February 13, 2012

VIA ELECTRONIC FILING – rule-comments@sec.gov
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Proposed Rule; Prohibition Against Conflicts of Interest in Certain Securitizations, Release No. 34-65355; File No. S7-38-11

Dear Ms. Murphy:

The Commercial Real Estate ("CRE") Finance Council® appreciates the opportunity to respond to the request of the Securities and Exchange Commission (the "Commission") for comments on proposed rules to prohibit conflicts of interest in certain securitizations, pursuant to Section 621 of the Dodd Frank Wall Street Reform and Consumer Protection Act.[1]

Our members are in accord with the intent expressed by Congress in adopting Section 621. We agree that market participants should not design asset-backed securities ("ABS") transactions to default in order to benefit from the default.[2] The CRE Finance Council commends the Commission for recognizing that any rules that implement Section 621 must, however, "strike an appropriate balance between prohibiting the specific type of conduct at which [Section 621] is aimed without restricting other securitization activities."[3] We accordingly believe that overall, an approach that is more principles-based, such as the approach

[1] Proposed Rule; Prohibition Against Conflicts of Interest in Certain Securitizations, Release No. 34-65355; File No. S7-38-11, 76 Fed. Reg. 60320 (Sept. 28, 2011) (the "Proposing Release").

[2] *See* 156 Cong. Rec. S5899 (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.")

[3] Proposing Release, 76 Fed. Reg. at 60324.

contemplated by the Commission, is preferable to attempting to prescriptively identify each and every type of transaction that would be prohibited. Thus, we view the proposed rule as a start in the right direction, and recommend areas where commercial mortgage-backed securities ("CMBS") market participants believe that additional guidance from the Commission is necessary.

The CRE Finance Council is the collective voice of the entire $3.5 trillion commercial real estate finance market, including loan and bond investors such as insurance companies, pension funds, and money managers; portfolio, multifamily, and CMBS lenders; issuers of CMBS; servicers; rating agencies; accounting firms; law firms; and other service providers.

Our principal functions include setting market standards, facilitating the free and open flow of market information, and education at all levels, particularly related to securitization. Securitization is one of the essential processes for the delivery of capital necessary for the growth and success of commercial real estate markets. One of our core missions is to foster the efficient and sustainable operation of CMBS. To this end, we have worked closely with policymakers to educate and inform legislative and regulatory actions to produce efficient and practical regulatory structures. We look forward to continuing to work with policymakers on this effort. We also continue our ongoing work with all market constituencies to develop industry standards which provide marked improvements in the CRE finance arena. Prime examples of our work include enhancements of both the CRE Finance Council's "Annex A" initial loan-level disclosure package and the Investor Reporting Package™ for ongoing disclosures and surveillance by investors.

I. Overview

While we believe the Proposing Release represents a productive beginning, the CRE Finance Council's members recommend that more clear and specific guidance be provided concerning certain concepts to enable market participants to more readily identify those activities that would constitute a prohibited "material conflict of interest" under the rules. Particularly, more specific guidance is required for transactions that involve:

- Standard business practices that do not constitute the types of conduct Section 621 seeks to address;

- Circumstances in which a "Covered Person"[4] takes a short position with respect to an index referencing assets owned by the Covered Person;

- Interest rate or currency swaps between a Covered Person and the issuing special purpose entity ("SPE"); and,

- Synthetic securitizations and credit default swaps ("CDS").

[4] The proposed rule would treat ABS underwriters, placement agents, initial purchasers, sponsors, or any affiliates of such entities as "Covered Persons." *See* Proposing Release, 76 Fed. Reg. at 60325.

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Recommendation: In each of these circumstances, the Proposed Rule should explain that these transactions do not entail prohibited conflicts of interest.

Our members are also concerned that the proposed regulatory text lacks definitions of key terms such as "material conflict of interest," and that the Commission would instead rely on interpretive discussion and examples in material accompanying the regulatory text to provide the bulk of the Commission's guidance to market participants on conflicts of interest. Since the interpretive material and examples in the Proposing Release would not have the force of law, market participants are concerned that they face greater uncertainty in determining whether their activities could be viewed as violating the regulation.

Recommendation: At a minimum, key definitions such as that for a "material" conflict of interest should be included in the text of the regulation.

Ultimately, the CRE Finance Council urges the Commission to continue to bear in mind – as the Commission has in the Proposing Release – that

> [L]ike other prophylactic conflict of interest rules – the proposed rule and interpretation might limit certain investment activities that might otherwise be made for bona fide purposes…. We therefore acknowledge the concern that this proposal might have unintended effects, such as potentially limiting investment opportunities for investors if a securitization participant refrains from structuring and selling ABS in reaction to this proposal.[5]

Recommendation: The Commission should seek to minimize unintended adverse consequences that this rule could have on securitization, which could impact the availability of credit at a time when credit markets are constrained.

The CRE Finance Council's recommendations are discussed in further detail below.

II. Additional Guidance is Necessary Regarding Certain Common Situations That Do Not Create the Types of Harm Congress Sought to Address in Section 621

Literal "conflicts" are inherent in securitizations because of the nature of the securitization framework, which involves the intentional transfer or dispersal of risk. Indeed, the risk transfer/dispersal mechanism, and the many different types of transactions it may involve (e.g., one party providing financing to another; hedging; existence of different classes of securities issued in a single transaction) are the reason that securitization is considered an efficient and valuable means of providing capital and liquidity to the nation's economy.[6]

[5] Proposing Release, 76 Fed. Reg. at 60330.
[6] *See id*. at 60321-24 and examples cited therein.

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For this reason, the CRE Finance Council does not advocate a broad-brush approach that would, for example, prohibit any transaction that could potentially create a conflict of interest. And we appreciate the Commission's effort to instead follow a principles-based approach in attempting to draw lines where there are often gray areas, and to explain the governing principles through the use of examples.

To this end, the Commission should be aware that there are certain types of transactions that occur in the CMBS market and do not create the types of harm Congress sought to address in Section 621, but are not addressed in the Proposing Release's examples. We suggest that the Commission's conflict of interest rule include discussion of the following:

A. Standard Business Practices That Are Outside the Scope of Conduct Section 621 Seeks to Address

Several types of transactions between securitization participants and investors are standard industry practices that are vital to the markets' functioning and beneficial to borrowers and investors. For example, an originator may provide other financing to facilitate an obligor's purchase of assets, in addition to the loan that is packaged into a securitization. In the CMBS market, such additional financing may be in the form of B-notes, mezzanine loans, or corporate loans, and are typically parts of a larger asset acquisition funding structure for the borrower. These other loans may be subordinate to the securitized loans, and if the junior loans are still held by a Covered Person and the borrower default, the situation could be characterized as a conflict between the senior investors and the Covered Person/junior lienholder. A securitization participant may also extend financing to investors, enabling an investor to purchase the ABS, but also creating an apparent conflict of interest. Neither of these examples present the type of circumstances Section 621 seeks to address, where market participants design securitizations to fail and then profit from the failure, thus placing their interests in diametric opposition to those of investors. Rather, the types of financing transactions described here facilitate the ability of borrowers and investors to participate in the commercial real estate market, and constitute standard business practices that are well-understood by market participants.

We recognize that the Proposing Release explains that a "Covered Conflict" exists only where a transaction "arise[s] as a result of or in connection with the related ABS transaction."[7] But industry participants are concerned that *any* acquisition funding provided at the same time as the securitized loans could be deemed to arise "as a result of or in connection with" the securitization, a construct that is too broad and would restrict non-mortgage and other types of financing that borrowers and investors rely upon to make complex transactions work.

Regardless of whether financing occurs at the beginning of a transaction to fund asset acquisition, or after ABS issuance to fund investors' purchase of the bonds, the party providing the financing is exposing itself to the risk of default of the underlying assets or the bonds. Therefore, that party's interests are actually aligned with investors. Given this marketplace

[7] Proposing Release, 76 Fed. Reg. at 60328.

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reality, it follows that even if a literal conflict of interest could be said to exist, such a conflict should be allowed under the Commission's rules.

B. Covered Person Takes Short Position on an Index Referencing Asset(s) Owned By the Covered Person

Another difficulty created by the lack of clarity as to whether a transaction "arise[s] as a result of or in connection with the related ABS transaction" concerns hedging by a Covered Person in the form of an investment in an index comprised of a number of securities (whether or not the index includes the related ABS). Such hedging should not constitute a prohibited activity because this investment is not an activity that arises out of or in connection with such ABS.

The CRE Finance Council requests the Commission to clarify that a firm's use of a market index such as CMBX to hedge CMBS exposure generally should not be interpreted as prohibited, even if the firm was a Securitization Participant with respect to one or more of the securities underlying the index. CMBX and other similar indices are not meant to track the performance of a particular transaction, but are instead broad-based indices intended to follow a range of similar deals in the market. In addition, it should be permissible under the final rule for a financial firm to go short in a segment of the ABS market even if the short instrument is highly correlated to ABS for which the financial firm acted as a Securitization Participant, but where the short position does not involve a specific ABS for which the financial firm was a Securitization Participant. We request that the Commission confirm in the final rule that the activities discussed in this paragraph would not fall within the scope of the rule, as they do not arise as a result of or in connection with the related ABS transaction.

C. Interest Rate or Currency Swaps Between Covered Person and Issuing SPE

As is the case for other asset classes, CMBS investors may seek interest rates or currencies that differ from those associated with the assets underlying the ABS, which requires the securitization structure to use interest rate or currency swaps. In practice, these swaps are bid out to various market participants including affiliates of the securitization participants, such as underwriters. While such swaps do not create conflicts between the securitization participant and the SPE regarding performance of the securitized assets, one can take the view that a "conflict" exists because the securitization participant and the SPE have divergent interests as to whether interest rates rise or fall, or as to how currency exchange rates move.

Divergences of this nature are not what Congress intended to address through Section 621; they do not involve designing a securitization to enable a securitization participant to profit from the securitization's failure, to investors' detriment. Nonetheless, the Proposing Release is unclear on the status of such swaps and similar transactions. A broad interpretation of "material conflict of interest" could preclude an underwriter's affiliate from providing such a swap, which could deprive investors of the most advantageous execution. Moreover, because interest rate and currency swaps with an SPE are often customized to a particular transaction and are difficult to hedge, subjecting these swaps to conflict of interest prohibitions would likely impair their use in securitizations.

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D. Synthetic Securitizations and CDS

As discussed, the Proposing Release recognizes that the proposal may have unintended effects, including prohibiting certain types of transactions that are being done for bona fide purposes. Among the casualties will be synthetic securitization transactions. There are bona fide purposes for using such tools, including significantly, investors' exercise of their own particular objectives (e.g., an investor can acquire credit exposure to a financial asset without the issuer actually acquiring the asset), and securitization parties seeking to responsibly manage risk. The credit derivatives market relating to ABS generally increases the overall liquidity and efficiency of the capital markets and the soundness of financial institutions. It follows that placing limitations on the ability to use synthetic securitizations curtails investor choice and the ability to manage risk.

Given that credit derivatives inherently involve long and short positions, so long as a securitization participant is not deliberately designing an ABS transaction to fail, such synthetic ABS transactions should not be subject to prohibition under the final rule.

Recommendation: For each of foregoing circumstances, the final rule should specify that these transactions do not entail prohibited conflicts of interest.

III. The Regulatory Text Should Include Definitions of Key Terms

The proposed text of the regulation would largely mirror the text of Section 621, prohibiting the existence of a "material conflict of interest." While interpretive material in the Proposing Release describes a "material" conflict essentially as occurring when a securitization participant takes a short position concerning the securitization that a reasonable investor would consider important, the text of the regulation would not define this or other key terms. For example, the regulatory text also would not define covered "conflicts," although the Proposing Release provides important qualifications to the concept that would exempt activities such as issuing investment research.

The Commission also states that going forward, it intends to rely primarily on interpretive guidance to assist market participants in determining whether activities are consistent with the rules.[8]

The Commission's interpretive discussion of conflicts of interest is helpful, but market participants are concerned that none of this discussion would have the force and effect of law. As a result, market participants face greater uncertainty in determining whether their activities could be viewed as violating the regulation.

Recommendation: To reduce such uncertainty in the securitization market, especially regarding key concepts such as the definition of a "conflict" and "material" conflicts, the CRE Finance Council suggests that these terms be defined in the regulatory text.

[8] *Id*. at 60329.

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IV. The Commission Must Remain Focused on the Types of Conduct Section 621 Was Intended to Address

The Commission has already recognized the importance of avoiding restrictions on legitimate securitization activity while "prohibiting the specific type of conduct at which [Section 621] is aimed."[9] We urge the Commission to keep this goal in mind as it develops conflict of interest rules.

These rules, like the others presently being contemplated for the securitization industry, will be imposed at a sensitive time for the CMBS market. While the CMBS market has shown some improvement since the height of the economic crisis in 2009, global economic difficulties and the sovereign debt concerns that arose in 2011 caused slower growth in issuance than had been anticipated for the year, with total issuance reaching approximately $30 billion. Predictions for 2012 are that issuance will remain at this level.

The slowed CMBS market recovery comes at a time when the CRE industry faces an increasing number of mortgage maturities for which capital will be required, either in the form of debt or equity, to avoid further declines in commercial property values. Through 2017 for example, approximately $600 billion of CMBS loans and more than $1.2 trillion in outstanding commercial mortgages will mature. Borrower demand to re-finance these mortgages will be at an all-time high. The Commission should adhere to its undertaking to avoid "unintended effects, such as potentially limiting investment opportunities for investors if a securitization participant refrains from structuring and selling ABS in reaction to this proposal,"[10] especially at a time when the markets are fragile.

Recommendation: The Commission should seek to minimize unintended adverse consequences that this rule could have on securitization, which could impact the availability of credit at a time when credit markets are constrained.

V. Conclusion

The CRE Finance Council appreciates the Commission's consideration of our comments regarding the Proposing Release. We stand ready to provide any additional assistance that may be helpful.

Respectfully submitted,

Stephen M. Renna
Chief Executive Officer
CRE Finance Council

[9] *Id*. at 60324.
[10] *Id*. at 60330.

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