.

[20] Section 619 of the Dodd-Frank Act, Pub. Law No. 111-203, § 619, 124 Stat. 1620 (July 21, 2010).

[21] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 FR 68846, 68893 (Nov. 7, 2011).

[22] 15 U.S.C. §77z-3 (2010).

II. Insurance-linked securities that reinsure natural catastrophe, pandemic, or similar risks should be excluded from coverage by the rule.

The proposed rule and illustrative examples are so vague and broad that they could be construed to encompass insurance-linked securities.[23] This ambiguity would impact the continued viability of the $10.7 billion insurance-linked securities market including, but not limited to, catastrophe bonds ("Cat Bonds").[24] In an insurance-linked securities transaction, the insurance company uses the capital markets to share the risks associated with high severity, low-probability catastrophe exposure. Moreover, each investor expressly agrees to assume a specific type or types of insurance risk "linked" to the occurrence of an adverse event or series of events such as natural catastrophes (*e.g.*, hurricane, earthquake, *etc.*), or pandemic events, or the adverse development of other categories of insurance risk (*e.g.*, life insurance).

While catastrophe bonds and ABS transactions have similar structures and offer a means to transfer risk, they differ in some important ways. Instead of monetizing future cash flows of credit card receivables, auto loans, student loans, residential or commercial mortgages, or other financial assets, Cat Bonds transfer liabilities associated with natural catastrophe and other insurance-related risks, not assets. Cat Bonds do not involve credit exposure to a portfolio of income-producing assets that are not held by the sponsoring insurer, and the return to investors is not based on the performance of an asset pool. Thus, Cat Bonds should not be viewed as an ABS or a synthetic ABS.

Also, in the transfer of insurance risk to the capital markets, the sponsoring insurer's interests are aligned with Cat Bond investors—neither stands to profit from a catastrophic event. For an investor, a catastrophic event can lead to the partial or total loss of principal. For the sponsoring insurer, the occurrence of a catastrophic event can result in negative consequences (*e.g.*, loss resulting from retained risk, loss from insufficient collateral supporting the policy liabilities, and potentially higher reinsurance rates for future catastrophic coverage).

The Roundtable believes the ambiguities inherent in the application of the proposed rule to the Cat Bond market would at the very least be disruptive—delaying or reducing significantly the volume of transactions. However, we believe the likely impact would be far more severe—closing a market to insurers and sophisticated institutional investors which today provides a means for insurers

---

[23] We are particularly concerned about the impact of a broad and incorrect interpretation of "Example 3—Synthetic ABS Transaction." *See* Proposing Release at 60338.

[24] *See* WILLIS CAPITAL MARKETS & ADVISORY, *ILS Market Update* (Nov. 2011) (estimating total Cat Bonds issued and outstanding as of September 30, 2011).

to manage risks and costs by providing a venue for risk transfer outside of the traditional reinsurance market to sophisticated institutional investors[25] who seek exposure to insurance risks that are not correlated to other types of investment risks.

We ask the Commission to clarify that insurance-linked securities would be excluded from the rule's prohibitions.

III. Ordinary business relationships between Covered Persons and borrowers who have loans that were securitized and between Covered Persons and third-party vendors who service securitized assets would not constitute "material conflicts of interest" under the rule.

A sponsor may have multiple lending relationships with consumer or commercial borrowers, including lines of credit, credit cards, mortgages, subordinate loans, and automobile loans. In the ordinary course of its business, the lender will evaluate the borrower's creditworthiness, adjust outstanding lines of credit, and make decisions on the priority of payments on the borrower's outstanding loans from available proceeds. As discussed below, the vagueness of the conflicts of interest test could be construed to include a securitization participant's ordinary business relationships with borrowers whose loans were securitized and with third parties who service the securitized assets. The following scenarios illustrate this issue:

Consumer Loans. The sponsor is the creditor in two transactions with the consumer: a credit card and a residential mortgage loan. The sponsor may securitize the mortgage loan. As a result, the consumer will owe the sponsor amounts due on the credit card and will owe investors in the ABS amounts due on the mortgage loan. In the ordinary course of its business, the sponsor (directly, or through third-party vendors) will service the line of credit and the mortgage loan. If the consumer's available funds are insufficient to service both the credit card debt and the mortgage loan, the sponsor and the ABS investors would be competing for the same funds. Thus, the manner in which the sponsor manages the consumer's credit would create a conflict of interest with the ABS investors.

Commercial Loans. In the commercial context, a commercial mortgage borrower may obtain a loan that consists of both a senior note (the "A Note") and subordinate note (the "B Note"). The A Note may be

[25] Cat Bond transactions typically are offered to "qualified institutional buyers" within the meaning of rule 144A under the Securities Act [17 C.F.R. § 230.144A (2010)].

securitized while the B Note remains with the sponsor. Similar to the example above, the holders of the securitized A Note will be in conflict with the sponsor as the holder of the B Note if the borrower defaults.

These types of conflicts are ones that arise because the sponsor is servicing the borrower's outstanding obligations, or because the borrower has more than one lending relationship with the sponsor. They are inherent in asset securitization. These are not conflicts that arise because the sponsor is executing a short transaction on the outstanding ABS. Additionally, in both scenarios the sponsor is not benefitting from a default—in fact, the sponsor's interest in the success of the borrower is aligned with the investors in the securitizations. However, the second prong of the conflicts of interest test[26] could be read to include ordinary business relationships between Covered Persons and borrowers who have loans that were securitized, and between Covered Persons and third-party vendors who service the securitized assets.

We ask the Commission to clarify that transactions that arise in the ordinary course of business between Covered Persons and borrowers who have loans that were securitized and between Covered Persons and third-party vendors who service securitized assets would not constitute "material conflicts of interest" under the rule.

IV. Covered Persons should exclude any affiliate, subsidiary, business unit, or trading desk that operates separately and independently from the ABS securitization participant, is not involved in creating, structuring, or distributing the ABS, and maintains information barriers to manage the potential for material conflicts of interest.

The proposed definition of "Covered Persons" also would include affiliates, subsidiaries, business units, or trading desks that are not involved in creating, structuring, or underwriting the ABS transaction, and whose transactions in the ABS are not coordinated with, or in support of, securitization participants who created, structured, and sold the ABS. As the Commission noted, federal securities law and regulations recognize the use of "information barriers," in the form of written, reasonably designed polices and procedures, as a means to address or mitigate potential conflicts of interest or other inappropriate activities. "For example, Section 15(g) of the Exchange Act[27] recognizes that information

---

[26] *See* Proposing Release at 60328 (noting that a covered conflict would not "be involved if the conflict in question . . . (2) did not arise as a result of or in connection with the related ABS transaction").

[27] 15 U.S.C. § 78o(g) (2010).

barriers may be used to effectively manage the potential misuse of material, non-public information."[28]

We believe information barriers also could be used to manage the potential for material conflicts of interest under the rule. A reasonably-designed information barrier can be an effective tool to assure the integrity of the independence between business units that are not involved in creating, structuring, or underwriting the ABS transaction and the securitization participant. While the Commission suggested some conditions that may be appropriate for this purpose,[29] the industry also has considerable experience in developing and implementing information barriers. For example, written policies and procedures may address measures such as compliance reviews; education and training of personnel; dissemination of sensitive information on a "need-to-know" basis; and pre-approval of trading in employee accounts.

Thus, the over-inclusive effect of the proposed definition could be addressed by exempting from the rule's prohibitions any affiliate, subsidiary, business unit, or trading desk that operates separately and independently from the ABS securitization participant (or participating business unit), is not involved in creating, structuring, or distributing the ABS, and maintains and enforces policies and procedures reasonably designed (taking in to consideration the nature of the entity's business) to prevent the flow of information related to any particular ABS transaction from the business unit that is the securitization participant to such other affiliates, subsidiaries, business units, or trading desks.

V. Unregistered ABS transactions made outside of the U.S. to non-U.S. persons (including Regulation S[30] transactions) are subject to regulation by the offshore jurisdiction and should be excluded from coverage by the rule.

The proposed rule would encompass ABS offerings that were exempt from registration under the Securities Act. Since offshore offerings also are exempt from registration, the proposed rule could be construed to include offshore ABS transactions. In view of the Commission's rationale when it adopted Regulation S, we believe offshore ABS offerings should be subject to regulation solely by the jurisdiction(s) in which the offers or sales are made. As the Commission noted, "[p]rinciples of comity and the reasonable expectations of participants in the global markets justify reliance on laws" of the non-U.S. jurisdiction in which the

---

28 *See* Proposing Release at 60341-42.

29 *See id.*, "Request for Comment No. 95" at 60342.

30 17 C.F.R. § 230.901 *et seq.* (2010).

transaction takes place.[31] "The territorial approach recognizes the primacy of the laws in which a market is located. As investors choose their markets, they choose the laws and regulations applicable in such market."[32]

We ask the Commission to clarify that any unregistered ABS transaction (pursuant to Regulation S or otherwise) made outside of the U.S. to non-U.S. persons would not be covered by the rule.

VI. The Commission should provide a safe harbor from the rule's prohibitions for transactions entered into prior to the effective date of the rule.

As the Commission noted, proposed rule 127B would prohibit any securitization participant from engaging in a transaction that would involve or result in a prohibited material conflict of interest during the one-year period following the first closing of the sale of the ABS to the public (the "Covered Timeframe").[33] All ABS offerings that close after the effective date of the rule and the Commission's interpretative guidance would be covered by the new rule and guidance. However, there also will be outstanding ABS transactions that were closed prior to the effective date of the rule and related guidance, and for which the Covered Timeframe will not have expired.

The proposed rule should not apply retroactively to outstanding ABS transactions that were entered into before the effective date of the rule and its related guidance. Prior to the Commission's formal approval of the rule and related guidance, securitization participants are unable to plan, develop, test, and implement processes that would enable their ABS transactions to comply with the rule. Therefore, we believe it would be appropriate to provide a safe harbor for any outstanding ABS transaction (a "grandfathered ABS"). This safe harbor would not be extended to exempt any person from a securities law violation in respect of a grandfathered ABS that was unrelated to rule 127B.

We ask the Commission to provide a safe harbor from the rule's prohibitions for ABS transactions entered into prior to the effective date of the rule.

---

[31] *See* Securities Act Release No. 6863, "Section II: Background and Introduction" at 55 FR 18306 (May 2, 1990).

[32] *Id.*

[33] Proposing Release at 60327.

The Roundtable and its members appreciate the opportunity to offer our perspectives on proposed rule 127B under the Securities Act. If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org or Rich Foster at Richard.Foster@fsround.org.

Sincerely yours,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel
The Financial Services Roundtable

With a copy to:

The Honorable Mary L. Schapiro, Chairman
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Daniel M. Gallagher, Commissioner

Robert W. Cook, Director
David Bloom, Branch Chief
Elizabeth Sandoe, Senior Special Counsel
Anthony Kelly, Special Counsel
Barry O'Connell, Attorney Advisor
Jack I. Habert, Attorney Fellow
Division of Trading and Markets

Meredith Cross, Director
Katherine Hsu, Chief, Office of Structured Finance
David Beaning, Special Counsel
Division of Corporation Finance