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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 230

~~[~~Release No. ~~33-11151~~33-11254; File No. S7-01-23~~]~~

RIN 3235-AL04

Prohibition Against Conflicts of Interest in Certain Securitizations

AGENCY: Securities and Exchange Commission.

ACTION: ~~Supplemental proposed~~**Final** rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is ~~reissuing~~**adopting**

~~and revising a proposal that was initially published in September 2011 that would implement a~~

~~provision under~~**a rule to implement Section 621 of** the Dodd-Frank Wall Street Reform and Consumer Protection

Act of 2010 ("Dodd-Frank Act") prohibiting an underwriter, placement agent, initial purchaser,

or sponsor of an asset-backed security (including a synthetic asset-backed security), or ~~any affiliate or~~**certain**

affiliates or subsidiaries >of any such entity, from engaging in any transaction that would involve<

~~subsidiary <of any such entity, from engaging in any transaction that would involve >~~or result in certain material conflicts of interest.

DATES: *Effective dates*: This final rule is effective on [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

***Compliance date*: See Section II.I.**

~~**DATES:** Comments should be received on or before March 27, 2023.~~

~~**ADDRESSES:** Comments may be submitted by any of the following methods:~~

~~*Electronic comments*:~~

- ~~Use the Commission's internet comment form (http://www.sec.gov/rules/ submitcomments.htm); or~~
- ~~Send an email to rule-comments@sec.gov. Please include File Number S7-01-23 on the subject line.~~

~~*Paper comments:*~~

- ~~Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.~~

~~All submissions should refer to File Number S7-01-23. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's Public Reference Room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.~~

~~Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such items will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.~~

FOR FURTHER INFORMATION CONTACT: ~~Benjamin Meeks~~**Brandon Figg**, Special Counsel, or ~~Brandon Figg~~**Kayla**

~~, Attorney-Adviser,~~**Roberts, Special Counsel** in the Office of Structured Finance, Division of Corporation Finance at

(202) 551-3850, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are adopting the following rule under 15 U.S.C. 77a *et seq*. ("Securities Act"):

Commission Reference		CFR Citation (17 CFR)
General Rules and Regulations, Securities Act of 1933	Rule 192	§ 230.192

Table of Contents

I. ~~Introduction~~ INTRODUCTION

A. Background

~~Section 621 of the Dodd-Frank Act[1] added Section 27B to the~~On January, 25, 2023, the Commission proposed new Rule 192 to implement the prohibition in Securities Act Section 27B[1] ("Section 27B")~~.~~,[2] which was added by Section 621 of the Dodd-Frank Act.[3] Section 27B(a) provides that an underwriter, placement agent, initial purchaser, or sponsor, or ~~any affiliate or subsidiary~~affiliates or subsidiaries of any such entity ~~(collectively, "securitization participants"),~~[2], of an asset-backed security ("ABS"), including a synthetic asset-backed security ~~("ABS")~~, shall not, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security, engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity.[3][4] Section 27B(b) further requires that the Commission issue rules for the purpose of implementing the prohibition in Section 27B(a).[4][5]

B.

Section 27B(c) provides exceptions from the prohibition in Section 27B(a) for certain risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities.[5][6]

Summary of the Proposed Rule

Proposed Rule 192 would implement the prohibition in Securities Act Section 27B(a) and, consistent with Section 27B(c), provide exceptions from the prohibition for certain risk-

~~In September 2011, the Commission proposed for comment <a rule designed to implement Section 27B>.[6] The 2011 proposed rule was based substantially on the text of Section~~

~~27B and would have made it unlawful for a securitization participant to engage in any transaction that~~

[1] ~~< Sec. 621, Pub. L. 111-203, 124 Stat. 1376, 1632.>~~

[2] ~~The proposed <definition of "securitization participant" for purposes of >the re-proposed rule is discussed below <in Section II.B.>~~

[3] 15 U.S.C. 77z-2~~(a)~~a.

[4] ~~< 15 U.S.C. 77z-2a(b).>~~

[5] ~~<15 U.S.C. 77z-2a(>c).~~

[6] >*Prohibition Against Conflicts of Interest in Certain Securitizations*<**, Release No. 33-11151 (Jan. 25, 2023) [88 FR 9678 (Feb. 14, 2023)] ("Proposing Release" or "proposed rule"). In Sept. 2011, the Commission proposed** >a rule designed to implement Section 27B<**, but no further action was taken on that proposal.** *See Prohibition against Conflicts of Interest in Certain Securitizations*, Release No. 34-65355 (Sept. 19, 2011) [76 FR 60320 (Sept. 28, 2011)] ~~("2011 Proposing Release" or "2011 proposed rule"). Section 27B is not effective until the adoption of final rules issued by the Commission. Section 621(b) of the Dodd-Frank Act states that "Section <27B of the Securities Act >of 1933, as added by this section, shall take effect on the effective date of final rules issued by the Commission . . . ."~~**.**

[3] >Sec. 621, Pub. L. 111-203, 124 Stat. 1376, 1632.<

[4] >15 U.S.C. 77z-2a(a).<

[5] >15 U.S.C. 77z-2a(b).<

[6] **15 U.S.C. 77z-2a(c).**

~~<would involve or result in any material conflict of interest between the securitization participant and >any investor in an ABS that the securitization participant created or sold at <any time for a period ending on the date that is one year after the date of the first closing of the sale of the >ABS.[7] <Consistent with Section 27B, the >2011 proposed rule would have provided exceptions for risk-mitigating~~**mitigating** hedging activities, liquidity commitments, and bona fide market-making activities.

[7] **The proposal was** ~~**Overview**~~

~~We are proposing new Rule 192 (the "re-proposed rule") pursuant to Section 27B(b), which requires the Commission to issue rules for the purpose of implementing the prohibition in Section 27B(a).[8] Senator Carl Levin stated that the "conflict of interest prohibition . . . is intended to prevent firms that assemble, underwrite, place or sponsor these instruments from making proprietary bets against those same instruments."[9] The re-proposed rule~~ ~~targets~~**intended to target** transactions that effectively represent a bet against a securitization and ~~focuses~~**focus** on the types of transactions that were the subject of regulatory and Congressional investigations ~~and were among the most widely cited examples of ABS-related misconduct during the lead up to~~**following** the financial crisis of ~~2007-2009.[10] For example, according to a Senate report, Goldman Sachs used net short positions to benefit from the downturn in the mortgage market, and designed, marketed,~~**2007-2009.**[8]

In response to the Proposing Release, the Commission received over 900 comment letters from a variety of commenters, including institutional investors, issuers, and various other market participants, professional, policy, and trade associations, Members of Congress, former Federal Government officials, academics, and unaffiliated individuals.[9]

Commenters generally supported the Commission's statutorily-mandated goal of protecting investors by preventing the

[7] *See*~~2011~~ Proposing Release~~at 60320~~ **Section I**I.

[8] ***See* Proposing Release Section I.**

[9] **Comment letters received by the Commission** >are available on our website at< >https://www.sec.gov/comments/<**s7-01-23/s70123.htm. The comment period for the Proposing Release was open for 60 days from issuance and publication on SEC.gov and ended on Mar. 27, 2023. Several commenters said that the comment period was insufficient. *See, e.g.*, letters from American Investment Council dated Mar. 27, 2023 ("AIC"); Investment Company Institute dated Mar. 27, 2023 ("ICI"); National Association of Bond Lawyers et al. dated Mar. 27, 2023 ("NABL et al."); U.S. Representatives Ann Wagner and Bill Huizenga dated Mar. 24, 2023 ("Representatives Wagner and Huizenga"); U.S. Senator John Kennedy dated Mar. 30, 2023 ("Senator Kennedy"). In stating that the comment period was insufficient, some commenters requested an extension (*see, e.g.*, letters from Alternative Investment Management Association and Alternative Credit Council dated Mar. 27, 2023 ("AIMA/ACC"); Association for Financial Markets in Europe dated Mar. 27, 2023 ("AFME"); American Property Casualty Insurance Association et al. dated Feb. 16, 2023 ("APCIA et al."); Loan Syndications and Trading Association dated Mar. 1, 2023 ("LSTA I")) and others indicated that they would submit multiple comment letters, some of which were received after the close of the comment period (*see* letters from Loan Syndications and Trading Association dated Mar. 27, 2023 ("LSTA II"); Loan Syndications and Trading Association dated May 2, 2023 ("LSTA III"); Loan Syndications and Trading Association dated Oct. 30, 2023 ("LSTA IV"); Managed Funds Association dated May 16, 2023 ("MFA II"); Structured Finance Association dated July 13, 2023 ("SFA II"); >Securities Industry and Financial Markets Association<, the Asset Management Group of SIFMA, and the Bank Policy Institute dated June 27, 2023 ("SIFMA II"). Some commenters requested that the Commission re-propose the rule after reviewing the comment letters. *See* letters from American Bar Association dated Apr. 5, 2023 ("ABA"); Andrew Davidson Co. dated Mar. 27, 2023 ("Andrew Davidson"); LSTA III; Securities Industry and Financial Markets Association, the Asset Management Group of SIFMA, and the Bank Policy Institute dated Mar. 27, 2023 ("SIFMA I"). Also, after the close of the comment period, one commenter submitted a letter referencing several of the Commission's proposals and stating that the number of outstanding proposals, together with insufficient time to respond, operated to deprive the public of the ability to meaningfully comment on all of the proposals. *See* letter from Managed Funds Association dated July 24, 2023 ("MFA III"). We have considered comments received since the issuance of the proposed rule, including those received after Mar. 27, 2023, and do not believe an extension of the comment period or a re-proposal of the rule is necessary.**

[8] ~~The numbering of the proposed rule under the 2011 Proposing Release was Rule 127B. Under this re-proposal, the numbering of the re-proposed rule is Rule 192.~~

[9] ~~*See* 156 Cong. Rec. S3470 (daily ed. May 10, 2010) (statement of Sen. Levin).~~

[10] ~~*See, e.g.*, 156 Cong. Rec. S3470 (daily ed. May 10, 2010) (statement of Sen. Levin) ("Goldman Sachs assembled and sold mortgage-related financial instruments, then placed large bets, for the firm's own accounts, against those very same instruments."); *see also* 156 Cong. Rec. S1363 (daily ed. Mar. 10, 2010) (statement of Sen. Levin) ("As has been widely reported, some institutions at the height of the boom in asset-backed securities were creating these securities, selling them to investors, and then placing bets that their product would fail. Phil Angelides, the chairman of the Financial Crisis Inquiry Commission, has likened this practice to selling customers a car with faulty brakes, and then buying life insurance on the driver.").~~

~~and sold collateralized debt obligation ("CDO") securities in ways that created conflicts of interest with the firm's clients.[11] In the 2011 Proposing Release, the Commission recognized that securitization participants may in some circumstances engage in a range of different activities and transactions that give rise to potential conflicts of interest.[12] Securitization markets have undergone various changes since that time, including as a result of other rules that regulate securitization activity that the Commission adopted following the publication of the 2011 Proposing Release.[13] As discussed below in Section III.B.3., while we do not have data on the extent of such conduct following the financial crisis of 2007-2009, we believe that securitization transactions continue to present securitization participants with the opportunity to engage in the conduct that is prohibited by Section 27B. Implementing the prohibition in Section 27B would provide an important safeguard against the misconduct that led up to the 2007-2009 financial crisis. The re-proposed rule would complement the existing Federal securities laws that <specifically apply to securitization, as well as the general anti-fraud and anti-manipulation provisions of the Federal securities laws, ><by explicitly protecting ABS investors against material conflicts of interest.>~~

~~The re-proposed rule takes into account developments in the ABS market since 2011 and the comments received in response to the 2011 proposed rule to provide greater clarity regarding~~

sale of ABS tainted by material conflicts of interest,[10] but many commenters expressed concern that the scope of the proposed rule was overly broad and could have unintended consequences on securitization markets as a whole.[11] While acknowledging that adopting a rule to address conflicts of interest in securitizations is still appropriate, some commenters also stated that the rule as proposed was not appropriately balanced to the current state of

securitization markets in light of the evolution of those markets since the enactment of the Dodd-Frank Act.[12] Section 27B mandates that the Commission issue rules with regard to conflicts of interest in securitizations. While we recognize that securitization markets have evolved in the years since the financial crisis of 2007-2009, we continue to believe that the adopted rule is necessary to prevent the resurgence of the types of transactions that were prevalent leading up to that time.[13] Additionally, we believe that the changes we have made in response to comments regarding the breadth of the proposed rule, which are discussed in detail below, take into account the current state of securitization markets, while still providing strong investor protection against material conflicts of interest in securitization transactions. As discussed in greater detail below, many commenters sought clarification or limitations with respect to the types of transactions and

[10] ***See, e.g.*, letters from ABA; Americans for Financial Reform Education Fund dated June 7, 2023 ("AFR"); Better Markets dated Mar. 27, 2023 ("Better Markets"); Structured Finance Association dated Mar. 27, 2023 ("SFA I").**

[11] ***See, e.g.*, letters from ABA, CRE Finance Council dated Mar. 27, 2023 ("CREFC I"); ICI; Arch Capital Group Ltd., Enact Holdings Inc., Essent Group Ltd., MGIC Investment Corporation, NMI Holdings, Inc., and Radian Group Inc. dated Mar. 27, 2023 ("PMI Industry I"); SFA I; SIFMA I.**

[12] ***See, e.g.*, letters from ABA; SIFMA I. These commenters cited the following as examples of the changes in securitization markets in that time period: the adoption and implementation of 17 CFR 246 ("Regulation RR"), 17 CFR 255 ("the Volcker Rule"), rules regulating swaps and security-based swaps, and changes in the regulation of nationally recognized statistical rating organizations ("NRSROs") to enhance transparency and address >conflicts of interest in connection with the <issuance of ABS.**

~~[11]~~[13] *See, e.g.*, Wall Street and The Financial Crisis: Anatomy of a Financial Collapse, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, United States Senate (Apr. 13, 2011) ("Senate Financial Crisis Report") ~~(describing the role of Goldman Sachs in various transactions, including Abacus 2007-AC1 where "Goldman did not take the short position, but allowed a hedge fund . . . that planned on shorting the CDO to play a major but hidden role in selecting the assets" and that "Goldman marketed Abacus securities to its clients, knowing the CDO was designed to lose value").~~.

financial products that would be subject to the rule,[14] as well as the activities of various market participants that would or would not result in such entities being securitization participants subject to the final rule.[15] Many commenters also expressed concerns that the proposed commencement point of the prohibition timeframe was insufficiently clear to allow market participants to conform their activities for compliance with the rule.[16] Most significantly, commenters expressed general opposition >to the proposed definition of <**"conflicted transaction" as overly broad and stated that it would unnecessarily capture a wide range of activities that are essential to the functioning and issuance of ABS and the routine risk management of securitization participants.[17] Commenters also requested that the final rule include an alternative materiality standard[18] and an "anti-evasion" provision rather than the "anti-circumvention" provision that was proposed.[19] Some commenters also requested that the final rule include a foreign transaction safe harbor to provide clarity with respect to the rule's cross-border application.[20] Finally, the Commission received comments suggesting certain revisions to** >the proposed exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities<.**[21] As we discuss in greater detail below, we have made certain revisions in response to the comments received.**

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[1] >*See* Section II.A<.

[12][15] *See* ~~2011 Proposing Release at 60324~~**Section II.B**.

[16] ***See* Section II.C.**

[17] ***See* Section II.D.**

[18] ***See* Section II.D.3.d.**

[19] ***See* Section II.H.**

[13][20] *See*~~, *e.g.*, discussion of other rules applicable to securitization transactions in Sections~~ **Section** II.A.~~ and III.B.~~3.**c.**

[21] ***See* Sections II.E. through II.G.**

C. Summary of the Final Rule

~~the scope of prohibited and permitted conduct.[14]~~ **New Rule 192 implements** ≥Section 27B to the Securities Act<**.** Fundamentally, the ~~re-proposed~~ rule is intended to prevent the sale of ABS that are tainted by material conflicts of interest~~. It seeks to accomplish this goal~~ by prohibiting securitization ~~participants[15]~~**participants[22]** from engaging in certain transactions that could incentivize a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors. By focusing on transactions that **effectively** represent a "bet" against the performance of an ABS, ~~the re-proposed rule seeks to provide an explicit standard for determining which types of transactions would be prohibited. We believe this standard would~~**Rule 192 will** provide strong **investor** protection against material conflicts of interest **in securitization transactions** while not ~~unnecessarily~~**unduly** hindering routine securitization activities that do not give rise to the risks that Section 27B ~~was~~**is** intended to address.

To achieve these objectives, ~~the re-proposed rule would~~**Rule 192**:

- ~~***Prohibit***~~***Prohibits****, for a specified period, a securitization participant from engaging in any transaction that would result in a* ~~"~~*material conflict of interest*~~"~~ *between the securitization participant and an investor in the relevant ABS.* A securitization participant ~~could~~**may** not, for a period **beginning on the date on which such person has reached an agreement to become a securitization participant with respect to an ABS and** ending on the date that is one year after the date of the first closing of the sale of ~~an~~**such** ABS,[23] directly or indirectly engage in any transaction that would involve or result in ~~any~~**a** material conflict of interest between the securitization participant and an investor in such

ABS. Under the ~~re-proposed~~**final** rule, such transactions ~~would be~~**are** "conflicted transactions" and ~~would~~ include~~, for example,~~ **(i) engaging in** a short sale of

[22] **The**> definition of "securitization participant" for purposes of< **new Rule 192 includes a sponsor, underwriter, placement agent, initial purchaser, and certain affiliates and subsidiaries of such entities, as discussed in detail**> in Section II.B<.

[23] ***See* Section II.C.**

the relevant ABS ~~or the purchase of~~**, (ii) purchasing** a credit default swap or other credit derivative that> entitles the securitization participant to receive payments upon the occurrence of specified credit events in respect of the ABS<**, or (iii) purchasing or selling any financial instrument (other than the relevant ABS) or entering into a transaction that is substantially the economic equivalent of the aforementioned transactions, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk.[24] Transactions unrelated to the idiosyncratic credit performance of the ABS, such as reinsurance agreements, hedging of general market risk (such as interest rate and foreign exchange risks), or routine securitization activities (such as the provision of warehouse financing or the transfer of assets into a securitization vehicle) are not "conflicted transactions" as defined by the rule, and thus are not subject to the prohibition in 17 CFR 230.192(a)(1) ("Rule 192(a)(1)");[25]**

~~[14] Comments received on the 2011 proposed rule <are available on our website at >< ><https://www.sec.gov/comments/>s7-38-11/s73811.shtml.~~

~~[15] *See* Section II.B.~~

~~<entitles the securitization participant to receive payments upon the occurrence of specified credit events in respect of the ABS>;~~[16]

- ~~*Define*~~ ***Defines*** *the persons that* ~~*would be*~~***are*** *subject to the* ~~*re-proposed rule.*~~ ~~The~~ ***rule.*** **A securitization participant includes any** ≥underwriter, placement agent, initial purchaser, or sponsor of an ABS ≤**(each as defined by 17 CFR 230.192(c) ("Rule 192(c)") and also includes any affiliate or subsidiary that acts in coordination with an underwriter, placement agent, initial purchaser, or sponsor or that has access to, or receives information about, the relevant ABS or the asset pool underlying or referenced by the relevant ABS prior to the first closing of the sale of the relevant ABS. The final rule includes functional definitions for the** terms "underwriter," "placement agent," "initial purchaser," and "sponsor~~" (collectively, together with their affiliates and subsidiaries, "securitization participants") would capture the persons subject to the re-proposed rule and would be functional definitions based on a~~**," which are based on the** person's activities in connection with a securitization~~, which would~~ **and are** generally ~~be~~ based on existing ~~definitions of such terms under the Federal securities laws and the rules thereunder to ease compliance with the re-proposed rule;~~[17]

[24] ***See*** **Section II.D.**
[25] ***Id.***

definitions of such terms under the Federal securities laws and the rules thereunder.[26] The definition of "sponsor" in the final rule excludes: (i) a person that acts solely pursuant to such person's contractual rights as a holder of a long position in the ABS; (ii) any person >that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, <**assembly, or ongoing administration of an** >ABS or the composition of the <**underlying pool of assets;[27] and (iii)** >the United States or an agency of the United States with respect to any <**ABS** >that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States<**;[28]**

- ~~*Define*~~***Defines*** *asset-backed securities that* ~~*would be*~~***are*** *subject to the prohibition.* ~~Prohibited transactions would be those with respect to~~**Under the final rule,** an "asset-backed security~~.~~" ~~An "~~**subject to the prohibition is defined, consistent with Section 27B, to include** asset-backed ~~security", for purposes of the re-proposed rule, would be~~**securities as** defined ~~based on the~~**in** Section 3 ~~definition of asset-backed security in the Securities~~**of the** Exchange Act of 1934 ("Exchange **Act")[29] and also includes synthetic ABS and hybrid cash and synthetic ABS;[30]**

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[16] ~~The proposed definition of "conflicted transaction" would also include any purchase or sale of any other <financial instrument (other than the relevant ABS) or >entry into a transaction through which the securitization participant would benefit from certain actual, anticipated, or potential adverse events <with respect to the relevant ABS or >its underlying asset pool. *See* Section II.D.~~

[26] **Rule 192(c) also defines "distribution" as used in the definition for "underwriter" and "placement agent." *See* Section II.B.**

[27] **As discussed in greater detail below, this exclusion includes accountants, attorneys, and credit rating agencies with respect to** >the creation and sale of an ABS <**and the activities customarily performed by trustees, custodians, paying agents, calculation agents, and other contractual service providers, including servicers. *See* Section II.B.3.b.iii.**

[17][28] ~~The~~**As discussed in greater detail below, we are not adopting** proposed ~~definition~~**paragraph (ii)(B)** of the ~~term~~ "sponsor" ~~would not include <the United States or an agency of the United States with respect to any>~~**definition, which would have captured any person that directs or causes the direction of the structure, design, or assembly of an** asset-backed security ~~<that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States>. The proposed~~**or the composition of the pool of assets underlying the asset-backed security. *See* Section II.B.3.b.ii. We are also not adopting the proposed**

exclusion from the definition of "sponsor" ~~would also not include~~**for** the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac" and, together with Fannie Mae, the "Enterprises") while operating under **the** conservatorship or receivership of the Federal Housing Finance Agency ("FHFA") with capital support from the United States with respect to any ~~asset-backed security~~**ABS** that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity. *See* Section II.B.**3.b.iv.**

[29] > 15 U.S.C. 78a *et seq*.<

[30] **For purposes of this rule**>, we use the term "cash ABS" to refer to ABS where the underlying pool consists of one or more financial assets. We use the term "hybrid cash and synthetic ABS" to refer to ABS where the underlying pool consists of one or more financial assets as well as synthetic exposure to other assets. <>*See* Section II.A.<

~~Act")[18] and also would specifically include synthetic ABS, as well as hybrid cash and synthetic ABS[19], which <is consistent with Section 27B>;[20] and~~

- ~~***Provide certain***~~***Provides*** *exceptions to the prohibition*~~. The re-proposed rule would implement certain exceptions~~ *for risk-mitigating hedging activities,* ***liquidity commitments, and*** *bona fide market-making activities*~~, and liquidity commitments as~~**. These exceptions, which are** specified in Section 27B~~. The proposed exceptions would focus on distinguishing the characteristics of such activities from speculative trading. The proposed exceptions would also seek to avoid disrupting current liquidity commitment, market-making, and balance sheet management activities that we do not believe would <give rise to the risks that Section 27B was intended to address.>[21] We believe that the re-proposed rule would help to prevent the abusive conduct that~~**, permit certain market activities, subject to satisfaction of the specified conditions, that would otherwise be prohibited by the rule;[31]**

~~<Section 27B is designed to prevent >by reducing the incentive for <a securitization participant to structure an ABS in a way that >would put <the securitization participant's interests ahead of >those of ABS investors.~~

- ***Addresses evasion of the exceptions.*** **Under 17 CFR 230.192(d) ("Rule 192(d)"), if a securitization participant engages in a transaction or series of related transactions that, although in technical compliance with the exception** >for risk-mitigating hedging activities, liquidity commitments, or bona fide market-making activities<**, is part of a plan or scheme to evade the prohibition in Rule 192(a)(1), that transaction or series of related transactions will be deemed to violate the prohibition;[32] and**

- ***Provides a safe harbor for certain foreign transactions*. Pursuant to 17 CFR 192(e) ("Rule 192(e)"), the prohibition will not apply to an asset-backed security if it is not issued by a U.S. person (as defined in 17 CFR 902(k) ("Rule 902(k) of Regulation S") and the offer and sale of the asset-backed security is in compliance with 17 CFR 203.901 through 905 ("Regulation S").[33]**

We discuss in greater detail below the securitization transactions and participants subject to Rule 192's prohibition, the timeframe during which the prohibition applies, the types of transactions that are prohibited by Rule 192 and the related exceptions, and the compliance date by which securitization participants must conform their activities with the requirements of the final rule. As adopted, Rule 192 will complement the existing federal securities laws that

[31] ***See* Sections II.E. through II.G.**

[32] ***See* Section II.H.**

[33] ***See* Section II.A.3.c.**

>specifically apply to securitization, as well as the general anti-fraud and anti-manipulation provisions of the Federal securities laws,<[34] >by explicitly protecting ABS investors against material conflicts of interest.<

II. ~~Discussion of Proposed Rule~~ DISCUSSION OF RULE 192

A. Scope: ~~Transactions with respect to ABS~~Asset-Backed Securities

1. Proposed Definition of Asset-Backed Security

~~Under~~The Commission proposed ~~Rule 192(a)(1),~~to prohibit a securitization participant ~~would be prohibited~~, for a specified ~~time~~ period of time with respect to an asset-backed security, from engaging in any transaction that would involve or result in a material conflict of interest between such securitization

~~[18]< 15 U.S.C. 78a *et seq*.>~~

~~[19] For purposes of this release<, we use the term "cash ABS" to refer to ABS where the underlying pool consists of one or more financial assets. We use the term "hybrid cash and synthetic ABS" to refer to ABS where the underlying pool consists of one or more financial assets as well as synthetic exposure to other assets.>~~

~~[20]< *See* Section II.A.>~~

~~[21] For example, the proposed <exceptions for risk-mitigating hedging activities and bona fide market-making activities >are similar to the equivalent exceptions under other rules applicable to certain securitization participants and other financial institutions. *See* discussion <below in Sections II.E. through II.G.>~~

participant and an investor in such asset-backed security. ~~For purposes of the re-proposed rule,~~ >Consistent with Section 27B, the <**Commission proposed that** the term "asset-backed security" would ~~be~~**include ABS as** defined in ~~proposed Rule 192(c) to have the same meaning as set forth in~~ Section 3 of the Exchange ~~Act[22]~~**Act[35]** ("Exchange Act ABS") (which~~, by extension, means that the re-proposed rule would cover~~ **encompasses** both registered and unregistered offerings)~~ and also would include synthetic ABS~~**,** as well as **synthetic ABS and** hybrid cash and synthetic ABS.~~ This approach is consistent with Section 27B[23] and the views of certain commenters who supported the 2011 proposed rule's definition of asset-backed security, which was based on the Exchange Act ABS definition[24] and also included synthetic ABS.[25] The Exchange Act ABS definition captures fixed-income and other securities <that are collateralized by any type of self-liquidating >asset,[26] regardless of whether the ABS is registered with the Commission under the Securities Act. We are proposing a definition of the term "asset-backed security" that includes Exchange Act ABS primarily for consistency with Section 27B(a). Additionally, we believe that it is appropriate for the definition to apply both to ABS sold in offerings registered with the Commission and ABS sold in offerings that are exempt from registration because both types of offerings could present securitization participants with the opportunity to engage in the conduct that is prohibited by Section 27B<. In particular, we note that a >number of the transactions that[36] **The Commission did not propose a definition of "synthetic ABS" due to concerns that any such definition could be potentially overinclusive or underinclusive, and** >that a securitization participant might attempt to evade the <**prohibition by structuring transactions around a particular definition, despite creating a**

product that is substantively a synthetic ABS, as that term is commonly understood in the market.[37]

[34] ***See, e.g.*, Section 17(a) of the Securities Act of 1933 (15 U.S.C. 77q), Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j) and 17 CFR 240.10b-5.**

[35] **17 >U.S.C. 78c(a)(<79). An Exchange Act ABS is defined as "a fixed-income or other security collateralized by any type of self-liquidating financing asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset..."**

[36] ***See* Proposing Release Section II.A.**

[37] ***See* Proposing Release Section II.A.**

2. Comments Received

Commenters generally supported the proposal to define "asset-backed security" for purposes of Rule 192 to include Exchange Act ABS, synthetic ABS, and hybrid cash and synthetic ABS,[38] though several commenters requested additional clarification regarding certain types of financial products and securities,[39] or that certain securities be excluded from the definition,[40] which we discuss in greater detail below. With respect to the proposed rule's inclusion of Exchange Act ABS in the definition of ABS, commenters generally supported the decision to incorporate the Exchange Act definition,[41] with some agreeing that market participants are familiar with analyzing whether a given security meets the definition and that there is common market understanding of whether Commission rules that use the Exchange Act ABS definition apply to them.[42] Other commenters disagreed, however, stating that it remains unclear to them whether certain securities would be captured by the definition as proposed.[43] Additionally, several commenters requested that the final rule include definitions for "synthetic

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[38] ***See, e.g.***, letters from ABA; AFR; Better Markets; ICI.

[39] ***See, e.g.***, letters from ABA (seeking, ***e.g.***, clarification with respect to reliance on existing guidance regarding a transaction's status as an asset-backed security); NABL et al. (indicating confusion regarding whether certain municipal securities are Exchange Act ABS); PMI Industry I (seeking clarification that mortgage insurance-linked notes are not synthetic ABS).

[40] ***See, e.g.***, letters from AFME (urging that the final rule include a safe harbor for ABS transactions that are not offered or sold to U.S. investors as part of the primary issuance); National Association of Health and Educational Facilities Finance Authorities dated Mar. 27, 2023 ("NAHEFFA") (requesting that single-asset conduit bonds be excluded from the definition of asset-backed security); NABL et al. (requesting that municipal securities be excluded from the definition of asset-backed security); SIFMA I (requesting that the Commission exclude corporate debt, insurance products, and Section 4(a)(2) private placement transactions from the definition of asset-backed security).

[41] ***See, e.g.***, letters from ABA; ICI; SIFMA I.

[42] ***See, e.g.***, letters from ABA; ICI. For example, one commenter expressed the view that common market understanding is that investment funds registered under the Investment Company Act of 1940 do not issue ABS and that their securities are not considered Exchange Act ABS. ***See*** letter from ICI. Whether such securities are Exchange Act ABS will depend on the characteristics and structure of the security.

[43] ***See, e.g.***, letters from NAHEFFA; NABL et al.

ABS"[44] and "hybrid cash and synthetic ABS"[45] to provide clarity regarding the scope of transactions that are subject to the prohibition in Rule 192. The Commission also received comments suggesting that we adopt a safe harbor for ABS transactions offered and sold outside of the United States.[46] Finally, while some commenters agreed that Rule 192's prohibition should not be limited >to ABS transactions that are intentionally <**"designed to fail,"[47] others expressed the view that Section 27B targets only ABS that are intentionally "designed to fail."[48]**

3. Final Rule

We are adopting, as proposed, a definition of "asset-backed security" for purposes of the prohibition in Rule 192(a)(1). As discussed below, under the final rule, "asset-backed security" will be defined to mean an Exchange Act ABS, a synthetic ABS, and a hybrid cash and synthetic ABS.[49] Rule 192, therefore, will apply to offerings of asset-backed securities as defined in Rule 192(c), regardless of whether the offerings are registered or unregistered. Consistent with the proposal, we are not adopting a definition for "synthetic ABS" or "hybrid cash and synthetic ABS." In response to comments received, final Rule 192 includes a safe harbor for certain foreign securitizations, which is discussed in greater detail in Section II.A.3.c. Finally, Rule 192 does not require that an ABS was intentionally "designed to fail" for the ABS to be subject to the prohibition against engaging in conflicted transactions. Section 27B does not contain language referencing an intent element and provides, in relevant part, that securitization participants "of an asset-backed security ... shall not ... engage in any transaction that would involve or result in

[44] ***See*** **letters from ABA; AFME; AIMA/ACC; ICI; SFA I; SFA II; SIFMA I; SIFMA II.**

[45] ***See*** **letter from AIMA/ACC.**

[46] ***See, e.g.*****, letters from ABA; AFME; AIC; SFA I; SFA II; SIFMA I; SFA II.**

[47] ***See*** **letters from AFR; Better Markets.**

[48] ***See, e.g.*****, letters from AIC; American Securities Association dated Mar. 23, 2023 ("ASA").**

[49] **17 CFR 230.192(c).**

any material conflict of interest."[50] The statutory text refers plainly to asset-backed securities (as defined in Section 3 of the Exchange Act and including synthetic ABS); it does not indicate that the ABS must have been intentionally designed to fail to be subject to the prohibition. As discussed below, further narrowing the scope in this way could reduce the effectiveness of the rule to prophylactically prevent these >types of material conflicts of interest <**with investors.[51] This, in turn, would frustrate the statutory mandate of Section 27B.**

a. Exchange Act ABS

Section 27B imposes a prohibition on transactions that would involve or >result in a material conflict of interest, <***i.e.*, a conflicted transaction under 17 CFR 230.192(a)(3) ("Rule 192(a)(3)"), and specifies that the prohibition applies to Exchange Act ABS. As a general matter, asset-backed securities differ from other types of securities because the securities are issued by a special purpose entity that has no business activities other than holding or owning the assets supporting the ABS and other activities reasonably incidental thereto.[52] As specified in the Exchange Act ABS definition, an asset-backed security is a security collateralized by any "self-liquidating financial asset."[53]**

The Commission received various comments requesting clarification about whether certain products and securities would be captured by the Rule 192 ABS definition and further requesting that, for the avoidance of doubt, certain products and securities be exempt from the

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~~[33]~~[50] ~~17~~ 15 U.S.C.~~78c~~ **77z-2**a(a~~(79)~~).

[51] ***See also*** **Sections II.B.3. and II.D. for additional discussions about why the final rule does not include a knowledge- or intent-based standard for securitization participants or conflicted transactions.**

[23] ~~Section 27B applies to an "asset-backed security (as such term is <defined in section 3 of the >Securities and Exchange Act of 1934 . . . which for purposes of this section shall include a synthetic asset-backed security)."~~

[24] ~~*See* comment letter from Better Markets, Inc. (Feb. 13, 2012) ("Better Markets Letter") at 4; comment letter from U.S. Senators Jeff Merkley and Carl Levin (Jan. 12, 2012) ("Merkley-Levin Letter") at 4.~~

[25] ~~*See* Merkley-Levin Letter at 4.~~

[26] ~~The Commission has described a "self-liquidating asset" as an asset that by its terms converts into cash payments within a finite time period.~~ [52] *See* Section III.A.2. of *Asset-Backed Securities*, Release No. 33-8518 (Dec. 22, 2004) [70 FR 1506 (Jan. 7, 2005)] ("2004 Regulation AB Adopting Release").

[53] **17** >U.S.C. 78c(a)(<**79).**

definition.[54] For example, several commenters requested that the rule exempt certain municipal securities from being ABS subject to the prohibition in 17 CFR 230.192(a) ("Rule 192(a)").[55] These commenters generally stated that certain municipal securities, including single-asset conduit bonds,[56] are structured and sold to achieve certain policy goals for the benefit of the government entity's citizens and that municipal issuers of such securities are subject to strict investment policies and federal and state statutes that limit their ability to engage in speculative investments, making it unlikely that relevant securitization participants could engage in conflicted transactions, therefore rendering the application of Rule 192 to municipal transactions unnecessarily burdensome.[57] Municipal securitizations >that are collateralized by any type of self-liquidating <**financial asset and that allow the holder of the security to receive payments that**

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[54] **As discussed in greater detail below, one commenter stated that it was unclear whether certain municipal securities meet the definition of Exchange Act ABS. We also note that municipal market participants are already required to analyze**> whether such a security meets the Exchange Act ABS definition< **and whether other Commission rules implementing various provisions of the Dodd-Frank**> Act that use the Exchange Act ABS definitio<**n, such as Regulation RR, 17 CFR 240.15Ga-1(a) ("Exchange Act Rule 15Ga-1"), and 17 CFR 240.17g-7(a)(1)(ii)(N) ("Exchange Act Rule 17g-7") are applicable. *See* Proposing Release Section II.A.**> *See also* Section IV.A.D.6<> of *Credit Risk Retention*, Release No. 34-70277 (Aug. 28, 2013) [78 FR 57928 (Sept. 20, 2013)]< **("RR Proposing Release") (explaining why an exemption from risk retention for securitizations of tax lien-backed securities sponsored by municipal entities was not proposed) and**> *Credit Risk Retention*, Release No. 34-73407 (Oct. 22, 2014) [79 FR 77602 (Dec. 24, 2014)] (<**"RR Adopting Release") at 77661 (adopting certain provisions that apply to municipal tender option bonds) and 77680 (explaining why separate loan underwriting criteria for single borrower or single credit commercial mortgage transactions were not adopted). Because participants in this market are already required to consider whether a municipal security meets the definition of Exchange Act ABS to determine whether such offering must comply with other rules and regulations adopted under the Securities Act and Exchange Act, we believe that concerns relating to burdens associated with determining whether or not a municipal security is an Exchange Act ABS for purposes of compliance with Rule 192 will be mitigated.**

[55] ***See, e.g.*, letters from ASA; NABL et al.; NAHEFFA; SIFMA I; Wulff, Hansen & Co. dated Apr. 14, 2023 ("Wulff Hansen"). *See also* Section II.B. for a discussion of comments received related to municipal issuers and the definition of "sponsor" in the final rule.**

[56] **As described by one commenter, a single-asset conduit bond is a tax-exempt bond issued by state and local governments for the benefit of tax-exempt organizations (as defined under Section 501(c)(3) of the Internal Revenue Code). The proceeds of the bond issuance are used to make a single loan to a single 501(c)(3) borrower, such as a hospital, higher education institution, provider of housing for elderly or low-income populations, museum, or other non-profit entity. The government issuer assigns the loan agreement to the bond trustee, which receives the borrower's loan payments (which mirror the government issuer's payment obligations on the bond) and makes those payments to the bondholders. *See* letter from NAHEFFA.**

[57] ***See, e.g.*, letters from ASA; NABL et al.; NAHEFFA; letter from National Association of Municipal Advisors dated Mar. 31, 2023 ("NAMA"); SIFMA I.**

depend primarily on the cash flow from such self-liquidating financial asset fall within the Exchange Act ABS definition. While it may be the case, as discussed above, that a municipal issuer is subject to restrictions that may limit their ability to engage in conflicted transactions, other parties to the securitization may not be subject to such restrictions and would therefore have the opportunity to engage in transactions that bet against the municipal ABS. For example, as one commenter stated, persons involved in municipal securitizations, such as the underwriter, may enter into swaps to mitigate risk associated with the security.[58] Such swaps or other transactions could be conflicted transactions if they meet the definition in Rule 192(a)(3).[59] We see no reason, therefore, why municipal securities that meet the definition of Exchange Act ABS (and are consequently subject to other federal securities laws), and which, like other Exchange Act ABS, involve securitization participants, such as an underwriter, that would have an opportunity to engage in conflicted transactions, >should be exempted from the <definition of ABS—and, thus, the prohibition against conflicts of interest—for purposes of this rule.[60]

With respect to single-asset conduit bonds, one commenter stated that the market (both municipal and non-municipal) does not consider a conduit bond backed by a single loan to be an asset-backed security.[61] This commenter further stated that, by referencing Exchange Act ABS instead of the definition of ABS included in Regulation AB, the Commission was using a broader definition and "eliminating" the requirement that an asset-backed security include a

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[58] *See* letter from ASA.

[59] *See* Section II.D.

[60] **See Section II.B.3.b. for a discussion of the definition of a "securitization participant" with respect to municipal securitizations.**

[61] **See letter from NAHEFFA.**

"pool"[62] of financial assets.[63] The commenter described this as a "novel application" of the Exchange Act ABS definition.[64] We disagree with the commenter's characterization of the proposed definition. Section 27B, which was added by Section 621 of the Dodd-Frank Act, specifically states that the prohibition shall apply to ABS as defined in Section 3 of the Exchange Act, and the definition in Section 3 was added by Section 941 of the Dodd-Frank Act. Defining "asset-backed security" for purposes of Rule 192 by referencing Exchange Act ABS, therefore, >is consistent with Section 27B. <**As the Commission has previously stated, an ABS that is backed by a single obligation would meet the definition of Exchange Act ABS.[65] Therefore, referring to Exchange Act ABS in identifying the types of ABS subject to the final rule is consistent with Section 27B and the inclusion of single-asset conduit bonds that meet the definition of Exchange Act ABS is consistent with our prior interpretation of both definitions.[66] Moreover, if we were to adopt an exemption for transactions collateralized by a single, self-liquidating asset, it would**

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[62] **The definition of "asset-backed security" in Regulation AB Item 1101(c) ("Regulation AB ABS"), which was adopted for the limited purpose of identifying an ABS that is**> eligible for the specialized registration and reporting regime under Regulation A<**B, defines an "asset-backed security," in relevant part, as a security that is primarily serviced by the cash flows of a "discrete pool of receivables or other financial assets..." *See* 17 CFR 229.1101(c). Additionally, the word "pool" in the Regulation AB ABS definition does not require that the ABS be collateralized by more than one asset. Instead, it is part of the phrase "discrete pool" in the definition, which indicates the general absence of active pool management, and emphasizes the self-liquidating nature of pool assets. *See, e.g.*, Section III.A.2. of**> 2004 Regulation AB Adopting Release<.

~~were the subject of regulatory and Congressional investigations in the wake of the financial crisis of 2007-2009 involved unregistered ABS offerings.[27]~~

~~We received comment in response to the 2011 proposed rule requesting clarification whether certain products, such as certain types of municipal securities, would be Exchange Act ABS.[28] Municipal securitizations[29] that are collateralized by any type of self-liquidating financial asset <that allows the holder of the security to receive payments that depend primarily on the~~

>cash flow from such self-liquidating financial asset fall within the Exchange Act ABS definition and are, for example, already subject to the rules adopted in 2011 to implement Section 943 of the Dodd-Frank Act[30] and the rules adopted in 2014 to implement the credit risk retention requirements of Section 941 of the Dodd-Frank Act.[31] In this regard, we believe that

[27][63] *See supra* note 10**letter from NAHEFFA**.

[64] ***Id.***

[28] *See* comment letter from The <Securities Industry and Financial Markets Association >(Feb. 13, 2012) ("SIFMA Letter") at 17.

[29] Most municipal entities do not typically issue ABS directly. Under the re-proposed rule, a municipal entity would be a sponsor of municipal ABS if the municipal entity met the proposed definition of "sponsor." Further, a municipal entity would be subject to the re-proposed rule's prohibition to the extent the municipal entity was a sponsor and the municipal ABS were Exchange Act ABS. *See* Section II.B. for discussion <of the proposed definition of "sponsor>" and its application to municipal entities. *See also* request for comment 9 regarding other parties related to a municipal securitization that could be "securitization participants" under the re-proposed rule.

[30] *See* Sections II.A.1. and II.A.3. of *Disclosure For Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Release No. 33-9175 (Jan. 20, 2011) [76 FR 4489 (Jan. 26, 2011)] (stating the broader definition of Exchange Act ABS and its application to municipal securities, such as student loan bonds, housing, and mortgage bonds). For a discussion of municipal securitizations, see generally Robert A. Fippinger, The Securities Law of Public Finance, Chapter 4 (3rd. ed. Practicing Law Institute, Sept. 2011, Supplement Oct. 2022).

[31] 17 CFR 246 ("Regulation RR"). *See* < *Credit Risk Retention*, Release No. 34-73407 (Oct. 22, 2014) [79 FR 77602 (Dec. 24, 2014)] (">[65] ***See, e.g.*, Section V.B.2. of the** RR Adopting Release") at 77661 (adopting certain provisions that apply to municipal tender option bonds). <*See also* Section IV.A.D.6>. <of *Credit Risk Retention*, Release No. 34-70277 (Aug. 28, 2013) [78 FR 57928 (Sept. 20, 2013)]> **(explaining why separate loan underwriting criteria for single borrower or single credit commercial mortgage transactions were not adopted) and Section IV.D.6. of RR Proposing Release** (explaining why an exemption from risk retention for securitizations of tax lien-backed securities sponsored by municipal entities was not proposed). Also,***See also* Proposing Release Section II.A., n. 31 (stating that** an ABS that is backed by a single asset or one or more obligations of a single borrower (often referred to as "single asset, single borrower" or "SASB" transactions) meets the definition of an Exchange Act ABS. *See* RR Adopting Release at 77680 (explaining why separate loan underwriting criteria for single borrower or single credit commercial mortgage transactions were not adopted).

[66] **Analyzing whether a municipal single-asset conduit bond is an ABS entails a consideration of the nature of the activities of the issuing entity. For example, if the issuing entity is authorized to extend credit or make loans and it engages in activities in addition to holding or owning the underlying single obligation supporting the bonds, or in addition to other activities reasonably incidental to holding or owning the underlying obligation, the securities it issued will not be an ABS.**

provide the opportunity for securitization participants to structure offerings as a series of transactions that would serve to evade the rule. For these reasons, we decline to include such an exemption from the definition of "asset-backed security."

One commenter suggested that we exclude direct private placement transactions exempt from registration under Section 4(a)(2) of the Securities Act,[67] stating that the ABS purchasers in such transactions are highly sophisticated investors that participate directly in nearly all phases of the structuring and creation of the ABS.[68] The commenter stated that such investor involvement renders the risk of a securitization participant entering into a separate transaction that gives rise to a material conflict of interest very low.[69] As discussed in the Proposing Release, and as we continue to believe, even if an investor is involved in asset selection or has access to information about those assets, such investor may not be aware of the involvement of other parties, nor does the participation of one investor in asset selection necessarily protect any other investors in the ABS.[70] We see no reason why investors in ABS sold in a Section 4(a)(2) private offering should not receive the protections provided by Section 27B that are available to all investors. Rather, excluding these transactions would place the burden on investors to confirm or otherwise negotiate for transaction terms to require that securitization participants not engage in bets against the ABS. Furthermore, excluding transactions that rely on Section 4(a)(2) would also result in excluding from the rule ABS sold to an initial purchaser in furtherance of

[67] 15 U.S.C. 77d. Section 4(a)(2) permits, without registration, the offer and sale of securities that do not involve a public offering.

~~market participants are familiar with analyzing <whether such a security meets the Exchange Act ABS definition >as the Commission has adopted other rules and regulations under the~~

~~Securities Act and the Exchange <Act that use the Exchange Act ABS definition >or a substantially similar definition.[32] Therefore, we believe that the re-proposed rule's definition of "asset-backed security" is sufficiently clear. We seek comment below on whether the re-proposed rule should provide additional specificity regarding the types of ABS that would be covered by the re-proposed rule.~~

~~We also received comment suggesting an exclusion from the rule for certain types of ABS, including ABS with underlying assets for which information is readily available or where the investor is involved in asset selection.[33] However, even if an investor is involved in asset selection or has access to information regarding the underlying assets, such investor may not know of the involvement of other parties with a potential conflict of interest. Such an investor would not necessarily know to be alert for potential selection of assets or structuring of an ABS that might disadvantage such investor.[34] Also, the participation of one investor in asset selection would not necessarily protect any other investors. Accordingly, the Commission does not believe that such an exclusion would be appropriate.~~

~~We also received comment on the 2011 proposed rule recommending that the rule should only cover synthetic ABS because greater risk arises out of synthetic ABS.[35] However, Section~~

[32] ~~*See, e.g.*, 17 CFR 240.15Ga-1(a), 17 CFR 240.17g-7(a)(1)(ii)(N), and 17 CFR 246.2. Similarly, regarding a commenter's request that we also specify whether mutual funds, exchange traded funds, or certain other products would be Exchange Act ABS (*see* SIFMA Letter at 17), we believe that there is a common market understanding of whether such products are Exchange Act ABS and whether other rules that use the definition of Exchange Act ABS, such as Regulation RR, apply to them.~~

[3268] *See~~, e.g.,~~* **letter from** SIFMA ~~Letter at 37-38~~**I**.

[69] ***Id*.**

[3470] ***See* Proposing Release Section II.A.** Moreover, even if an investor were aware of a potential conflict of interest, ~~the re-proposed rule~~**Rule 192** does not include an exception based on disclosure of material conflicts of interest~~, as discussed below~~ **because such an exception would be inconsistent with the prohibition** in Section **27B. *See* Section** II.D. **for a discussion of comments received related to** >the use of disclosure to <**mitigate conflicts of interest.**

[35] ~~*See* comment letter from Association of Institutional Investors (Feb. 13, 2012) ("AII Letter") at 4-5.~~

resales in compliance with Securities Act Rule 144A.[71] As a result, purchasers of that ABS in the immediately subsequent Rule 144A transaction would not benefit from the protections afforded by the rule. Consequently, we believe that such an exclusion to the ABS definition would not be appropriate. Therefore, any securities that meet the definition of "asset-backed security," as adopted for purposes of Rule 192, will be subject to the prohibition in Rule 192(a), whether registered or unregistered.

The Commission also received comments requesting exclusions or clarifications regarding certain financial products and securities that the Commission has not historically viewed as asset-backed securities.[72] Some commenters sought clarification that insurance policies or contracts (and securities related to those insurance products, such as mortgage insurance linked-notes ("MILNs")[73]) and corporate debt securities are not Exchange Act ABS.[74] Insurance policies and contracts, such as private mortgage insurance contracts, are not securities,[75] and therefore are not Exchange Act ABS subject to Rule 192. MILNs are reinsurance products used by insurance companies to obtain reinsurance coverage for a portion of their risk related to private mortgage insurance policies, which assist homebuyers in obtaining low-down payment mortgages.[76] The collateral for the MILN are the private mortgage insurance contracts, which are not self-liquidating financial assets.[77] Corporate debt securities are issued

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[71] 17 CFR 230.144A. For example, collateralized loan obligations ("CLOs") are typically sold> in a private placement to one or more initial< purchasers in reliance on Section 4(a)(2) (which is only available to the issuer>), followed by resales of the securities to "qualified institutional buyers" in< compliance with Rule 144A.

[72] ***See, e.g.***, letters from ABA; Representative Nickel et al.; SFA I; SIFMA I.

[73] ***See also*** note 80, and the accompanying text for a discussion regarding funding agreement-backed notes.

[74] ***See*** letters from AFME; ABA; SIFMA I.

[75] 15 U.S.C. 77c.

[76] ***See, e.g.***, letter from ABA.

[77] **For additional discussion regarding mortgage insurance-linked notes, and why the existing structures do not satisfy the criteria to be synthetic ABS or "conflicted transactions," see Sections II.A.3.b. and II.D.**

~~27B <specifies that the prohibition applies to >both Exchange Act ABS and synthetic ABS, and the misconduct that Section 27B is designed to prevent can occur with respect to both synthetic ABS and non-synthetic ABS. For example, a securitization participant could enter into a bilateral credit default swap ("CDS") contract referencing a non-synthetic ABS in order to bet against the performance of the ABS. Therefore, excluding non-synthetic ABS from the re-proposed rule would be inconsistent with the conflict of interest protection intended by Section 27B.~~

by a corporate issuer and represent direct payment obligations of the corporate issuer.[78] The corporate issuer is ultimately responsible for payment on the debt, compared to asset-backed securities that are issued by a special purpose issuing entity where payment depends primarily on the cash flow from an underlying self-liquidating financial asset. In each of these cases, the securities do not meet the definition of Exchange Act ABS and, therefore, are not asset-backed securities as defined in Rule 192(c).[79]

One commenter also requested clarification that, where the Commission or its staff has already provided guidance stating that a financial product or security would not be an asset-backed security, such products or securities would not be asset-backed securities under Rule 192(c) and thus would not be subject to the prohibition.[80] The definition of asset-backed security we are adopting in Rule 192(c) does not change the Exchange Act ABS definition, nor does it impact existing Commission guidance or staff positions regarding that definition. Market participants may, therefore, continue to look to such guidance or staff positions unless and until they are changed, withdrawn, or otherwise superseded, as applicable.

~~With regard to synthetic ABS, we received comment suggesting that the term "synthetic ABS" should be defined.[36] In contrast, we also received comment that a definition of the term "synthetic ABS" is not warranted because the~~

~~term is well understood.[37] The re-proposed rule does not define "synthetic ABS."~~

~~We~~**b. Synthetic ABS and Hybrid Cash and Synthetic ABS As discussed in the Proposing Release, we** have previously described synthetic securitizations~~, in general, as securitizations~~ **as transactions** that are designed to create exposure to an asset that is not

[78] ***See, e.g.*, letter from SIFMA I.**

[79] ***See* 17 CFR 230.192(c).**

[80] ***See* letter from ABA. This commenter provided the example of an existing staff position indicating that funding agreements between an insurance company and a special purpose entity, where the insurance company is directly liable for the funding agreement that backs the notes, is not an Exchange Act ABS. *See* Regulation AB Compliance & Disclosure Interpretation 301.03 (updated Sept. 6, 2016), *available at* https://www.sec.gov/corpfin/divisionscorpfinguidanceregulation-ab-interpshtm. These interpretations, and any other staff statements referenced in this release, represent the views of SEC staff. They are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved their content. Staff statements have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.**

transferred to or otherwise part of the asset pool.[38] These synthetic transactions are, generally effectuated through the use of derivatives such as a **credit default swap ("**CDS**")** or a total return swap, **(**or an ABS structure that replicates the terms of such a swap**)**. We believe that our previous descriptions of synthetic securitizations are well understood by market participants and adequately address the key issues raised by commenters, and that market participants have been able to readily distinguish synthetic ABS from other types of transactions. We are concerned that any particular definition of "synthetic ABS" that we might propose would be susceptible to potential overinclusiveness or[81] **The Commission received several comment letters requesting that we adopt a definition of "synthetic asset-backed security"[82] and "**>hybrid cash and synthetic asset-backed security<**"[83] to address what the commenters said was a lack of certainty with respect to the scope of Rule 192. Some of these commenters offered suggestions for a definition of synthetic ABS that they believe represent market understanding of the term and that would appropriately capture the types of transactions that Section 27B and Rule 192 are intended to cover.[84] While the text of the suggested definitions vary, including with respect to the level of specificity, they include a number of common elements, generally identifying synthetic ABS as a security issued by a special-purpose entity, secured by one or more credit derivatives or similar financial instrument that references a self-liquidating financial asset or pool of assets, and for which payment to the investor is dependent primarily on the performance of such reference asset or reference pool.[85]**

[38] *See* comment letter from Americans for Financial Reform (Feb. 13, 2012) ("AFR Letter") at 7; comment letter from Chris Barnard (Sept. 28, 2011) ("Barnard Letter") at 2; Better Markets Letter at 4; Merkley-Levin Letter at 5 (suggesting as a possible definition a "fixed-income or other security that references any type of financial assets . . . and <allows the holder of the security to receive payments that depend primarily on the >value or performance of the referenced assets").

[81] *See* comment letter from American Securitization Forum (Feb. 13, 2012) ("ASF Letter") at 23.

Given the variation of suggested definitions provided by commenters, >we do not believe that <**adopting any one of these definitions, or a combination thereof, would**

appropriately capture the scope of the various features of existing synthetic ABS and possible future structures or designs of synthetic ABS; however, commenters' suggestions are consistent with the characteristics that we have previously identified as features of synthetic ABS.[86] Because of the

[81] ***See*** **Proposing Release Section II.A. and Section III.A.2. of the 2004 Regulation AB Adopting Release.**

[82] ***See, e.g.*****, letters from ABA; AIMA/ACC; AFME; SFA I; SFA II; SIFMA I; SIFMA II.**

[83] ***See*** **letter from AIMA/ACC.**

[84] ***See*** **letters from ABA; AFME; SFA II; SIFMA I; SIFMA II.**

[85] ***See, e.g.*****, letters from ABA; SFA II; SIFMA II.**

~~[86]~~ ~~For a general discussion of synthetic securitizations, see~~***See*** **Proposing Release Section II.A. and** Section III.A.2. of **the** 2004 Regulation AB Adopting Release.

complexity of these transactions, however, we agree with commenters that guidance regarding synthetic ABS is beneficial. Accordingly, while a synthetic ABS may be structured or designed in a variety of ways, we generally view a synthetic asset-backed security as a fixed income or other security issued by a special purpose entity that >allows the holder of the security to receive payments that depend primarily on the <**performance of a reference self-liquidating financial asset or a reference pool of self-liquidating financial assets.**[87]

The Commission also received comments requesting clarification about whether the rule applies to synthetic transactions that have not traditionally been considered synthetic securitizations. Some commenters asked that we clarify that mortgage insurance-linked notes are not synthetic asset-backed securities under Rule 192(c) and that the reinsurance agreements embedded in the MILN transactions are not "conflicted transactions" under Rule 192(a)(3).[88] **As** >discussed in Section II.A.<**3.a., above, while MILNs create synthetic exposure to insurance contracts, they are not covered by this rule because the underlying private mortgage insurance contracts are not self-liquidating.**[89] **Accordingly, MILNs are not synthetic ABS subject to the**

~~underinclusiveness. Because of the inherent complexity of the transactions involved in a synthetic ABS, we are also concerned~~ <~~that a securitization participant might attempt to evade the~~ >~~re-proposed rule's prohibition by structuring such transactions around any particular definition of "synthetic ABS" while nonetheless creating a product that would be a synthetic ABS within the commonly understood meaning of the term, which would weaken the re-proposed rule's conflict of interest protection for investors.~~

~~We received comment in response to the 2011 proposed rule that the rule should explicitly cover hybrid ABS that contain a mix of financial and synthetic assets.[39] Given that Section 27B specified that the prohibition applies to both Exchange Act ABS and synthetic ABS, it would be inconsistent for the rule not to apply to a hybrid ABS that has characteristics <of both cash ABS and synthetic ABS. >Furthermore, the ability and incentive for a person to engage in the type of conduct <that Section 27B is intended to prevent >are present with respect to hybrid ABS. Therefore, the definition of the term "asset-backed security" in the re-proposed rule would explicitly cover hybrid cash and synthetic ABS that contain a mix of underlying financial and synthetic assets.~~

~~We also received comment recommending that the rule include a catch-all provision to cover any product that functions as the economic equivalent of a cash ABS, synthetic ABS, or hybrid ABS.[40] However, Section 27B prohibits material conflicts of interest with respect to Exchange Act ABS and synthetic ABS, and consistent with Section 27B, the re-proposed rule covers Exchange Act ABS as well as synthetic ABS and hybrid ABS. A security that functions as the economic equivalent of a cash ABS, synthetic ABS, or hybrid ABS, as contemplated by~~

~~[39]~~ ~~*See* Merkley-Levin Letter at 5~~[87] ***Id***.

~~[40]~~ ~~*See* Better Markets Letter at 4; Merkley-Levin Letter at 5.~~

[88] **_See, e.g._, letters from ABA; letter from Housing Policy Council dated Mar. 27, 2023 ("HPC"); Mortgage Bankers Association dated Mar. 27, 2023 ("MBA"); PMI Industry I; Arch Capital Group Ltd., Enact Holdings Inc., Essent Group Ltd., MGIC Investment Corporation, NMI Holdings, Inc., and Radian Group Inc. dated Oct. 20, 2023 ("PMI Industry II") (suggesting rule text to include an exclusion in the final rule for activities related to the purchase or sale of MILNs); U.S. Representatives Blaine Luetkemeyer and Emmanuel Cleaver dated May 23, 2023 ("Representatives Luetkemeyer and Cleaver"); SFA I; SIFMA I. *See also* Section II.D. for a discussion of the types of** >transactions that would be "conflicted transactions" under the <**final rule.**

[89] **In a typical MILN structure, the mortgage insurer enters into a reinsurance agreement with a special purpose insurer, which issues the MILNs to investors and places the proceeds from the sale of those securities in a reinsurance trust to make any required payments to the mortgage insurer under the reinsurance agreement, which requires payments based on certain losses incurred on a specified pool of mortgage insurance policies that are obligations of the mortgage insurer. The premiums paid by the mortgage insurer to the special purpose insurer are used to make interest payments to the holders of the MILNs. Because the reinsurance agreement functions similarly to a swap and the reference mortgage insurance policies are not transferred to the reinsurance trust, commenters requested confirmation that MILNs are not synthetic ABS that would be asset-backed securities as defined for purposes of Rule 192.**

***See, e.g.*, letters from ABA; HPC; MBA; PMI Industry I; Representatives Luetkemeyer and Cleaver; SFA I; SIFMA I.**

these comments, should already meet the re-proposed rule's definition of ABS<. Therefore, we do not believe >a catch-all provision to capture other products beyond the proposed definition of "asset-backed security" is necessary.

We received comment on the 2011 proposed rule from portfolio managers at large banks[41] and collateralized loan obligation ("CLO") investors[42] that suggested an exception for certain synthetic balance sheet CLOs to retain the use of such CLOs as a risk management tool and an investment.[43] We are concerned that an exception for such a product has the potential to weaken conflict of interest protections for ABS investors because the relevant securitization participant could structure synthetic ABS products that entitle the securitization participant to receive cash payments in the event that the referenced ABS, which the securitization participant also structured and sold to investors, fails. Therefore, we have not included such an exception.

Finally, we received comment on the 2011 proposal stating that not excluding Enterprise or Ginnie Mae ABS from the scope of the rule would have significant economic and market impacts.[44] As discussed below, the re-proposed rule does not include an exception for Enterprise or Ginnie Mae ABS.[45] However, the proposed definition of "sponsor" does include an exception that, subject to certain conditions, would apply to the Enterprises and Ginnie Mae with <respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by >such entity.

prohibition in Rule 192(a)(1), and consequently, neither would the reinsurance agreements executed between the mortgage insurer and the special purpose insurer be conflicted transactions under Rule 192(a)(3).[90]

Some commenters also requested confirmation that synthetic ABS for purposes of Rule 192 does not include equity-linked or commodity-linked products.[91] Because such

products do not involve self-liquidating financial assets, they are not synthetic ABS subject to Rule 192's prohibition. Similarly, some commenters requested confirmation that corporate debt obligations and security-based swaps are not synthetic ABS.[92] As described above, we generally view a synthetic asset-backed security as a fixed income or other security issued by a special purpose entity >that allows the holder of the security to receive payments that depend primarily on the <**performance of a reference self-liquidating financial asset or a reference pool of self-liquidating financial assets. In contrast, as discussed above, a corporate debt obligation is issued by, and offers investors recourse to, an operating entity that is not a special purpose entity. Therefore, a corporate debt obligation is not a synthetic ABS for purposes of Rule 192. Similarly, a security-based swap is also not a synthetic ABS for purposes of Rule 192 because it is a financial contract between two counterparties without issuance of a security from a special purpose entity.[93] A security-based swap can represent a component of a synthetic ABS transaction where, for example, the relevant special purpose entity that issues the synthetic ABS enters into a security-based swap that collateralizes the synthetic ABS that it is issuing. However, the standalone**

[90] ***See*** **Section II.D. for a discussion of "conflicted transactions" under the final rule.**

[91] ***See, e.g.*****, letters from SFA II; SIFMA I; SIFMA II.**

[92] ***See, e.g.*****, letters from ABA; SFA II; SIFMA I; SIFMA II.**

[93] ***See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*****, Release No. 33-9338 (July 18, 2012) [77 FR 48208 (Aug. 13, 2012)] (establishing that a credit default swap or total-return swap on a single loan or narrow-based index is a security-based swap).**

security-based swap in such example is not a synthetic ABS; it is only one component of the broader synthetic ABS transaction. Under the final rule, >whether a transaction is a "<**synthetic ABS" subject to Rule 192 will depend on the nature of the transaction's structure and characteristics of the underlying or referenced assets.[94] A similar analysis will be necessary to determine whether a transaction constitutes a hybrid cash and synthetic ABS, which would have characteristics** >of both cash ABS and synthetic ABS.<

c. Cross-border Application of Rule 192

The Commission received several comments relating to the potential cross-border application of Rule 192.[95] Before addressing those comments, we are providing the following guidance as to Rule 192's cross-border scope. As a threshold matter, Rule 192's cross-border scope is co-extensive with the cross-border scope of Securities Act Section 27B(a), which this rule implements pursuant to the mandate in Section 27B(b). It is therefore appropriate to consider Section 27B(a)'s cross-border scope when determining whether Rule 192 applies in a cross-border context.

Our understanding of Section 27B(a)'s cross-border scope is based on the territorial approach that the Commission has applied when adopting rules to implement other provisions of the securities laws.[96] Consistent with that territorial approach, which is based on U.S. Supreme

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[94] **For example, such transactions generally should be analyzed to determine whether the assets that are transferred to or otherwise part of the asset pool are self-liquidating. Additionally, we note that a synthetic transaction could be effectuated through the use of derivates or swaps but could also use some other feature or structure that replicates the terms of a derivate or swap.**

[~~41~~95] *See, e.g.*, ~~comment letter from The <International Association of Credit Portfolio Managers >(Feb. 6, 2012) ("IACPM 1 Letter") at 2~~**letters from ABA; AFME; AIC; SFA I; SFA II; SIFMA I; SIFMA II**.

[~~42~~] ~~*See, e.g.*, comment letter from Orchard Global Asset Management (June 28, 2012) ("Orchard Letter").~~

[~~43~~96] *See, e.g.*, ~~comment letter from Deutsche Bank AG (Feb. 9. 2012) ("Deutsche Bank Letter") at 1-8; comment letter from The International Association of Credit Portfolio Managers (June 28, 2012) ("IACPM 2 Letter") at 1-4; and comment letter from PGGM Investments (June 20, 2012) ("PGGM Letter") at 1-3.~~***Regulation***

***SBSR—Reporting and Dissemination of Security-Based Swap Information*, Release No. 34-74244 (Feb. 11, 2015), [80 FR 14563, 14649 (Mar. 19, 2015)] ("2015 Regulation SBSR Adopting Release") (discussing the territorial approach to the cross-border application of Title VII requirements for regulatory reporting and public dissemination of security-based swap transactions).**

~~44 *See* SIFMA Letter at 18–21.~~

~~45 *See* Section II.B.2.~~

Court precedent, including *Morrison v. National Australia Bank, Ltd*,[97] the Commission understands the relevant domestic conduct that triggers the application of Section 27(B)(a)'s prohibition to be the sale in the United States of the ABS.[98] If there are ABS sales in the United States to investors, the prohibition of Section 27B(a)—as implemented through the provisions of Rule 192—applies. Put simply, the existence of domestic ABS sales to investors means that securitization participants are prohibited pursuant to the terms of Rule 192 from engaging in their own separate transactions that would cause a material conflict with the ABS investors.[99] And when domestic ABS sales exist, the prohibition on securitization participants engaging in separate transactions that would cause >the material conflicts of interest <**applies *even if* the securitization participants seek to engage in those prohibited transactions exclusively overseas or if the securitization participant is itself a non-U.S. entity.[100] In this way, Section 27B(a) and Rule 192 further the statutory objective of prophylactically protecting ABS investors in the U.S. securities markets from ABS transactions that would involve material conflicts of interest.[101]**

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[97] ***Morrison v. National Australia Bank, Ltd. et al.*, 561 U.S. 247 (2010).**

[98] ***See generally* 561 U.S. 247. *See, e.g.*, *Abitron Austria GmbH v. Hetronix Int'l, Inc*, No. 21-1043, 2023 WL 4239255, at *4 (U.S. June 29, 2023) (stating that "[the Supreme Court has] repeatedly and explicitly held that courts must "identif[y] 'the statute's "focus"' and as[k] whether the conduct relevant to that focus occurred in United States territory").**

[99] **Securitization participants are advised that even if there is no domestic sale to an investor that would trigger Rule 192's regulatory prohibition, the Commission still retains broad cross-border antifraud authority that will apply when securities participants engage in fraudulent or manipulative conduct that has a sufficient nexus to the United States. Specifically, the Commission's antifraud authorities will apply if a securities participant engages in securities fraud that involves: (1) conduct within the United States that constitutes significant steps in furtherance of the fraud, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring entirely outside the United States that has a foreseeable substantial effect within the United States. *See* Section 27(b) of the Exchange Act (15 U.S.C. 78aa). *See also SEC v. Scoville*, 913 F.3d 1204, 1215-1219 (10th Cir. 2019) (holding "that Congress has 'affirmatively and unmistakably' indicated that the antifraud provisions of the federal securities acts apply extraterritorially when the statutory conduct-and-effects test is met").**

[100] ***See Abitron Austria GmbH*, 2023 WL 4239255, at *2529 (explaining that "[i]f the conduct relevant to the statute's focus occurred in the United States, then the case involves a permissible domestic application of the statute, even if other conduct occurred abroad" (citations and internal quotation marks omitted)).**

[101] ***See, e.g.*, Section I.C.**

~~*Request for Comment*~~

~~1. We seek comment on the proposed definition of asset-backed security for purposes of proposed Rule 192. Is it necessary to further clarify components of the proposed definition?~~

~~2. Are market participants familiar with which securities products fall under the definition of Exchange Act ABS? Should the re-proposed rule provide more specificity regarding the types of ABS that would be subject to the re-proposed rule?~~

~~3. Should we add a catch-all provision <to the proposed definition of >asset-backed security to cover any product that functions as the economic equivalent of a cash ABS, synthetic ABS, or hybrid cash and synthetic ABS? Please comment on the advantages or disadvantages. If so, what additional types of securities or transactions should be included that would not be covered by the definition of asset-backed security in the re-proposed rule?~~

~~4. The re-proposed rule does not define "synthetic ABS," and we are not providing specific guidance regarding whether any particular products are "synthetic ABS." As stated above, we have described synthetic securitizations as securitizations that are designed to create exposure to an asset that is not transferred to or otherwise part of an asset pool, such as through a CDS or a total return swap. Should we define "synthetic ABS" to incorporate that description or otherwise define such term as a fixed-income or other security that references any type of financial asset and allows the holder of the security to receive payments that depend primarily on the value or performance of the referenced assets? Are there particular products (1) where additional clarity is necessary as to whether such products are "synthetic ABS" or (2) that the rule should expressly state are~~

not "synthetic ABS"? Please identify any such products and explain why additional clarification is needed. Furthermore, is additional clarification needed regarding what is or is not a <hybrid cash and synthetic asset-backed security>?

5. Should proposed Rule 192(b) contain an additional exception from <the prohibition on material conflicts of interest >for certain synthetic balance sheet CLOs, as suggested by commenters to the 2011 proposed rule,[46] that would permit a securitization participant that is a lender to hedge a portfolio of its originated loans and extensions of credit by purchasing a CDS contract from the special purpose entity that issues a synthetic ABS? If so, please explain what types of synthetic balance sheet CLOs should not be covered by the rule, and what conditions should have to be satisfied in order to ensure that such CLOs would be used solely as a risk mitigation tool rather than a speculative investment. Please also explain how such an exception would be consistent with Section 27B.

6. As stated above, municipal securitizations that are Exchange Act ABS would fall within the definition of asset-backed security for purposes of the re-proposed rule. Should we clarify in rule text or through guidance the types of municipal securitizations that would be covered by the re-proposed rule? If so, please identify those types of municipal securitizations that you believe require clarification and explain why. Are there types of municipal securitizations that should be exempt from the re-proposed rule? If so, please explain why they should be exempt, including whether the opportunity exists for securitization participants to engage in the type of conduct the re-proposed rule is designed to prohibit with respect to such municipal securitizations.

Having provided the foregoing general guidance regarding Rule 192's cross-border scope, we turn to address those comments that raised cross-border considerations. Some

commenters expressed concerns that the Commission did not address cross-border application of the proposed rule in the Proposing Release,[102] with some stating that, without guidance regarding cross-border applicability, together with the proposed definition of affiliates and subsidiaries, the proposed rule could potentially apply to all affiliates and subsidiaries of the named securitization participants anywhere in the world, regardless of their knowledge of, or participation in, the transaction.[103] One commenter further stated that such application could have a significant adverse effect on the ability of market participants in non-U.S. jurisdictions to satisfy the prudential and capital requirements regulations related to permissible securitization transactions used for capital optimization and balance sheet management in those jurisdictions.[104] For example, this commenter stated that certain synthetic securitizations are permitted in the European Union and the United Kingdom under the European Banking Authority's Simple, Transparent and Standardized ("STS") framework.[105] The commenter further stated that, to the extent that such framework could be inconsistent with final Rule 192, cross-border applicability of Rule 192 could result in those transactions being impermissible, which could have undesirable consequences for European markets.[106]

[102] ***See, e.g.***, letters from AFME, AIC; SFA I.

[103] ***See, e.g.***, letter from AFME. One commenter also stated that it is unclear whether the Commission has authority over foreign entities apart from legal and practical issues regarding supervision and enforcement and that Rule 192 could put U.S. entities at a competitive disadvantage in relation to their international peers. ***See*** letter from AIMA/ACC. In addition to the changes discussed in this section, we believe that the revisions to the rule's coverage of affiliates and subsidiaries, as discussed in Section II.B.3.c. below, will mitigate such concerns.

[104] ***See*** letter from AFME.

[105] ***Id.***

[106] ***Id.***

The Commission also received comments requesting that the final rule include a safe harbor for foreign >transactions and securitization participants to <**provide clarity to the market.**[107] **These commenters stated that such an approach would be consistent with other Commission rules applicable to securitizations that were promulgated under the Securities Act and Exchange Act, such as Regulation RR**[108] **and Exchange Act Rule 15Ga-2.**[109] **Some of these commenters further suggested that the final rule include a foreign transaction safe harbor that states specifically that the prohibition in Rule 192 does not apply to an asset-backed security if the offer and sale of the ABS was or is not required to be registered (and is/was not registered) under the Securities Act of 1933, the offer and sale of all of the ABS is or was made outside the United States, and** >the issuing entity of the ABS <**is a foreign issuer,**[110] **which is similar to the safe harbor included in Rule 15Ga-2 and incorporates principles contained in Regulation S.**[111]

After considering these suggestions, we are including a foreign transaction safe harbor in final Rule 192 to provide additional certainty with regard to the territorial approach discussed above. Moreover, we agree with commenters that including a foreign transaction safe harbor is consistent with other securitization rules promulgated by the Commission, such as Regulation RR and Exchange Act Rule 15Ga-2, and that commenters' suggestions to rely on the principles contained in Regulation S in adopting such a safe harbor are consistent the Commission's cross-

107 ***See, e.g.,*** **letters from ABA; AFME; AIC (requesting that the Commission adopt a safe harbor for foreign entities and transactions and suggesting that it could do so by exempting foreign entities from the definition of "securitization participant" and excluding securities issued pursuant to Regulation S from the definition of "asset-backed security"); SFA I; SFA II; SIFMA I (citing** ***Morrison v. Nat'l Austl. Bank Ltd.*****, 561 U.S. 247 (2010) as the existing law on the extent of the rule's extraterritorial reach and seeking a safe harbor to provide clarity in order to facilitate compliance); SIFMA II.**

108 ***See*** **12 CFR 246.20.**

46 **109 17 CFR 240.15Ga-2.** *See, e.g.*, ~~IACPM 1 Letter at 2; Orchard Letter~~**letters from ABA; AIC; AFME; SFA I; SFA II; SIFMA I; SIFMA II**.

[110] ***See, e.g.*, letters from SFA II; SIFMA II.**

[111] ***See* 17 CFR 240.15Ga-2(e) ("Rule 15Ga-2(e)") and 17 CFR 230.901 and 902(e).**

~~7. Are there types of government-guaranteed securities that should be exempt from the re-proposed rule? Please explain why they should be exempt, including whether the opportunity exists for securitization participants to <engage in the type of conduct that >the re-proposed <rule is designed to prohibit >with respect to such securities.~~

border authority.[112] We also agree with commenters that it is appropriate to model the safe harbor provision in Rule 192 on existing Rule 15Ga-2(e).[113] Therefore, the prohibition in final Rule 192(a)(1) will not apply to an asset-backed security (as defined by this rule) if

B. it is not issued by a U.S. person (as that term is defined in Rule 902 of Regulation S)[114] and the offer and sale of such asset-backed security is in compliance with Regulation S.[115] The inclusion of this safe harbor for certain foreign securitizations will help address commenters' concerns with respect to application of the rule to extraterritorial transactions and securitization participants.

Scope: Securitization Participants

1. Proposed Scop~~:~~e of Securitization Participants

Consistent with Section 27B(a), the **Commission proposed that the** prohibition in ~~the re-proposed rule~~**Rule 192** would apply to transactions entered into by ~~certain key participants involved in <the creation and sale of an ABS>, namely~~ an underwriter, placement agent, initial purchaser, or sponsor **of a covered ABS, as well as any of their affiliates or subsidiaries**, each of which would be a "securitization participant" as defined in ~~proposed~~ Rule 192(c). ~~The functions performed by such persons are essential to the design, creation, marketing, and/<or sale of an ABS. >The re-proposed rule focuses on transactions that could give such persons~~ [116] **The Commission proposed** >definitions for the terms "underwriter," "placement agent," "initial purchaser," and "sponsor" that <>are generally based on existing definitions and <**reflect**

the functions of these >market participants in ABS transactions and not merely their formal labels.<[117] **In addition,** the ~~incentive~~

[112] ***See Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247 (2010).**

[113] **Rule 15Ga-2(e) generally states that the requirements of Rule 15Ga-2 would not apply to an offering of an asset-backed security if certain conditions are met, including (1) the offering is not required to be, and is not, registered under the Securities Act, (2) the issuer of the rated security is not a U.S. person (as defined in Rule 902 of Regulation S), and (3) all offers and sales of the ABS is in compliance with Regulation S.**

[114] **17 CFR 230.902(k).**

[115] **17 CFR 230.901 through 905. *See* Rule 192(e). Securitization participants are advised that even if the safe harbor conditions are met, the Commission still retains broad cross-border antifraud authority that will apply when securities participants engage in fraudulent or manipulative conduct that has a sufficient nexus to the United States. *See supra* note 99.**

[116] ***See* Proposing Release Section II.B.**

[117] ***Id*. The Commission also proposed that "affiliate" and "subsidiary" would have the same meaning as set forth in Securities Act Rule 405 (17 CFR 230.405).**

~~to market or structure~~ **proposed definition of "sponsor" was based on the definition of sponsor in Regulation AB as well as**>, subject to certain exceptions, any person that directs or causes the direction of the structure, design, or <**assembly of the ABS or** >the composition of the pool of assets underlying the ABS or <**that** >has the contractual right to do so.<[118] **As explained in the Proposing Release, such a person is in a unique position to structure the** ABS and/or construct **the** underlying asset ~~pools~~**pool or reference pool** in a way that would position ~~them~~**the person** to benefit from the actual, anticipated, or potential adverse performance of the **of the** relevant ABS or its underlying asset pool~~. Also, consistent with Section 27B(a) and to help prevent potential evasion, the prohibition in the re-proposed rule would apply to the transactions entered into by the affiliates and subsidiaries of any such person. Subject to certain exceptions discussed below, each of the foregoing entities would be captured by~~ **if such person were to enter in a conflicted transaction.[119] The Commission also proposed certain limited exclusions from** the definition of "~~securitization participant" in the re-proposed rule.~~**sponsor" for persons that perform only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the ABS,[120] as well as for certain U.S. Federal Government** >entities and the Enterprises, subject to certain conditions.<[121]

2. Comments Received

Commenters generally supported the proposal to define the securitization participants subject to the prohibition in the final rule.[122] While some commenters agreed with the proposed approach of defining the covered persons with respect to their functions in securitization markets,[123] several commenters expressed significant concerns regarding the scope of the

[118] ***See* Proposing Release Section II.B.**

[119] ***See* Proposing Release Section II.B.**

[120] ***See* Proposing Release Section II.B.2.b.**

[121] ***See* Proposing Release** >Section II.B.2.c.<

[122] ***See, e.g.*, letters from AFR; ICI. The Commission also proposed a definition of "distribution" as used in the underwriter and placement agent definition but did not receive comment addressing** >the proposed definition of "distribution<**."**

~~The Commission did not propose definitions of the terms <"underwriter," "placement agent," "initial purchaser," and ">sponsor" in the 2011 proposed rule, and we received comment to the 2011 proposed rule that we should refrain from providing definitions for certain persons.[47]~~

~~[47] *See, e.g.*, comment letter from Akshat Tewary, Esq. (Dec. 2, 2011) ("Tewary Letter 1") at 4.~~

However, certain other commenters to the 2011 proposed rule expressed support for defining these terms to specify the persons covered by the rule.[48] In order to facilitate compliance, as discussed below, we are proposing <definitions for the terms "underwriter," "placement agent," "initial purchaser," and "sponsor" that>, with a few exceptions, <are generally based on existing definitions and >are designed to reflect the functions of such <market participants in ABS transactions and not merely their formal labels.>

Request for Comment

8. Should we <modify the proposed definition of >the term "securitization participant," and if so, how? Are any modifications necessary or advisable to mitigate any unintended consequences?

9. <As discussed above in Section II.>A., municipal securitizations that are Exchange Act ABS would fall within the definition of asset-backed security for purposes of the re-proposed rule. Therefore, parties related to a municipal securitization that are "securitization participants" would be subject to the re-proposed rule. For example, under the re-proposed rule a "municipal advisor" under 17 CFR 240.15Ba1-1(d)(1) could be a "securitization participant" under the re-proposed rule based on the functions that it performs in connection with a municipal securitization. Should certain parties related to a municipal securitization be excluded from the scope of the re-proposed rule? If so, how would those exclusions be consistent with Section 27B? Are there any special considerations related to municipal advisors that should be considered in applying the re-proposed rule?

[48][123] *See, e.g.*, SIFMA Letter at 10-11; Merkley-Levin Letter at 3**letters from AFR; Better Markets (expressing support for the definition of "sponsor" as proposed)**.

proposed definition of "sponsor," stating that it could potentially capture market participants that Section 27B did not intend to include.[124] For example, several commenters stated >that the proposed definition of "<**sponsor" was overly broad and exceeded the intent of Section 27B.[121] As discussed below, some of these commenters stated that including any person that directs or has the contractual right to direct the structure, design, or assembly of an ABS could result in nearly every participant in a securitization transaction being a sponsor, including, for example, investors in the relevant ABS.[126] Many commenters acknowledged that Section 27B specifically identifies affiliates and subsidiaries of other named securitization participants as being subject to the rule's prohibition, but also expressed concern that the inclusion of certain affiliates and subsidiaries would make the rule unworkable.[127] Accordingly, several commenters requested that the rule permit** >the use of information barriers <**to address these challenges.[128] The Commission also received comments requesting revisions to the proposed exclusion for persons that perform only administrative, legal, due diligence, custodial, or ministerial acts related to the**

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[124] ***See, e.g.*, letters from ABA; AIMA/ACC; CREFC I, MBA; MFA II; NAMA; U.S. Representatives Wiley Nickel, Bryan Steil, Josh Gottheimer, Blaine Luetkemeyer, Jim Himes, Michael V. Lawler, Juan Vargas, Scott Fitzgerald, Vicente Gonzalez, Young Kim, Ritchie Torres, Zach Nunn, Gregory W. Meeks, Andy Barr, Steven Horsford, Andrew R. Garbarino, Brittany Pettersen, Ann Wagner, David Scott, Bill Huizenga, Brad Sherman (Ranking Member, Subcommittee on Capital Markets), Byron Donalds, Bill Foster, Emanuel Cleaver, II, and Sean Casten dated Oct. 31, 2023 ("Representative Nickel et al.") (referring generally to the definition of "securitization participant"); SFA I; SIFMA I. Some commenters also stated that certain underwriters, placement agents, and initial purchasers that were not part of the design of the ABS could be scoped in as well. *See* Sections II.B.2. and II.B.3.a.**

[121] ***See, e.g.*, letters from ABA; AIC; AIMA/ACC; AFME; Loan Syndications & Trading Association dated May 2, 2023 ("LSTA III"); MBA; MFA II; NAMA; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SIFMA I; Wulff Hansen.**

[126] ***See, e.g.*, letters from ABA; AFME; CREFC I;** >International Association of Credit Portfolio Managers <**dated Mar. 27, 2023 ("IACPM"); MBA; SFA I.**

[127] ***See, e.g.*, letters from ABA; AIC; AFME; ICI; LSTA III; Loan Syndications & Trading Association dated Oct. 30, 2023 ("LSTA IV"); MFA II; SFA I; SIFMA I.**

[128] ***See, e.g.*, letters from ABA; AIMA/ACC; AFME; AIC; ICI; LSTA II; LSTA III; MFA II; Pentalpha Surveillance LLC dated Mar. 27, 2023 ("Pentalpha"); SFA I; SIFMA I.**

ABS or its underlying or referenced asset pool[129] and the proposed exclusion for certain U.S. Federal Government entities and the Enterprises, which we discuss in greater detail below.[130] Finally, one commenter stated that a securitization participant should only come >within the scope of the <**prohibition in Rule 192 if such participant intended to profit from the securitization transaction to the detriment of investors or otherwise designed an ABS to fail.[131]**

3. Final Rule

As discussed below, we are adopting the definitions of >"underwriter," "placement agent," "initial purchaser," and "<**distribution" as proposed. We are modifying the proposed definition of "sponsor" to address commenter concerns regarding the scope of the definition with respect to a person who acts solely pursuant to such person's contractual rights as a holder of a long position in an asset-backed security and a person's administrative and ministerial activities related to the ongoing administration of an ABS.[132] Also, as discussed in greater detail in Section II.B.3.b.ii. below, we are not adopting proposed paragraph (ii)(B) of the "sponsor" definition, which would have captured any person** >that directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security. <**In response to comments received relating to confusion with respect to the proposed rule's treatment of credit risk transfer transactions, we are removing the specific exclusion for the Enterprises in favor of addressing those comments through the risk-mitigating hedging exception, which we discuss in more detail in Sections II.B.3.b.iv. and II.E., below. To address**

[129] ***See, e.g.*, letters from CREFC I; LSTA III; SFA I; SIFMA I.**

[130] ***See, e.g.*, letters from Fannie Mae and Freddie Mac dated Mar. 27, 2023 ("Fannie and Freddie"); Housing Policy Council dated Mar. 27, 2023 ("HPC"); Mark Calabria, Former FHFA Director, dated Mar. 25, 2023 ("M. Calabria").**

[131] ***See*** **letter from HPC.**

[132] ***See*** **Section II.B.3.b. for a detailed discussion of the comments received and the revised definition.**

concerns about the rule's applicability to affiliates and subsidiaries, we are adopting revisions to the definition of "securitization participant" regarding when >an affiliate or subsidiary of an underwriter, placement agent, initial purchaser, or sponsor <**is subject to the prohibition against engaging in conflicted transactions.**[133] **Final Rule 192 does not include a requirement that the securitization participant intended to profit from a transaction to the detriment of investors or otherwise designed the ABS to fail. As discussed in greater detail in Sections II.A.3. and II.D., we believe that narrowing the scope of the final rule to add an element of intent is inappropriate and it is not relevant for purposes of the final rule whether the securitization participant makes (or intended to make) a profit. Narrowing the scope of the rule to require knowledge or intent would frustrate the statutory mandate of Section 27B.**

a. **Placement Agent, Underwriter, and Initial Purchaser**

Consistent with the proposal, final ~~Proposed~~ Rule 192(c) ~~would define a~~**defines** "placement agent" ~~or~~**and** "underwriter" as a person who has agreed with an issuer or selling security holder to:

- Purchase securities from the issuer or selling security holder for distribution;
- Engage in a distribution for or on behalf of such issuer or selling security holder; or
- Manage or supervise a distribution for or on behalf of such issuer or selling security holder.[134]

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[133] ***See*** **Section II.B.3.c.**

[134] **17 CFR 230.192(c).**

~~The terms "placement agent" and "underwriter" would have the same definition in the re-proposed rule because the functional roles of the persons who act as a placement agent or an underwriter are the same. These definitional prongs~~**These definitions** are focused on the functional role ~~of~~**that** a person **would assume** in connection with a distribution of securities~~ and should cover the activities of a placement agent or underwriter that has agreed with an <issuer or selling security holder to >facilitate an offering of securities.[49] These definitional prongs are also used for purposes of the definition of the term "underwriter" under 17 CFR 255 ("Volcker Rule")[50] and 17 CFR 242.100 through 105 ("Regulation M");[51] however, the Volcker Rule's definition of "underwriter" includes an additional prong that is intended to capture selling group members that may not have <an agreement with the issuer or selling security holder>.[52] The definition that we are proposing~~

.[135] Also consistent with the proposal,[136] final [49] ~~We also believe that the prongs included in the proposed definition would mitigate concerns raised by a commenter on the 2011 proposed rule about the potential overinclusiveness of the definition of "underwriter" in Section 2(a)(11) of the Securities Act, which could potentially include entities that do not have an agreement with the issuer or the selling security holder and have no ability to influence the design of the relevant ABS. *See* SIFMA Letter at 10-11. <The definition of underwriter for purposes of >the re-proposed rule would have <no impact on the definition, responsibility, or liability of an underwriter under >Section 2(a)(11).~~

[50] ~~17 CFR 255.4(a)(4). The re-proposed rule would have no impact on <the definition of "underwriter" in the Volcker Rule>.~~

[51] ~~17 CFR 242.100(b). The re-proposed rule would have no impact on the definition of "underwriter" in Regulation M.~~

[52] ~~17 CFR 255.4(a)(4).~~

~~for purposes of the re-proposed rule would be limited to persons that have agreed with an issuer or a selling security holder to perform such functions, and selling group members who have no agreement with an issuer or selling security holder to engage in such functions would not be a "placement agent" or "underwriter" for purposes of the re-proposed rule. Although selling group members <may help facilitate a successful distribution of securities to a wider variety of purchasers, >such as regional purchasers that the underwriter or placement agent may not be able to access as easily, <selling group members do not have a direct relationship with the issuer or selling security holder and >are therefore <unlikely to have the same ability to influence the design of the relevant ABS.>~~

~~Proposed~~ Rule 192(c) ~~would define~~**defines** "distribution" as used in the ~~proposed~~ definitions ~~of~~**for** "underwriter" ~~or~~**and** "placement agent" to mean:

- An offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary **course** trading transactions by the presence of special selling efforts and selling methods; or
- An offering of securities made pursuant to an effective registration statement under the Securities Act.[137]

The definition of "initial purchaser" is similarly focused on a person's function in a securities offering and includes, as proposed, >"a person who has agreed with an issuer to purchase a security from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon Rule 144A or that are otherwise not required to be registered because they do not involve any public offering."<[138]

[135]> The definition of underwriter for purposes of< **Rule 192 has**> no impact on the definition, responsibility, or liability of an underwriter under< **Securities Act Section 2(a)(11). Additionally, while these definitional prongs are also used for**> the definition of "underwriter" in the Volcker Rule< **(17 CFR 255.4(a)(4)) and Regulation M (17 CFR 242.100(b)), the definition we are adopting in Rule 192(c) has no impact on the definition of "underwriter" in either of those rules.** ***See also*** **Proposing Release Section II.B.1.**

[136] **The Commission did not receive any comments addressing the proposed definition of "distribution."** ~~This proposed definition <is the same as the >definition of "distribution" under the Volcker Rule, which is focused on the presence of special selling efforts and selling methods. We believe that focusing on special selling efforts and selling methods would help to distinguish an offering of ABS from secondary trading and helps to target the re-proposed rule to persons engaged in selling an ABS offering to investors once such ABS is created. Activities~~[137] **17 CFR 230.192(c). As the Commission noted in the Proposing Release, activities** generally indicative of special selling efforts and ~~selling~~ methods include, but are not limited to, greater than normal sales compensation arrangements, delivering a sales document (~~such as~~***e.g.,*** a prospectus **or offering memorandum**), and

conducting road shows.[53] A primary offering of an ABS made pursuant to an effective Securities Act registration statement under the Securities Act would also be captured under <the proposed definition of "distribution>" because, in the context of Section 27B, such an offering would beis a primary issuance by an issuer immediately following the creation of the relevant ABS, which would beis clearly distinguishable from an ordinary secondary trading transaction and, therefore, an identification of special selling efforts or selling method would be unnecessary in this context.. *See* Proposing Release at 9683.

138 **The definition of "initial purchaser" in Rule 192(c) has no impact on the application of Rule 144A (17 CFR 230.144A).**

Proposed Rule 192(c) would define "initial purchaser" in a manner consistent with the Commission's prior use of that term in the context of ABS.[54] Specifically, the re-proposed rule would define the term "initial purchaser" as <"a person who has agreed with an issuer to purchase a security from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon Rule 144A or that are otherwise not required to be registered because they do not involve any public offering." >This definition is also consistent with industry use of the term "initial purchaser" in the context of private placement transactions to mean a person (typically a broker-dealer) who, pursuant to an agreement with the issuer, performs the function of acquiring securities from an issuer in a private placement and reselling those securities to qualified institutional buyers in reliance on Rule 144A or to

53 *See Review of Anti-manipulation Regulation of Securities Offerings*, Release No. 34-33924 (Apr. 19, 1994) [59 FR 21681 (Apr. 26, 1994)] at 21685; *see also Trading Practices Concerning Securities Offerings*, Release No. 34-37094 (Apr. 11, 1996) [61 FR 17108 (Apr. 18, 1996)], *Anti-manipulation Rules Concerning Securities Offerings*, Release No. 34-38067 (Dec. 20, 1996) [62 FR 520 (Jan. 3, 1997)], and *Securities Offering Reform*, Release No. 33-8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)].

54 While not defined in rules adopted by the Commission, the Commission has used the term when describing the distribution of an asset-backed security. *See, e.g.*, *Asset-Backed Securities*, Release No. 33-9117 (Apr. 7, 2010) [75 FR 23328 (May 3, 2010)] at 23332 (stating that CDOs are typically sold by the issuer <in a private placement to one or more initial >purchaser or purchasers in reliance upon the Section 4(2) private offering exemption in the Securities Act, which is available only to the issuer<, followed by resales of the securities to "qualified institutional buyers" in >reliance upon Rule 144A); *id.* at 23393 (stating that the initial purchaser is typically a registered broker-dealer). The definition of "initial purchaser" in the re-proposed rule would have no impact on the application of Rule 144A.

Some commenters requested that we limit the definition of "underwriter," "placement agent," and "initial purchaser" to capture only those persons who are directly involved in structuring the relevant ABS or selecting the assets underlying the ABS, stating as an example that underwriting syndicate co-managers generally rely on lead managers and have little direct involvement with the aforementioned securitization activities.[139] While it may be the case that underwriters, placement agents, or initial purchasers are involved in the issuance of an ABS in varying degrees, the prohibition in Rule 192(a)(1) only applies to such persons if they have entered into an agreement[140] with an issuer (or, with respect to underwriters and placement agents, a selling security holder) because those persons would likely be privy to certain information about the ABS or underlying assets. Conversely, underwriters, placement agents, and initial purchasers with no such agreement with the issuer or selling security holder ("selling group members"), as applicable, >may help facilitate a successful distribution of securities to a wider variety of purchasers, <**but these** >selling group members do not have a direct relationship with the issuer or selling security holder and<**, thus, are** >unlikely to have the same ability to influence the design of the relevant ABS. <**Therefore, selling group members who do not have such an agreement are not underwriters, placement agents, or initial purchasers as defined in Rule 192(c).[141] Moreover, such a limitation could have the unintended consequence of creating uncertainty about whether an** >underwriter, placement agent, or initial purchaser <**is subject to the rule's prohibition because it would require a determination of whether such person is "directly involved" in structuring an ABS or selecting the underlying assets. For purposes of Rule 192,**

~~purchasers in sales that otherwise do not involve any public offering.[55] Proposing to define the term "initial purchaser" in a manner consistent with the Commission's prior use of that term in~~

~~the context of ABS and also the common industry understanding of the term should ease compliance with the re-proposed rule because market participants are familiar with that usage of the term and should already have mechanisms in place to determine when the proposed definition is met.~~

~~The proposed definitions of the terms "underwriter," "placement agent," and "initial purchaser" in the re-proposed rule would identify persons by their function in connection with a securitization as suggested by certain commenters to the 2011 proposed rule.[56] We believe that function-based definitions would encompass those persons who have a key role in the creation or sale of an ABS transaction, which would help prevent evasion by persons seeking to avoid the re-proposed rule's prohibitions by using a different title to refer to themselves, even though they perform the function described in the definition. These function-based definitions should address evasion concerns raised by certain commenters.[57]~~

~~The proposed definitions of the terms "underwriter," "placement agent," and "initial purchaser" do not exclude an underwriter, placement agent, or initial purchaser that was not directly involved in structuring an ABS transaction or selecting the assets underlying the ABS, as requested by a commenter to the 2011 proposed rule.[58] As discussed above, the proposed~~

~~55~~ [139] *See*~~comment letter from The Investment Company Institute (Feb. 13, 2012) ("ICI Letter") at 3; SIFMA Letter at 11~~<. ~~These commenters suggested that the~~ >~~definition incorporate a specific reference to the functions of an underwriter in connection with a Rule 144A transaction. As the proposed definition refers to a person agreeing to acquire a security from an issuer in a private placement for purposes of resales pursuant to Rule 144A, this proposed definition is appropriate and should capture the common industry understanding of "underwriting" a Rule 144A transaction.~~ **letters from SFA I; SIFMA I. Another commenter stated that underwriters and other participants should be defined to include persons who make a "material contribution" to the economic structure, composition, management,**> or sale of an ABS.< ***See*** **letter from AFR**.

[140] ***See*** **Section II.C.3. for a discussion of what constitutes an "agreement" for purposes of Rule 192(a)(1).**

~~56~~ ~~*See, e.g.*, Better Markets Letter at 3; Merkley-Levin Letter at 3-4.~~

~~57~~ ~~*See, e.g.*, Better Markets Letter at 3-4.~~

~~58~~ [141] *See* ~~SIFMA Letter at 10~~***also*** **Proposing Release Section II.B.1**.

therefore, it is sufficient that a person who otherwise meets the definitions of "underwriter," "placement agent," or "initial purchaser" in Rule 192(c) has >an agreement with the issuer or selling security holder<**, as applicable, to perform the enumerated functions because, as stated above, such persons would likely be privy to information about the ABS or underlying assets, giving them the opportunity to influence the structure of the relevant ABS and engage in a bet against it. No factual determination of whether such person actually had "direct involvement" in the structure or design of the ABS is required.**

b. Sponsor

We are adopting the definition of "sponsor" with certain modifications from the proposal in response to comments received. The definition of "sponsor" will differ in four ways from the proposal. First, we are not adopting proposed paragraph (ii)(B) of the "sponsor" definition, which would have captured any person that >directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security. <**Second, we are revising the text of the final rule to state that persons who act solely pursuant to their contractual rights as holders of a long position in the relevant ABS are excluded from paragraph (ii) of the definition of sponsor, as discussed below. Third, we are revising the text to specifically exclude persons who perform only administrative, legal, due diligence, custodial, or ministerial activities related to the ongoing administration of the ABS or the composition of the pool of assets underlying or referenced by the ABS.[142] Fourth, we are deleting the proposed exclusion from the "sponsor" definition for the Enterprises while they are operating under the conservatorship or receivership of FHFA with capital support**

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[142] **The inclusion of the language "or referenced by the asset-backed security" in the definition of sponsor and other aspects of final Rule 192 is designed to address activities related to the reference pool for a synthetic ABS.**

definitions of those terms in the re-proposed rule are functional definitions that are based on such a person entering into an agreement with the relevant ABS issuer to perform specific functions. Such specific functions are essential to the successful issuance of the relevant ABS and, even if, for example, the relevant "sponsor" is the person most directly involved in the selection of assets, the relevant <underwriter, placement agent, or initial purchaser >would also be in a position to influence the structure of the relevant ABS given its role in the transaction. Therefore, we do not believe that including the requested exclusion would be appropriate.

Request for Comment

10. Are the proposed definitions of the terms "initial purchaser," "placement agent," and "underwriter" overinclusive or underinclusive, and why? If you believe that any of the proposed definitions are overinclusive or underinclusive, please provide an alternative definition and explain why you believe it is appropriate.

11. Should we modify the proposed definition of the terms "placement agent" and "underwriter," and if so, how should the proposed definition be modified and why? Specifically, is it appropriate to use the same definition for such terms? If not, please explain why and suggest revisions. Should we modify the proposed definition to provide for functions in addition to the functions specified in the proposed definition?

12. As discussed above, the proposed definition of the terms "placement agent" and "underwriter" would be limited to persons that have agreed with an issuer or a selling security holder to perform the functions detailed in the proposed definition. Should the proposed definition be expanded to include selling group members who have no such agreement with an issuer or selling security holder? Why or why not?

from the United States, which we discuss in Section II.B.3.b.iv., below.[143] Accordingly, for purposes of Rule 192, "sponsor" means:

~~13. Should the proposed definition of the term "distribution" be modified? If so, please explain why and provide an alternative definition. In particular, should "the presence of special selling efforts and selling methods" be included in the proposed definition? Additionally, should the magnitude of the offering be considered as part of the proposed definition?[59] Why or why not? If so, please describe the factors that should be considered when determining the magnitude of an offering (*e.g.*, the aggregate principal or notional amount of ABS to be sold, either in absolute terms or relative to the aggregate outstanding principal or notional amount of ABS issued by the issuer of the ABS and/or the normal trading volume of the ABS).~~

~~14. Should we modify the proposed definition of the term "initial purchaser," and if so, how should the proposed definition be modified and why?~~

~~**Sponsor**~~

~~Proposed Rule 192(c) would, subject to certain exceptions,[60] define the term "sponsor" as:~~

- Any person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the

entity that issues the asset-backed security **(a "Regulation AB-based Sponsor")**; or

~~[59] The definition of "distribution" in Regulation M considers the magnitude of the offering, in addition to the presence of special selling efforts and selling methods. *See* 17 CFR 242.100(b).~~

~~[60]~~ ~~• As discussed below in Section II.B.2.b., the proposed definition of "sponsor" excludes a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to~~ **Any person with a contractual right to direct or cause the direction of** the structure, design, or assembly of an asset-backed security or the composition of the pool of assets

underlying **or referenced by** the asset-backed security~~. As discussed below in Section II.B.2.c., the proposed definition of "sponsor" also excludes certain U.S. Federal government <entities and the Enterprises, subject to certain conditions.>~~ **(a "Contractual Rights Sponsor"), other than a person who acts solely pursuant to such person's contractual rights as a holder of a long position in the ABS (a "Long-only Investor")**

- ~~Any person:~~

- **But not including:**
  - ~~With a contractual right to direct or cause the direction of~~**A person who performs only administrative, legal, due diligence, custodial, or ministerial acts related to** the structure, design, ~~or~~ assembly**, or ongoing administration** of an asset-backed security or the composition of the pool of assets underlying **or referenced by** the asset-backed security **(the "Service Provider Exclusion")**; or
    - ~~That <directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security.>~~
  - **The United States or an agency of the United States with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States ("U.S. Government Exclusion").[144]**

[143] **As discussed below, final Rule 192 includes the proposed exclusion from definition of "sponsor" for the United States or any agency of the United States with respect to its fully insured or fully guaranteed ABS.**

[144] ***See* Sections II.B.2. and II.B.3.b.iv. for a discussion of comments received and the final U.S. Government Exclusion.**

~~Thus~~**As with the definitions discussed above, we are adopting a functional definition of "sponsor" that will apply regardless of the person's title and that instead focuses on the person's activities with respect to the ABS transaction. Accordingly**, a person who organizes and initiates an ABS transaction, or who ~~directs or causes~~**has a contractual right to direct or cause** the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying ~~the ABS (or who has the contractual right to do so), would, subject to the~~**or referenced by the ABS whether before or after the initial issuance of the relevant ABS, is a sponsor under Rule 192 (unless one of the** exceptions described below~~, be <a sponsor for purposes of >the re-proposed rule. This would include~~ **applies). For example**>, an "issuer" of a municipal securitization <**will** >be a "sponsor" if its activities meet the <**definition. This definition also includes**, for example, a portfolio selection agent for a **collateralized debt obligation ("**CDO**")** transaction~~,~~ **with a contractual right to direct or cause the direction of the composition of the pool of assets on behalf of the CDO or** a collateral manager for a **collateralized loan obligation ("**CLO**")** transaction with the contractual right to direct **or cause the direction of** asset purchases or sales on behalf of the CLO~~, or a hedge fund manager or other private fund manager who directs the structure of the ABS or the composition of the pool of assets underlying the ABS as described in the definition. Whether other parties to a securitization transaction, such as servicers, would meet the re-proposed rule's definition of "sponsor" is a determination that would be based upon the specific facts and circumstances of the ABS transaction, including whether such a party would qualify for the exclusion in paragraph (ii)(C) of the proposed definition of "sponsor" for a <person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, >or assembly <of the ABS or the composition of the pool of assets underlying >the ABS, as discussed below in Section II.B.2.b.~~.[145]

~~Similar to the other proposed definitions discussed above, the proposed definition of the term "sponsor" is a functional definition that would apply regardless of the title bestowed upon the person (*e.g.*<, an "issuer" of a municipal securitization >would <be a "sponsor" if its activities meet the >re-proposed rule's definition).~~[61]

~~a~~*i*. ~~Sponsor in~~ *Regulation* ~~AB~~***AB-based Sponsor***

~~Paragraph~~**We are adopting paragraph** (i) of the ~~proposed~~ definition of "sponsor" ~~in~~**as** proposed**. For purposes of** Rule 192~~(c)~~, ~~which <is derived from the definition of the term "></~~**therefore, a** sponsor~~" in Regulation AB,~~[62] includes**, but is not limited to,** any person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the entity that issues the asset-backed security. ~~However,~~[146] **This portion of** the definition ~~in the re-proposed rule is not <limited to the Regulation AB definition>.~~[63] ~~The Regulation AB definition was adopted to define who a sponsor is for purposes of the Regulation AB registration and reporting regime, and accordingly, that definition was intended to identify the party or one of the parties that is responsible for complying with the offering and reporting requirements of Regulation AB.~~[64] ~~Moreover, the Regulation AB definition of "sponsor" was adopted for the limited purpose and scope applicable only to those~~>is derived from the definition of the term "<**sponsor" in Regulation AB and was generally supported by commenters, who stated that it is consistent with the use of**

145 ***See also*** **Sections II.A.2. and II.A.3. for a discussion of the comments received and the final definition of "asset-backed security" as it applies to municipal securitizations.**

146 **17 CFR 230.192(c).**

the term in both Regulation AB[147] and Regulation RR,[148] as well as market understanding of what a securitization sponsor is.[149]

Some commenters requested that we exclude states and their political subdivisions from the definition of "sponsor" under the final rule.[150] These commenters generally stated that application of Rule 192's prohibition to municipal issuers is unnecessary because these issuers engage in transactions pursuant to enabling legislation that is designed specifically to aid in the furtherance of important government functions and other public purposes, are restricted from engaging in speculative investments, and are not driven by a profit motive that would lead to the type of behavior that Section 27B is intended to address.[151] While municipal issuers may be subject to other provisions that regulate their conduct, we are not persuaded that issuers of municipal ABS are uniquely different from other securitization participants such that they should be excluded from the final rule. Similarly, the fact that municipal entities are subject to investment policies that limit the ability of such entities as investors to engage in speculative investments is not a reason to exempt these entities from the definition of "sponsor." While the outcome of such policies may be that the entities may not, for example, take a short position

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147 **17 CFR 229.1101(l).**

148 **17 CFR 246.**

149 ***See, e.g.*, letters from AIC; SFA I; SIFMA I.**

150 ***See, e.g.*, letters from NABL et al.; NAHEFFA (also requesting that 501(c)(3) organizations and the issuers of qualified 501(c)(3) conduit bonds to such organizations be excluded from the definition); NAMA; SIFMA I; Wulff Hansen (expressing support for the comments submitted by NAMA).**

151 ***Id.* One of these commenters also stated that application of the prohibition in Rule 192 to State and local governmental issuers would be a breach of the principles of federalism and intergovernmental comity. *See* SIFMA I. The U.S. Supreme Court has held that State and local governments "must find their protection from congressional regulation through the national political process, not through judicially defined spheres of unregulable state activity." *See Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985); *South Carolina v. Baker*, 485 U.S. 505 (1988). Congress enacted Section 621 of the Dodd-Frank Act, adding Section >27B of the Securities Act<. Rule 192 implements Section 27B of the Securities Act with respect to certain activities undertaken by State and local governmental issuers that fall within its proscriptions. It follows, therefore, as provided in *Garcia* and *Baker*, that the application of Rule 192 to State and local governmental issuers is not inconsistent with principles of federalism and intergovernmental comity.**

against their municipal ABS, the objectives of those policies are typically focused on protection of the entity's investment portfolio.[152] Being subject to various laws and regulations that may intersect is not a position that is unique to issuers of municipal ABS. Additionally, the prohibition in Rule 192 is designed to prophylactically protect investors in U.S. securities markets from ABS transactions tainted by material conflicts of interest, regardless of whether a securitization participant has a profit motive or actually does profit from such transactions.[153] As such, while it may be unlikely, as some commenters stated, that issuers of municipal ABS would >engage in the type of conduct that <Section 27B prohibits for the reasons discussed above,[154] we do not believe that an exclusion from the definition of "securitization participant" or "sponsor" would be appropriate because investors are entitled to the protections afforded by the statute regardless of how likely the securitization participant is to engage in a conflicted transaction.

Some commenters went on to state that, because municipal ABS issuers are unlikely to engage in conflicted transactions for the reasons discussed above, these entities would need to expend administrative and financial resources to "prove a negative" (*i.e.*, that they do not engage in conflicted transactions), especially if securitization participants were to >be required to have documented policies and procedures in place <to prevent violation of the prohibition, adding compliance costs without a clear regulatory benefit.[155] Although the Commission requested comment in the Proposing Release about whether the final rule should >include a requirement that a securitization participant have documented policies and procedures <reasonably designed to

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[152] ***See*** **letter from NABL et al. (stating that municipal investment policies are "centered on preservation of principal or moderate growth.")**

[153] *See* Section II.~~A. for discussion of the proposed definition of "asset-backed security" and its application to municipal securitizations.~~**D.3**

[154] ***See, e.g.*, letters from NABL et al.; NAHEFFA; NAMA; SIFMA I.**

[155] ***See, e.g.*, letters from NAHEFFA; NAMA.**

prevent a violation of the rule's prohibition on conflicted transactions,[156] the Commission did not receive any comments in support of such a requirement. Commenters, however, expressed concerns about the potential costs associated with such a provision,[157] and therefore, final Rule 192 does not include a requirement that securitization participants have documented >policies and procedures reasonably designed to <**prevent a violation of the rule's prohibition. As such, while we recognize that compliance with the prohibition against engaging in conflicted transactions may result in increased compliance costs to municipal issuers subject to Rule 192, we expect that such costs will be modest because the final** >rule does not include a <**general requirement for policies and procedures.[158]**

~~[155] 17 CFR 229.1101(l). Under the Regulation AB definition, a sponsor is the person who~~**For these reasons, we continue to believe that any such costs will be justified because investors in municipal securitizations should be entitled to the same legal protections as investors in other types of ABS that meet the definition of "asset-backed security" in Rule 192(c). Accordingly, if a municipal security meets the definition of Exchange Act ABS,[159] then the municipal issuer that** organizes and initiates ~~an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.~~**such an offering[160] is** >a sponsor for purposes of <**Rule 192.[161]**

~~[156] Some commenters to the 2011 proposed rule supported adopting the Regulation AB definition of the term "sponsor." *See* SIFMA Letter at 11 (suggesting that the term "sponsor" be defined as "<a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.>"); *see also* ASF Letter at 22-23 n.36 (supporting the Regulation AB definition of sponsor and stating that "[w]e do not believe the definition of 'sponsor' should cover servicers, custodians or collateral managers, since those who merely service or manage the assets underlying an ABS, by definition, do not play a role in structuring an ABS and are not, therefore, in a position to design the ABS to default or fail"); comment letter from American Bar Association (Feb. 13, 2012) ("ABA Letter") at 4 (supporting the Regulation AB definition of the term "sponsor").~~

~~[157] *See* <2004 Regulation AB Adopting Release.>~~

[156] ***See* Proposing Release Request for Comment 59.**

[157] ***See, e.g.*, letters from NAHEFFA, NAMA.**

[158] ***See* Section IV for a discussion of the Commission's economic analysis of the impacts of Rule 192 and a discussion of alternatives considered.**

[159] ***See* Section II.A.3.a.**

[160] **Or, in the case of a municipal advisor, if the advisor has a contractual right** >to direct or cause the direction of the structure, design, or assembly <**of a municipal ABS, such person is a sponsor under paragraph (ii) of the "sponsor" definition in final Rule 192(c). *See* Section II.B.3.b.ii.**

[161] **The same analysis will apply for issuers of single-asset conduit bonds that meet the definition of Exchange Act ABS or otherwise meet the definition of "asset-backed security" in Rule 192(c). *See* Section II.A.3.a.**

ii. Contractual Rights Sponsor

We are adopting the definition of "Contractual Rights Sponsor" that was proposed >in paragraph (ii)(A) of the proposed definition of "sponsor" <**with certain modifications in response to comments received. Also, in response to comments received, we are not adopting the definition of "Directing Sponsor" that was proposed** >in paragraph (ii)(B) of the proposed definition of "sponsor." <**Accordingly, paragraph (ii) of the definition of "sponsor" for purposes of Rule 192 captures, subject to certain exceptions discussed below, any person with a contractual right to direct or cause the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying or referenced by the asset-backed security (a Contractual Rights Sponsor), other than a person who acts solely pursuant to such person's contractual rights as a holder of** >a long position in the <**asset-backed security (a Long-only Investor).**[162] **The revision to explicitly exclude Long-only Investors from the definition of sponsor by deleting the proposed "Directing Sponsor" definition is consistent with the Commission's stated intent in the Proposing Release that an ABS investor (that does not otherwise meet any of the other definitions of parties covered by the rule) would not be a sponsor under the rule** >merely because such investor expresses its preferences regarding the assets that would collateralize its ABS investment.<[163] **Also, Rule 192 is not designed to discourage ABS investors from exercising contractual rights as a holder of a long position in an ABS. As discussed below, the final rule excludes any person who acts solely pursuant to such person's contractual rights as a holder of a long position in the ABS.**

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[162] **As discussed in more detail below, we are also adopting an exclusion from the "sponsor" definition for any person who performs only administrative, legal, due diligence, custodial, or ministerial acts related to the ABS and**> for the United States or an agency of the United States with respect to<> ABS that is fully insured or fully guaranteed< **as to the timely payment of principal and interest by the United States. *See* Sections II.B.3.b.iii. and II.B.3.b.iv.**

[163] ***See* Proposing Release Section II.B.2.b.**

~~ABS eligible for registration under Regulation AB, and would not be appropriate to cover the full range of ABS that would be covered by the re-proposed rule, including those that are unregistered.[65] Accordingly, the proposed definition of "sponsor" in the re-proposed rule would include, but would not be limited to, a sponsor as defined in Regulation AB. As discussed below, we are proposing a~~**The Commission proposed a comprehensive** definition of "sponsor" that would ~~apply more broadly to also cover, subject to certain exceptions, <any person that directs or causes the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS or has the >contractual right to do so. This is because such a person~~**include a person that** is in a unique position to structure the ABS and/or construct the underlying asset pool or reference pool in a way that would position the person to benefit from the actual, anticipated, or potential adverse performance of the relevant ABS or its underlying asset pool if such person were to enter ~~into~~**in** a conflicted transaction.[164] **Some commenters supported this approach, citing the significant role that such parties play in securitization transactions.[165] As discussed in greater detail below, a number of commenters, however, opposed the proposed inclusion of Contractual Rights Sponsors and Directing Sponsors as too broad.[166] Some of these commenters requested that the "sponsor" definition be limited to paragraph (i) (*i.e.*, a Regulation AB-based sponsor),[167] while others stated that such a definition would not be sufficient to capture the key transaction parties that have a significant role in asset selection for ABS transactions.[168] Some commenters also stated that defining "sponsor" to include functions beyond the scope of the Regulation AB-based Sponsor definition extends beyond the "ordinary and natural meaning" of the term, which they state is understood by market participants to be the definition that was codified in Regulation AB.[169] These commenters stated that the Commission codified the "ordinary**

and natural meaning" of the term "sponsor" when it adopted the definition in Regulation AB in 2004

~~**b. <Contractual Rights Sponsor and Directing Sponsor>**~~

~~Consistent with our concerns about the potential underinclusiveness of the Regulation AB definition of "sponsor" for purposes of the re-proposed rule, paragraph (ii) of the proposed definition of "sponsor" in proposed Rule 192(c) would apply more broadly to also cover<, subject to certain exceptions, any person that directs or causes the direction of the structure, design, or>~~

[164] ***See*** **Proposing Release Section II.B.**

[165] ***See*** **letters from AFR; Better Markets.**

[166] ***See, e.g.*****, letters from ABA; AIMA/ACC; AFME; CREFC I, CRE Finance Council dated July 5, 2023 ("CREFC II"); NAMA; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SFA II; SIFMA I.**

[167] ***See, e.g.*****, letters from ABA; AIC; SIFMA I. letters from ABA; AIC; SIFMA I. *See* Section II.B.3.b.i. above for a discussion of paragraph (i) of the "sponsor" definition in Rule 192(c).**

[168] ***See, e.g.*****, letters from Better Markets (expressing support for the scope of the definition and stating that collateral managers should be subject to the rule because they play a significant role in selecting and managing the assets underlying an ABS); SFA II (acknowledging the Commission's desire to scope in CLO managers that are not sponsors for purposes of Regulation RR).**

[169] ***See, e.g.*****, letters from ABA; AIC; SIFMA I.**

and that, because Section 27B uses the term "sponsor" without separately defining it, any other definition for purposes of Rule 192 would be inconsistent with Congressional intent.[170]

Regulation AB is a set of disclosure items that form the basis for disclosure in Securities Act registration statements and Exchange Act reports for asset-backed securities and identify the transaction parties responsible for making that disclosure.[171] When the Commission adopted these specialized registration, disclosure, and reporting requirements in Regulation AB for certain types of asset-backed securities, it explained that those requirements were specifically designed for asset-backed securities that have certain characteristics (*i.e.*, ABS as defined in Regulation AB).[172] At that time, the Commission acknowledged that the types of ABS that would meet the definition in Regulation AB were a subset of the full spectrum of ABS in the market.[173] For example>, synthetic securitizations are not eligible for <**registration and reporting under Regulation AB because such** >securitizations are primarily based on the performance of assets or indices not included in the ABS<.[174] **As such, the concept of a sponsor "selling or transferring assets...to the entity that issues the [ABS]" in the "sponsor" definition under Regulation AB would not be applicable in a synthetic ABS because, as** >described in Section II.A.<**3.b. above, a synthetic ABS is designed to create exposure to an asset that is not sold, transferred to, or otherwise part of the asset pool. Rule 192, consistent with the express language**

170 *See, e.g.*, letters from ABA; AIC; SIFMA I.

171 *See* Sections III.A.2. and III.B.3. of the 2004 Regulation AB Adopting Release.

~~[172] Not all ABS are <eligible for the specialized registration and reporting regime under Regulation AB>. For example, because synthetic <securitizations are primarily based on the performance of assets or indices not included in the ABS><, synthetic securitizations are not eligible for >the Regulation AB registration and reporting regime. *See*~~ **[172] *See* Section III.A.2. of the** 2004 Regulation AB Adopting Release ~~at 1513-14 (stating that in instances where ABS are not eligible, additional or different disclosures and/or registration and reporting treatment may be more appropriate and stating that synthetic securitizations do not meet the Regulation AB definition of ABS). Also as <discussed in Section II.A.>, the definition <of ABS for purposes of the >re-proposed rule is broader than the~~

~~definition of ABS in Regulation AB. For example, the re-proposed rule's definition of ABS includes synthetic ABS as required by Section 27B, whereas Regulation AB's definition of ABS does not.~~.

173 ***Id.*** **(stating, for example, that a default application of the traditional disclosure regime might not be appropriate for some structured securities, but that treating them the same as ABS as defined in Regulation AB may not be appropriate either and that, depending on the structure of the transaction and the terms of the securities, it might be most appropriate to apply some aspects of both regimes in combination). The Commission also acknowledged in that release that there may be securities developed in the future that are not contemplated in Regulation AB, which would similarly require consideration of which regulatory regime would be most appropriate.**

174 ***See also*** **Section III.A.2. of the 2004 Regulation AB Adopting Release.**

of Section 27B, applies to a wider spectrum of ABS (*i.e.*, Exchange Act ABS, synthetic ABS, and hybrid cash and synthetic ABS)[175] than Regulation AB and—as discussed throughout this section—the characteristics of the structure, assets, and the role of transaction parties involved in those types of ABS may differ significantly from those in Regulation AB ABS. We do not believe the concept of "sponsor" in Section 27B is >limited to the Regulation AB definition <**of that term, as that would mean that there is no "sponsor" for synthetic asset-backed securities, even though Congress explicitly referenced those participants in the statute. It is therefore appropriate for Rule 192 to define the securitization participants subject to the rule's prohibition to align with the characteristics of that wider spectrum of ABS. Accordingly, we continue to believe that, while it is appropriate for the final rule to incorporate a definition based on the Regulation AB definition of sponsor, defining "sponsor" for purposes of Rule 192 as a Regulation AB-based sponsor alone would not be sufficient to address the full range of securitization activities involved in asset-backed securities transactions that Section 27B addresses.**

One commenter also cited to the holding of the U.S. Court of Appeals for the District of Columbia Circuit >that the application of the <**term "securitizer"[176] to CLO collateral managers in Regulation RR was an overreach of its authority.[177] The Court's analysis was centered around the statutory text that directed the Commission, together with several other Federal agencies, to issue regulations to require any securitizer to "retain" an ~~economic interest in a portion~~ of the**

[175] *See* Section II.A.3.

[176] The statutory term at issue in the case was "securitizer," which was defined by Congress as an issuer of an ABS or >a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer. <***See*** **Section 15G(a)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*-11(a)(3)), which was added by Section 941 of the Dodd-Frank Act (Pub. L. 111-203).**

[177] *See* letter from AIC (citing *The Loan Syndications and Trading Association v. Securities and Exchange Commission et al.*, 882 F.3d 220 (D.C. Cir. 2018) (the "LSTA Decision") and stating that, by proposing to define "sponsor" in Rule 192 to refer to functions beyond the scope of the Regulation AB-based Sponsor definition, the Commission failed to heed the D.C. Circuit's guidance and exceeded the scope of its authority).

credit risk for any asset that the securitizer, through the issuance of an asset-backed security, "transfers, sells, or conveys" to a third party.[178] The Court held that, because open-market CLO managers do not "hold" the securitized loans in a CLO transaction at any point, they can neither "transfer" those loans, nor "retain" credit risk in the loans because such terms require that the "securitizer" has control over the assets via possession or ownership.[179] We believe a different analysis is applicable to Section 27B, which directs the Commission to prohibit securitization participants of Exchange Act ABS and synthetic ABS from engaging >in transactions that would involve or result in a material conflict of interest. <**Section 941 of the Dodd-Frank Act added Section 15G of the Exchange Act,[180] in which Congress provided a statutory definition for the term "securitizer" that incorporated** >from the Regulation AB definition of sponsor <**the general concept of transferring or selling assets into a special purpose entity. In the case of Section 15G, therefore, the statutory text specified the functions that Congress intended to be captured by the term "securitizer." In Section 27B, however, Congress did not define "sponsor," but it did specify the types of ABS (*i.e.*, Exchange Act ABS and synthetic ABS) that are subject to the prohibition. Moreover, as evidenced by statutory text in other laws, where Congress intended to refer to a portion of Regulation AB, it did so explicitly.[181]**

As we discussed above, the characteristics of the structure, assets, and the role of transaction parties involved in the wider spectrum of ABS covered by Section 27B (including

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[178] *See* LSTA Decision. *See also* 15 U.S.C. 78*o*-11(b)(1).

[179] *See* LSTA Decision, 882 F.3d at 223.

[180] 15 U.S.C. 78*o*-11(a)(3).

[181] *See, e.g.*, Credit Rating Agency Reform Act of 2006 (Pub. L. 109-291) (referring specifically to "issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph)"). We also note that the term "sponsor" appears in several other places throughout the securities laws with varying meanings. For

example, in Item 901 of Regulation S-K, a sponsor is defined in the context of roll-up transactions as "the person proposing the roll-up transaction." *See* 17 CFR 901(d).

synthetic asset-backed securities) differ significantly from those ABS subject to Regulation AB, and therefore the definitions adopted by the Commission in Regulation AB do not capture the types of ABS that Congress determined should be subject to Rule 192's prohibition. Accordingly, we believe that the statutory inclusion of these types of ABS requires that Rule 192 define the market participants and their roles in such ABS in congruence with the structures and characteristics specific to the relevant ABS.

A number of commenters also expressed concern that paragraph (ii) of the "sponsor" definition includes activities that could be attributed to a wide variety of transaction parties and could therefore be understood to scope in, as a Contractual Rights Sponsor or Directing Sponsor, almost any party with any role in the structuring of the transaction.[182] Commenters stated that the definition could include entities such as investors,[183] asset managers[184] and other investment advisers,[185] servicers,[186] and warehouse lenders,[187] each of which we discuss below.

Many commenters expressed concern that ABS investors could be captured by the definition of sponsor by virtue of the iterative negotiation process between deal participants and investors.[188] These commenters recognized the stated intent in the Proposing Release[189] that investors >acquiring a long position in an ABS would not be <**Directing Sponsors merely because**

[182] ***See, e.g.*, letters from ABA; AIMA/ACC; AFME, CREFC I; CREFC II; NAMA; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SFA II; SIFMA I.**

[183] ***See, e.g.*, letters from ABA; CREFC I; CREFC II; SFA I; SFA II; SIFMA I.**

[184] ***See, e.g.*, letter from ABA; LSTA IV.**

[185] ***See, e.g.*, letter from ICI.**

[186] ***See, e.g.*, letters from MBA; SFA I; CREFC I. We discuss the final rule's applicability to servicers in Section II.B.3.b.iii., below.**

[187] ***See, e.g.*, letter from ABA.**

[188] ***See, e.g.*, letters from ABA; AFME; CREFC I; CREFC II; IACPM; ICI; MBA; MFA II; LSTA III; LSTA IV; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SFA II; SIFMA I; SIFMA II.**

[189] ***See* Proposing Release Section II.B.2.**

they express their preferences regarding the structure of the ABS or the underlying assets, but requested that this be codified in rule text to avoid the unintended consequence of discouraging investors from actively participating in discussions about deal structures and underlying asset pools in their ABS investments and to help ensure that they are not unnecessarily subject to additional costs associated with developing compliance programs under Rule 192.[190] In current market practice, investors in ABS transactions may receive information about collateral (including, for example, specific loan data and due diligence results) and may specify preferences or requirements for a given deal structure or terms of the security.[191] Commenters stated, and we agree, that these negotiations are important and beneficial market functions.[192] Consequently, as requested by commenters and to help ensure that Rule 192 is not an impediment to an investor's negotiating power, we are not adopting paragraph (ii)(B) (Directing Sponsor) >of the proposed definition of "sponsor<."

Some commenters suggested that the regulatory text should specify that long investors are also excluded from proposed paragraph (ii)(A) (Contractual Rights Sponsor).[193] Relatedly, some commenters stated that the exercise of contractual rights inherent to the purchase of the ABS should not be conflicted transactions under Rule 192(a)(3).[194] In securitizations, it is often the case that long investors purchasing the most senior or the most subordinated tranche of the relevant ABS negotiate for certain rights that are exercisable over the life of the securitization. A

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[190] ***See, e.g.***, letters from ABA; AFME; CREFC I; CREFC II; IACPM; ICI; MBA; MFA II; LSTA III; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SFA II; SIFMA I; SIFMA II.

[191] For example, investors may specify a certain rating, yield, or maturity on the bonds, require particular levels of subordination or credit enhancement, or may request that assets be added or removed to satisfy preferences with respect to asset quality, concentration levels, etc.

[192] ***See, e.g.***, letters from CREFC I; ICI; SFA II.

[193] ***See, e.g.***, letters from CREFC I; SFA II; SIFMA II.

[194] ***See, e.g.***, letter from CREFC I; SFA I.

person's contractual rights as a holder of a long position in the ABS could include, for example, consent rights over major decisions such as initiating foreclosure proceedings with respect to assets underlying the ABS, the right to replace the special servicer of the ABS, or the right to direct or cause the direction of an optional redemption of outstanding interests in the ABS. Rule 192 is not designed to impair an ABS investor's ability to negotiate for such contractual rights as a holder of a long position in the ABS. Nor is it designed to discourage investors from exercising such rights as a holder of a long position in the ABS. Therefore, we are adopting paragraph (ii) of the definition of "sponsor" to exclude from the definition of Contractual Rights Sponsor any person who acts solely pursuant to such person's contractual rights as a holder of a long position in the ABS.

Whether a long investor is acting "solely" pursuant to its contractual rights as a holder of a long position in the relevant ABS will depend on the relevant facts and circumstances, including what other roles the long investor may have in the transaction. For example, some commenters requested that the rule specify that the holders of "B-piece" bonds (the "B-piece buyer") in commercial mortgage backed securities ("CMBS") transactions[195] are not "sponsors" as defined by the final rule or, alternatively, that the B-piece buyers be otherwise excluded because they should be considered long investors.[196] Whether a B-piece buyer in a CMBS transaction is a "sponsor" for purposes of Rule 192 or satisfies the condition of the exclusion for Long-only Investors will depend on the facts and circumstances of a given transaction and B-

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[195] As is the case with most ABS, CMBS securities are offered in tranches, with each tranche representing a different risk profile. The top tranche (referred to as "AAA") represents the lowest risk investment while the lower tranches (typically non-investment grade) represent the highest risk profile because they are the first to incur losses in the event that there are shortfalls in collections on the underlying assets. In CMBS, the "B-piece" bonds are the lowest tranche(s) of the CMBS (*i.e.*, the most subordinate tranche(s), meaning that holders are purchasing the first-loss position) and the holders of those bonds are typically third-party purchasers, commonly referred to as the "B-piece buyer." *See, e.g.*, Section III.B.5. of the RR Adopting Release.

[196] *See, e.g.*, letters from ABA; CREFC I; Fannie and Freddie; MBA.

piece buyer.[197] Generally, the B-piece buyer purchases the most subordinate tranches of the ABS and, in connection with this investment, performs extensive due diligence on the underlying loans and negotiates with the deal sponsor for changes to pool composition and to increase credit quality of the pool. As a holder of a long position in the relevant ABS, a B-piece buyer will generally have additional ongoing rights in >an ABS transaction. For example, <**transaction agreements may dictate that certain actions with respect to the asset pool underlying the ABS (such as releasing a property from a lien) are subject to the approval of the B-piece buyer,[198] giving the B-piece buyer a contractual right to direct or cause the direction of the composition of the pool. As such, absent the exclusion we are adopting for Long-only Investors, a B-piece buyer could be subject to the prohibition of Rule 192(a)(1) as a Contractual Rights Sponsor. Under the final rule, if the B-piece buyer exercises such rights solely pursuant to its contractual rights as a holder of a long position in the ABS, then the B-piece buyer will satisfy the conditions for the Long-only Investor carve-out from the definition of Contractual Rights Sponsor as adopted and, therefore, will not be subject to the prohibition in Rule 192(a)(1).**

In some circumstances, however, the B-piece buyer can also act as a special servicer for the securitization (*i.e.*, a contractual party to the transaction) or may be an affiliate or subsidiary of the special servicer. Whether a special servicer's activities satisfy the conditions of the exclusion for persons that perform only administrative, legal, due diligence, custodial, or ministerial acts with respect to the relevant ABS will depend on the nature of the special servicer's activities.[199] Accordingly, if a B-piece buyer is also a special servicer for an ABS

[197] The same analysis applies for the directing noteholder in a commercial real estate collateralized loan obligation ("CRE CLO"), which functions similarly to the B-piece buyer in CMBS transactions.

[198] *See, e.g.*, letter from CREFC I.

[199] ***See* Section II.B.3.b.iii. for a discussion of the final rule's application to special servicers.**

transaction, the B-piece buyer will not be acting "solely" pursuant to its rights as a holder >of a long position in the relevant ABS <**and will need to then consider whether the performance of its contractual obligations as special servicer will be sufficiently administrative or custodial in nature to be excluded from the definition.[200] Similarly, if the B-piece buyer is an affiliate or subsidiary, as defined by this rule, of another securitization participant in the relevant ABS, then it will also be a securitization participant subject to the prohibition in Rule 192(a)(1).[201] For the foregoing reasons, whether a B-piece buyer is a "sponsor" for purposes of Rule 192, or is eligible for the Long-only Investor exclusion, will depend on the facts and circumstances of the particular ABS and the roles of the B-piece buyer and its** >affiliates and subsidiaries in the <**ABS transaction.**

Some commenters requested that market participants acting subject to a fiduciary duty to a client or customer, such as open-market CLO collateral managers, municipal advisors,[202] or other investment advisers >be excluded from the definition of "sponsor" <**because such participants are already subject to various laws and regulations that regulate their conduct and address conflict management.[203] Rule 192 will complement the existing federal securities laws, including those that govern a market participant's Federal fiduciary duties. As discussed earlier, the fact that an entity is subject to other rules, laws, or regulatory policies pertaining to its conduct, including the existence and management of conflicts of interest, does not preclude such**

[200] *Id.* As discussed in Section II.D.3.c., however, the exercise of such contractual rights and obligations will not themselves be conflicted transactions under the final rule. Also, if the performance of the B-piece buyer's contractual obligations as special servicer is sufficiently administrative or custodial in nature to rely on the Service Provider Exclusion and the B-piece buyer's only other role in the transaction is as a Long-only Investor, then the B-piece buyer will not be a sponsor under the final rule.

[201] *See* Section II.B.3.c.

[202] *See* Section II.B.3.b.i. for additional discussion about Rule 192's application to municipal advisors.

[203] ***See, e.g.*, letters from ABA; ICI; LSTA IV; NAMA; Wulff Hansen.**

entity from satisfying the conditions of other regulatory requirements. Additionally, we recognize, as one commenter stated, that securitization participants in an ABS subject to Rule 192 do not owe a fiduciary duty to the investors in an ABS because the securitization participants' advisory clients are the deal sponsors rather than the ABS investors.[204] In cases where a sale of an ABS does not involve the sale of an interest in a private fund[205] or other vehicle advised by an investment adviser, there is no advisory relationship creating a Federal fiduciary duty owed between a purchaser and seller. In cases where the private fund issues ABS (such as tranches of a CLO), the private fund's adviser owes a Federal fiduciary duty to the fund and the antifraud provisions of the Advisers Act and the rules thereunder (the "Antifraud Provisions") apply.[206] Such advisers include CLO collateral managers who will also be subject to Rule 192. Although the application of an adviser's Federal fiduciary duty, which requires the adviser to serve the best interests of its clients,[207] and the Antifraud Provisions provide protections relating to conflicts of interest that act in harmony with Rule 192, these duties and provisions do not necessarily require elimination of conflicted transactions. Accordingly, a fiduciary duty-based exclusion from Rule 192 would frustrate Section 27B's prophylactic investor protection objectives to eliminate certain conflicted transactions.

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[204] *See* letter from SIFMA I.

[205] Section 202(a)(29) of the Investment Advisers Act of 1940 (the "Advisers Act") defines the term "private fund" as an issuer that would be an investment company, as >defined in section 3 of the <Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act.

[206] *See* 17 CFR 275.206(4)-8 ("Advisers Act Rule 206(4)-8"), which prohibits investment advisers to a pooled investment vehicle from (1) making untrue statements of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or (2) otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle). *See also Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, Release No. IA-2628 (Aug. 3, 2007) [72 FR 153 (Aug. 9, 2007)]).

[207] *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)] ("IA Interpretation").

Some commenters also stated that an adviser's Federal fiduciary duty may address conflicts of interest, including through appropriate disclosure and informed client consent.[208] As the Commission has stated, while full and fair disclosure of all material facts relating to the advisory relationship or of conflicts of interest and a client's informed consent prevent the presence of those material facts or conflicts themselves from violating the adviser's fiduciary duty, such disclosure and consent do not satisfy the adviser's duty to act in the client's best interest.[209] By contrast, Rule 192 sets forth an express prohibition against certain conflicted transactions. The final rule will therefore provide additional prophylactic protections for ABS investors by requiring the elimination of those conflicted transactions. For these reasons, we do not believe it would be necessary, appropriate, or consistent with the investor protection objectives of Section 27B to provide a fiduciary duty-based exclusion >from the definition of "sponsor<**."**

Some commenters also expressed concern that investment advisers who do not participate in the structuring or distribution of ABS would be captured by >the proposed definition of "securitization participant" <**only as a result of being an affiliate or subsidiary of another named securitization participant.[210] One of these commenters stated, however, that permitting the use of information barriers in the final rule would "solve this problem."[211] Our changes to the scope of**

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[208] ***See, e.g.*, letters from AIMA/ACC; ICI; SIFMA I.** ***See also*** **IA Interpretation at 33676 (noting that an adviser must eliminate or at least expose through full and fair disclosure the conflicts associated with its allocation policies, including how the adviser will allocate investment opportunities between clients, such that a client can provide informed consent.).**

[209] ***See*** **IA Interpretation at 33676.**

[210] ***See, e.g.*, letters from AIC; ICI; LSTA IV. For example, these commenters stated that investment advisers may engage in separate businesses that are unrelated to their securitization activities, and thus those entities and their employees would have no knowledge of, or involvement in, the securitization activity.** ***See also*** **letter from SFA II (stating that advisers typically have fiduciary duties to multiple clients and that such advisers must act in the best interest of each client separately).**

[211] ***See*** **letter from LSTA IV.**

the affiliates and subsidiaries covered by the rule, including permitting securitization participants and their affiliates and subsidiaries to employ various mechanisms (such as information barriers) to prevent coordination or sharing of information tailored to their organization,[212] will help address commenters' concerns about the rule's applicability to affiliates and subsidiaries. Therefore, a fiduciary duty-based exclusion to address these concerns is unnecessary.[213]

Some of these commenters also requested that municipal advisors be excluded from the definition of "sponsor."[214] These commenters stated that, in addition to the reasons already stated that make it unlikely that a municipal issuer would engage in conflicted transactions, municipal advisors also have a fiduciary duty to their clients, various existing rules and regulations governing their conduct, and that any proprietary bet by a municipal advisor against its client's ABS would already be a violation of the federal securities laws.[215] Municipal advisors participate in structuring the securities, and although municipal advisors may be subject to other provisions that regulate their conduct, we are not persuaded that advisors to municipal ABS are uniquely different from other securitization participants such that they should be excluded from the final rule. The fact that such entities are subject to potential liability for violations of other laws and regulations does not preclude the Commission from subjecting them to other rules with different objectives>. In particular, we note that a <municipal advisor's fiduciary duty is to its municipal entity clients, not to investors, and therefore would not

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[212] ***See*** **Section II.B.3.c.**

[213] ***See also*** **Section II.D. for a discussion of the revised definition of "conflicted transaction" and the rule's applicability to transactions undertaken pursuant to a fiduciary duty.**

[214] ***See*** **letters from NAMA; Wulff Hansen.**

[215] ***Id. See also*** **Sections II.B.3.c. and II.D.3. for additional discussions with respect to fiduciary duties in relation to Rule 192.**

necessarily require elimination of conflicted transactions.[216] As discussed earlier, Rule 192 will complement the existing federal securities laws, including general anti-fraud and anti-manipulation provisions, as well as those that apply specifically to securitization, by prophylactically protecting against the sale of ABS tainted by material conflicts of interest.[217]

The Commission also received comment requesting that providers of warehouse financing be excluded from the definition of "sponsor."[218] A warehouse financing facility is a secured loan from a warehouse lender to provide capital to sponsors to acquire and aggregate assets for securitization.[219] One commenter stated that, because a warehouse lender bears the risk with respect to any assets that cannot be securitized, it acts pursuant to strict underwriting standards reflective of the lender's risk tolerance.[220] If a lender determines that it is unwilling to lend against certain assets, this commenter stated that such influence over the exclusion of those assets could be construed as >directing or causing the direction of the structure, design, or assembly of an ABS or the composition of the <**asset pool.[221] As stated in the Proposing Release, the rule is not designed to hinder routine securitization activities that do not** >give rise to the risks that Section 27B was intended to address.<[222] **Warehouse financing is a routine activity to finance the purchase of assets by a securitization participant in furtherance of the issuance of an ABS. A warehouse lender whose role is to engage in such routine lending activity with respect to the ABS, including the lender's right to determine which assets it is or is not willing to finance**

[216] 15 U.S.C. 78*o*-4(c)(1).

[217] *See* Section I.C.

[218] *See* letter from ABA.

[219] *See also* Section II.D.

[220] *Id.*

[221] *Id.*

[222] **See Proposing Release Section II.D.1.**

pursuant to its underwriting standards, does not meet the definition of "sponsor" under the final rule.[223] However, if a securitization participant has an affiliate or subsidiary that is a warehouse lender, and such affiliate or subsidiary meets the definition of securitization participant in Rule 192(c), such person will be subject to the prohibition in Rule 192(a).[224]

In the Proposing Release, the Commission explained that the definition of Contractual Rights Sponsor in paragraph (ii)(A) would not require an actual exercise of contractual rights. Two commenters opposed this approach, stating that such person should only be a sponsor if it actually exercised its contractual rights to >direct or cause the direction of the structure, design, or assembly of an ABS or the <**underlying or referenced assets.[225] One of these commenters requested that, if the definition of "sponsor" is not limited to paragraph (i), the final rule should define "sponsor" to include a Regulation AB-based Sponsor or *both* a** >Contractual Rights Sponsor and Directing Sponsor <**(*i.e.*, a person who both has a contractual right to, and actually does, direct or cause the direction of the structure, design, or assembly of an ABS or the underlying or referenced assets).[226] This commenter stated that any person who does not have the contractual right, but that is actually involved in the structuring of an ABS or the composition of the underlying or referenced asset pool, would have no practical ability to structure the ABS to fail because the Regulation AB-based Sponsor in the deal (who has exposure to the credit risk of the ABS by operation of the risk retention requirement in Regulation RR) would have no reason to take direction from such person, and that any person who has the contractual right but**

~~assembly of an ABS or <the composition of the pool of assets underlying the ABS or ><has the contractual right to do so.>~~

First, paragraph (ii)(A) of the proposed definition of "sponsor" would include, subject to certain exceptions, any person with a <contractual right to direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the >pool of assets underlying the ABS (a "contractual rights sponsor").[66] The definition of sponsor in the re-proposed rule refers to a contractual right to direct or cause the direction of "the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security" because we believe that the structure of the ABS and the composition of the underlying asset pool are the factors that will most impact the performance of the ABS. Additionally, a person with the contractual right to direct or cause the direction of these aspects of an ABS that enters into a conflicted transaction would have the incentive and ability to engage in the conduct that is prohibited by Section 27B. For example, participating in asset selection for an ABS provides the opportunity for a person to benefit through a bet against the ABS or the underlying assets by selecting assets that such person believes will perform poorly.[67] Therefore, the definition that we are proposing would cover various parties with a significant role in asset selection for an ABS transaction, whether before or after the initial issuance of the relevant ABS, such as a portfolio selection agent for a CDO transaction, a collateral manager for a CLO transaction with the contractual right to direct asset purchases or sales on behalf of the CLO, or a hedge fund manager or other private fund manager with substantial involvement in the selection

[66] <This approach is consistent with >a commenter's suggestion in response to the 2011 proposed rule to define the term "sponsor" broadly for purposes of Section 27B in order to ensure that the prohibition would apply to a broad range of persons with "significant influence in the structure, composition, and management of an ABS." *See* Merkley-Levin Letter at 3–4.

[67] [223] *See* ***also*** Section II.D. **below** for a discussion of what would be **why warehouse financing is not** a "conflicted transaction" under the re-proposed**final** rule.

[224] ***See*** **Section II.B.3.c.**

[225] ***See*** **letters from AIC; SIFMA I (stating that such a position would be inconsistent with the ordinary and natural meaning of the term). We discuss the comments related to the "ordinary and natural meaning" of sponsor earlier in this section.**

[226] ***See*** **letter from AIC.**

does not exercise it has no real culpability.[227] While the risk retention requirement in Regulation RR does contribute to the alignment of interests between ABS sponsors and investors, not all types of ABS that are subject to the prohibition in Rule 192 are subject to Regulation RR. A sponsor of an ABS that is not subject to Regulation RR would not be required to retain exposure to the credit risk of the ABS, meaning that there may not be an alignment of interests between the sponsor and investors, which could create an opportunity for the sponsor to be influenced by a third party's requests. Moreover, any person with a contractual right to structure, design, or assemble an ABS or the underlying or referenced pool of assets—whether those rights are exercised or not—would have access to information about the ABS or its underlying or referenced assets prior to the sale of the ABS and would therefore have the opportunity to use that information to engage in a conflicted transaction with respect to such ABS or underlying or referenced assets. As discussed above, final Rule 192 is designed to eliminate such opportunity and incentive. As such, a person may be a "sponsor" subject to the prohibition in final Rule 192 if it is either a Regulation AB-based Sponsor or a Contractual Rights Sponsor, and the final rule does not require that an actual exercise of contractual rights is necessary to meet the definition of "sponsor." Consequently, a person who meets the definitional criteria in Rule 192(c) can be a "sponsor" regardless of whether it is referred to as the sponsor or some other title (*e.g.*, issuer, depositor, originator, collateral manager).

While we understand commenter concerns about the number and types of entities that may be sponsors under the rule, we continue to believe, for the reasons discussed above, that the scope of the definition is necessary to capture the relevant securitization participants that would have the incentive and ability to engage in conflicted transactions >as a result of their <**ability to**

[227] *Id.*

of the assets underlying an ABS (other than in connection with its acquisition <of a long position in the relevant ABS>).

The re-proposed rule does not provide that an actual exercise of contractual rights would be necessary for purposes of the proposed definition of "sponsor." Our understanding of general industry practices based on our oversight of ABS markets is that there are a relatively small number of parties in a given ABS transaction with such contractual rights, and that in most instances a party with such contractual rights (*e.g.*, a portfolio selection agent or collateral manager) would in fact exercise (and often has a contractual duty to exercise) those contractual rights with respect to the ABS. Accordingly, we believe it is appropriate for the proposed definition of "sponsor" to capture contractual rights sponsors without requiring a factual determination of whether a contractual rights sponsor has exercised its contractual right to direct or cause <the direction of the structure, design, or assembly of an ABS or the composition of the pool >of assets underlying the ABS.

We understand that there may be instances where a person that does not have a contractual right to do so may nevertheless direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS. For example, in connection with certain well-known examples of synthetic CDOs that were issued in the lead up to the financial crisis of 2007-2009, hedge funds that desired to take short positions in synthetic CDO securities (*i.e.*, so that the hedge fund could benefit if the synthetic CDO securities performed adversely) would direct or cause the direction of the composition of the portfolio assets in ways that would increase the likelihood of realizing an ultimate gain on their short position.[68] Paragraph (ii)(B) of the proposed definition of "sponsor" would therefore also

[68] *See* Senate Financial Crisis Report.

include any person that directs or causes the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS even if that person does not have a contractual right to do so (a "directing sponsor"). A determination that a person meets the definition of sponsor for this reason would be based upon the specific facts and circumstances.

As stated above, participating in asset selection for an ABS provides the opportunity for a person to benefit through a <bet against the ABS or the >underlying assets by selecting assets that such person believes will perform poorly. Therefore, the definition that we are proposing would cover a person, such as a private fund manager, who selects all or a portion of the assets underlying the ABS by directing the relevant person with the contractual right to do so and, based on its ability to select assets that are expected to perform poorly, enters into a transaction to short the ABS. The facts and circumstances regarding the actions of such a person would be distinguishable from that of an ABS investor that is acquiring <a long position in the >relevant ABS. An ABS investor that is acquiring a long position in the relevant ABS would be expected to provide input with respect to the structure of the ABS investment or the underlying pool of assets for the purpose of maximizing the expected value of its ABS investment. For example, investors in certain ABS markets may have stipulations regarding general characteristics of the composition of the underlying pool of an ABS that must be satisfied in order for that investor to agree to acquire the relevant securities, including to ensure that the ABS investment would comply with its investment guidelines. Therefore, an ABS investor that is interested in <acquiring a long position in an ABS would not be >considered to direct the composition of assets <merely because such investor expresses its preferences regarding the assets that would collateralize its ABS investment. >Paragraph (ii)(B) of the proposed definition of "sponsor" is not intended to capture such investors as a "sponsor" and is intended to capture only those persons—such as the

hedge fund managers in the examples referred to above—that direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS other than in connection with their acquisition of a long position in the ABS.

The proposed definition of "sponsor" is a functional definition that would apply regardless of the title bestowed upon such person. Accordingly, a person would be a sponsor for purposes of the re-proposed rule if such person organized and initiated the ABS transaction or directed or had the contractual right to direct the structure, design, or assembly of the ABS or the composition of the pool of assets underlying the ABS, regardless of whether the person is referred to as the sponsor of the ABS or by some other title (*e.g.*, issuer, depositor, originator, or collateral manager),[69] and even if the person does not have a named role in the ABS transaction and is not a party to any of the transaction agreements. This is consistent with a commenter's suggestion in response to the 2011 proposed rule to define the term "sponsor" broadly for purposes of Section 27B in order to ensure that the prohibition would apply to a broad range of securitization participants, including collateral managers and other parties with significant influence in the structure, composition, and management of an ABS.[70]

To avoid having the scope of the proposed definition of "sponsor" extend beyond those persons with the incentive and ability to engage in the conduct that is prohibited by Section 27B, paragraph (ii)(C) of the proposed definition of "sponsor" would exclude a person <that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, >or assembly of the <ABS or the composition of the >pool of assets underlying the ABS. Whether a person performs only such functions is a determination that would be based upon the

[69] For example, if a person is designated an "issuer" of a transaction, the person could also be a "sponsor" if the person performs the functions specified in the proposed definition.

[70] *See* Merkley-Levin Letter at 3-4.

structure, design, or assemble an ABS or its underlying or referenced asset pool. Moreover, we believe that commenters' concerns will be mitigated by the revisions made to the definition of "sponsor" to exclude Long-only Investors and to not adopt the proposed definition of Directing Sponsor, as discussed above, and to the scope of affiliates and subsidiaries captured by the definition of "securitization participant" discussed in Section II.B.3.c. below, as well as the guidance that we have provided with respect to certain market participants discussed in this section and in the discussion about the Service Provider Exclusion in Section II.B.3.b.iii. below.

iii. Service Provider Exclusion

Commenters generally supported an exclusion from the definition of "sponsor" for transaction parties performing the enumerated types of activities, but requested certain modifications to clarify the scope of the exclusion.[228] Several commenters stated that the activities performed over the life of the securitization by servicers, special servicers, and other contractual providers are consistent with the activities enumerated in the Service Provider Exclusion in proposed paragraph (ii)(C) and requested that servicers be specifically listed in the exclusion.[229] Some commenters further requested that the rule include an explicit exclusion for credit rating agencies in the final rule text.[230]

~~specific facts and circumstances of <an ABS transaction. For example, >we believe~~**Consistent with the view expressed by the Commission in the Proposing Release,[231] we agree with commenters** that the activities customarily performed by accountants, attorneys, and credit rating agencies with respect to the creation and sale of an ABS, ~~and~~**as well as** the activities

[228] *See, e.g.*, letters from AIC; CREFC I; LSTA III; LSTA IV; MBA; SFA II; SIFMA I; SIFMA II.

[229] ***See, e.g.*, letters from AIC; CREFC I; CREFC II; MBA; SFA II; SIFMA I. One of these commenters noted that its membership was not in agreement with respect to whether a special servicer in CMBS transactions** >should be included in the <**Service Provider Exclusion. *See* letter from SFA II.**

[230] ***See* letters from LSTA III; SFA I; SFA II; SIFMA I.**

[231] ***See* Proposing Release at 9686.**

customarily performed by trustees, custodians, paying agents, calculation agents, and ~~other contractual service providers~~**servicers,**[232] relating to the ongoing management and administration of the entity that issues the ABS **and its related assets**, are the ~~sorts~~**types** of activities ~~that would typically fall within the exclusion from the definition of the proposed definition of the term "sponsor." This exclusion should address the concerns of a commenter that the persons defined to be subject to the prohibition of the re-proposed rule should not inadvertently include trustees, servicers, law firms, accountants, and diligence providers.[71] This exclusion should also mitigate concerns about the potential overinclusiveness of a definition of the term "sponsor," including concerns raised by certain commenters on the 2011 proposed rule about a definition that is broader than the Regulation AB definition.[72] While we received comment to the 2011 proposed rule that the definition of "sponsor" should include a catch-all to cover "any other person that makes a material contribution to the design, composition, assembly, sale, or management of an asset-backed security,"[73] we believe that such a catch-all provision would be overly broad as it could potentially include trustees, attorneys, or others that, for the reasons discussed above, should not be treated as "sponsors" under the re-proposed rule.~~**described in the Servicer Provider Exclusion. We understand, however, commenters' concern that, because the proposed text of the exclusion did not refer specifically to activities that constitute "ongoing administration" of the ABS or the underlying or referenced asset pool, the scope of the exclusion as proposed could be read to refer only to activities performed in connection with the initial creation of the securitization and therefore was not sufficiently clear.**[233]

~~[71] See SIFMA Letter at 9.~~

~~[72] See ASF Letter at 23 n.36; and ABA Letter at 4–5.~~

We are revising the definition of "sponsor" to align with the Commission's intent as stated in the Proposing Release and in response to commenter requests to specify in the rule text that the activities performed over the life of the securitization by third-party servicers

and other contractual providers[234] are consistent with the activities enumerated in the rule.[235] As adopted, therefore, the definition of "sponsor"—notwithstanding paragraph (ii)—excludes any >person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, <**assembly, or ongoing administration** >of the ABS or the composition of the pool of assets underlying <**or referenced by the ABS (the Service Provider Exclusion).[236] For purposes of the Service Provider Exclusion, "ongoing administration" refers to the types of activities**

232 ***See*** **Section II.D. below for a discussion of servicing activity as it relates to the definition of "conflicted transaction" under the rule.**

233 ***See, e.g.*****, letters from AIC; CREFC I; CREFC II; MBA; SFA I; SFA II.**

234 Servicers and other contractual service providers whose activities meet the criteria specified in the Service Provider Exclusion may nonetheless be securitization participants subject to the prohibition in Rule 192(a)(1) with respect to the relevant ABS if, for example, such person is an affiliate or subsidiary of a named securitization participant. ***See*** **Section II.B.3.c.**

235 ***See, e.g.*****, letters from AIC; CREFC I; CREFC II; MBA; SFA II; SIFMA I.**

236 Because the types of activities listed in the Service Provider Exclusion rule text already cover the activities of credit rating agencies, no additional revision to the rule text is unnecessary.

typically performed by servicers, trustees, custodians, paying agents, calculation agents, and other contractual service providers pursuant to their contractual obligations in a securitization transaction over the life of the ABS; it does not refer to active portfolio management or other such activity that would be subject to the "sponsor" definition.[237]

Some commenters also requested that we replace the qualifier "only" in the Service Provider Exclusion with "primarily,"[238] stating that the use of "only" erodes the exclusion because the administrative, legal, due diligence, custodial, or ministerial acts performed by the service providers discussed above could also be viewed as activities causing >the direction of the structure, design, or assembly of an ABS or the composition of the pool <**assets.[239] As one of these commenters pointed out, such activities could include the drafting and negotiation of the operating and disclosure documents with respect to an ABS, setting fees to be paid to certain transaction parties, reviewing the asset pool, negotiating the priority of payments within an ABS transaction, potentially advising on how to structure an ABS to meet the objectives of the deal parties, collecting payments on underlying assets, and making distributions to bondholders.[240] While we agree that such activities could be understood to be consistent with the activities described in the Contractual Rights Sponsor definition, we also agree that they are consistent with the administrative, legal, due diligence, custodial, and ministerial activities covered by the Service Provider Exclusion. As the Commission stated in the Proposing Release, the Service Provider Exclusion is intended to avoid inadvertently including certain parties to securitization transactions whose contractual rights could be interpreted as consistent with the activities**

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[237] *See, e.g.*, the discussion in Section II.D. below related to normal-course servicing activity in a covered transaction not constituting a "conflicted transaction" under the final rule.

[238] *See, e.g.*, letters from SFA I; SFA II; SIFMA II.

[239] *See, e.g.*, ~~Better Markets Letter at 3; Merkley-Levin Letter at 3-4~~**letters from SFA I; SFA II**.

[240] ***See*** **letter from SFA II.**

described in paragraph (ii) of the definition of "sponsor" but who are otherwise not the parties that Section 27B was intended to cover. For this reason, so long as a person's activities with respect to the relevant ABS are only administrative, legal, due diligence, custodial, or ministerial in nature, the Service Provider Exclusion is available "notwithstanding" the fact that such a person's contractual rights could also be understood to be captured by paragraph (ii) of the definition of sponsor. Accordingly, we do not believe that changing "only" to "primarily" is necessary.

Moreover, we continue to believe that limiting the exclusion in this way is necessary to ensure that it does not inadvertently extend to deal participants with more active participation in the creation and administration of asset-backed securities. For example, a special servicer can potentially have a significant role in the servicing and disposition of troubled assets in an asset pool, such as the ability to determine whether (and when) to negotiate a workout of a loan, take possession of the property collateralizing a loan, and purchase the loan out of the securitization at a discount and, therefore, the special servicer's activities may not be limited to the types of administrative or ministerial functions eligible for the exclusion.[241] As such, whether a special servicer qualifies for the exclusion will depend on >the facts and circumstances of the <**ABS and the activities performed by the special servicer.[242] Similarly, as support for its request that the Service Provider Exclusion include activities relating to ongoing administration of the ABS, one commenter gave the example of a situation in which a placement agent for a CLO may also be an administrative agent under a loan that underlies a CLO and therefore has various duties that it**

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[241] ***See*** **Section II.B.3.b.ii. and Section II.D.1.c.iii.**

[242] **For example, if the special servicer for a CMBS transaction is also the B-piece buyer (or an affiliate or subsidiary of the B-piece buyer) and can exercise such contractual rights with respect to the asset pool without needing to obtain the consent of any unaffiliated investor or transaction party in the CMBS**

transaction, then the special servicer's activities are not only administrative, legal, due diligence, custodial, or ministerial in nature with respect to such CMBS transaction.

~~c. Federal Government Entities and Certain Other Entities Backed by the Federal Government Would Not be Defined to be a Sponsor of Fully Insured or Fully Guaranteed ABS~~

~~Paragraph (iii)(A) of the proposed definition of "sponsor" in proposed Rule 192(c) would provide that the United States or an agency of the United States would not be a "sponsor" for purposes of the re-proposed rule with respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest[74] by the United States. Additionally, under paragraph (iii)(B) of the proposed definition of "sponsor," Fannie Mae or Freddie Mac operating under the conservatorship or receivership of FHFA with capital support from the United States[75] would not be a "sponsor" for purposes of the re-proposed rule with respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity.[76]~~

~~As discussed below, with respect to the types of fully insured or fully guaranteed securities of which the United States, an agency of the United States, or the Enterprises might otherwise be a sponsor absent these proposed exclusions, it is the United States that is exposed to the credit risk of the underlying assets. Therefore, if these entities were to enter into the types of conflicted transactions that this rule is intended to address, investors would ultimately not be exposed to credit risks stemming from such transactions.~~

~~[74] The re-proposed rule does not define what "fully insured or fully guaranteed as to the timely payment of principal and interest" means in this context as we believe that concept is commonly understood by market participants with respect to the relevant security.~~

~~[75] This would also include any limited life regulated entity succeeding to the charter of either Fannie Mae or Freddie Mac pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that such entity is operating with capital support from the United States.~~

~~[76] One commenter to the 2011 proposal stated that not excluding Enterprise or Ginnie Mae ABS from <the scope of the rule would >have significant economic and market impacts. *See* SIFMA Letter at 18-21.~~

must perform.[243] This commenter requested, therefore, that the final rule include an exception for actions taken by securitization participants pursuant to their duties under the CLO or underlying loan documents and stated that including ongoing administration activities in the Service Provider Exclusion would achieve that.[244] In the example provided by this commenter, such administrative agent is also the placement agent for the relevant ABS, and therefore will be ineligible to rely on the Service Provider Exclusion because its activities are not "only" administrative in nature and because, as placement agent, such person is a securitization participant pursuant to the definition of "placement agent" in Rule 192(c).[245] For these reasons we do not believe that it would be appropriate to revise the exclusion as requested.

The Commission also received comment requesting that third-party asset sellers be included in the Servicer Provider Exclusion.[246] A third-party asset seller is a third-party originator who sells loans or other assets to the ultimate ABS sponsor before those assets are transferred into the securitization structure. The purchase of assets from unaffiliated originators to be later transferred into a securitization is a routine capital market function through which the seller would not have the >contractual right to direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the <**underlying or referenced pool of assets. Such persons' activities are limited to merely originating assets that are then transferred to the ABS sponsor in a true sale; they do not have ongoing roles or contractual rights or duties with respect to the assets or the ultimate ABS. Therefore, while we do not believe that the function performed by these third-party asset sellers is ~~consistent with the types of~~ activities enumerated**

[243] ***See*** **letter from LSTA IV.**

[244] ***Id.***

[245] ***See*** **Section II.B.3.a.**

[246] ***See* letter from SFA II.**

~~Each of these exclusions would apply only to the entities specified in the relevant exclusion, and any other securitization participants <involved with an ABS issued or guaranteed by >such <entity (*e.g.*, an underwriter or a non-governmental sponsor) >would be subject to the re-proposed rule. Additionally, each of these exclusions is subject to certain conditions. If those conditions are not satisfied with respect to certain ABS (*e.g.*, an ABS is not fully insured or fully guaranteed by the relevant entity), then any securitization participant with respect to such ABS would still be subject to the prohibition of the re-proposed rule.~~

in the Service Provider Exclusion, we do agree that such persons are not "sponsors" under the rule.[247]

~~i~~***iv*. ~~United States~~ *U.S. Government ~~and Agencies~~Exclusion**

~~With~~**Consistent with the proposal, the United States or an agency of the United States is not a "sponsor" for purposes of the final rule with** respect to ~~an~~**its** ABS that ~~is~~**are** fully insured or fully guaranteed as to the timely payment of principal and interest~~ by the United States, the United States or an agency of the United States would not be a "sponsor" under paragraph (iii)(A) of the proposed definition of "sponsor" in proposed Rule 192(c). These ABS would include <mortgage-backed securities ("MBS") guaranteed by the Government National Mortgage Association ("Ginnie Mae")>, a wholly owned U.S. Government corporation that guarantees investors the timely payment of principal and interest on MBS backed by Federally insured or guaranteed loans, including mortgage loans insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs. As a result of the proposed exception in paragraph (iii)(A) of the proposed definition of "sponsor," Ginnie Mae would not be a "sponsor" with respect to its guaranteed ABS. Ginnie Mae's guarantee is backed by the full faith and credit of the United States. Given that Ginnie Mae sets certain guidelines and serves as guarantor for the MBS that it guarantees,[77] Ginnie Mae.~~[248] **However, in a change from the**

proposal, we are not adopting the proposed exclusion from the "sponsor" definition for the Enterprises, which we discuss in greater detail below.

~~[23] *See, e.g.*, 24 CFR 320 and the Ginnie Mae MBS Guide, available at https://www.ginniemae.gov/issuers/program_guidelines/Pages/mbs_guide.aspx.~~

~~would, absent the proposed exception, be a sponsor of the ABS that it guarantees for purposes of the re-proposed rule.~~

~~As guarantor,~~ **With** >respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by <the United States**, it is the United States as guarantor that** is exposed to the full credit risk related to the underlying assets~~. In turn,~~**, rather than the** investors in **the** ABS ~~that are fully backed by the United States government~~ .[249] **This is because investors in such ABS** rely on the support provided by the full faith and credit of the United States and not on the creditworthiness of the obligors on the underlying assets, ~~and therefore~~**meaning they** are not exposed to the credit risk of the underlying assets. ~~As a result~~[250] **Consequently**, investors in such ABS are not exposed to the risk that was present in certain ABS transactions ~~prior to~~**at** the **time of the** financial crisis of 2007-2009 where investors suffered credit-based losses due to the poor performance of the relevant asset pool while key securitization parties entered into transactions to profit from such poor performance.

[247] An originator that is affiliated with an underwriter, placement agent, initial purchaser, or sponsor of a covered transaction, however, may be a securitization participant subject to the rule's prohibition against engaging in conflicted transactions. *See* Section II.B.3.c. below.

[248] 17 CFR 192(c).

[249] *See* Proposing Release Section II.B.2.c.

~~ii. Enterprises~~[250] *Id.*

~~Similar to the reasons for excepting~~**Commenters supported the proposal to exclude** the United States government and ~~agencies thereof, under~~ **its agencies from the definition of "sponsor,"[251] with one of these commenters specifically agreeing that** >mortgage-backed securities ("MBS") guaranteed by the Government National Mortgage Association ("Ginnie Mae") <**are fully guaranteed by the United States government[252] and thus should be excluded from the "sponsor" definition.[253] This commenter also stated that, because issuers of Ginnie Mae MBS have "considerable discretion" over which loans to include in the MBS, those issuers should be sponsors under the rule.[254] For purposes of the final rule, and as noted in the Proposing Release, the exclusion in** paragraph (~~iii)(B~~**iv**) of the ~~proposed~~ definition of "sponsor" ~~in proposed Rule 192(c), Fannie Mae and Freddie Mac, in each case, for so long as the applicable Enterprise is operating under conservatorship or receivership[78] of FHFA with capital support from the United States,[79] would not be defined as a "sponsor" for purposes of the re-proposed rule with respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by such Enterprise.~~**applies only to the specified entities (*i.e.*>,** the United States or an agency of the United States<**).[255] Any other securitization participant** >involved with an ABS issued or guaranteed by <**a specified** >entity (*e.g.*, an underwriter or a non-governmental sponsor) <**is subject to the prohibition in Rule 192 against engaging in transactions that effectively represent** >a bet against the relevant ABS.<[256] **If, therefore, the issuer of a fully-guaranteed Ginnie Mae ABS meets the definition of "sponsor" as adopted,[257] such issuer is prohibited from engaging in conflicted transactions.[258]**

~~[78] Under the Federal Housing Enterprises Safety and Soundness Act of 1992, FHFA may be appointed as the conservator or receiver for an Enterprise. Although Fannie Mae and Freddie Mac have been operating under the conservatorship of FHFA since September 6, 2008, the re-proposed rule includes the reference to "receivership" in order to align with the statutory authority of FHFA under the Federal Housing Enterprises Safety and Soundness Act of 1992.~~

~~[79] This would also include any limited life regulated entity succeeding to the charter of either Enterprise pursuant to the authority of FHFA as conservator or receiver in respect of such Enterprise under the Federal Housing Enterprises Safety and Soundness Act of 1992, provided that such successor entity is operating with capital support from the United States.~~

Comments related to >the proposed exclusion from the definition of "sponsor" for the Enterprises <**were mixed. Some commenters supported the exclusion of Fannie Mae and Freddie**

[251] ***See, e.g.*, letters from M. Calabria; SIFMA I.**

[252] ***See*** **Title III of National Housing Act, 12 U.S.C. §1716-1723 (2019) (stating that "[t]he** >full faith and credit of the United States <**is pledged to the payment of all amounts which may be required to be paid under any guaranty under this subsection.") *available at* https://www.ginniemae.gov/about_us/what_we_do/Documents/statutes.pdf.**

[253] ***See*** **letter from M. Calabria.**

[254] ***Id.***

[255] ***See*** **Rule 192(c) and Proposing Release Section II.B.2.c.**

[256] ***Id.***

[257] ***See*** **Sections II.B.3.b.i. and II.B.3.b.ii.**

[258] ***See*** **Section II.**>D. for a discussion of what <**constitutes a "conflicted transaction" under the final rule.**

~~The Enterprises act as mortgage loan seller, master servicer, and, at times, trustee for collateralized mortgage obligations and other MBS. The Enterprises select and manage the assets in the asset pools underlying the securities and set the selection criteria and servicing guidelines for the securities. The Enterprises serve as guarantors for MBS, and, as guarantors, they are required to make principal and interest payments on the securities regardless of credit losses on the underlying mortgages.~~

~~Because some of these activities fall within the proposed definition of "sponsor," Fannie Mae or Freddie Mac (or a successor limited-life regulated entity) would, absent an exception, be the sponsor of the ABS that it issues for purposes of the re-proposed rule. However, because such entities would <be excluded from the definition of "sponsor" >under, and subject to the conditions of, paragraph (iii) of the proposed definition of "sponsor," neither Enterprise would be subject to the rule's prohibition with respect to the relevant Enterprise-guaranteed ABS. We believe that this is appropriate where Fannie Mae and Freddie Mac operate with capital support from the United States and fully guarantee the timely payment of principal and interest on their guaranteed ABS. This is because Fannie Mae and Freddie Mac are exposed to the entire credit risk of the mortgages that collateralize such ABS instead of investors, and an Enterprise's guarantee would protect investors fully against the risk of credit losses on the underlying assets, at least for so long as the Enterprise remains in conservatorship with capital support from the United States as discussed below.~~

~~Both Fannie Mae and Freddie Mac have been operating under the conservatorship of FHFA since September 6, 2008. Concurrently with being placed in conservatorship under Section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, each Enterprise entered into a Senior Preferred Stock Purchase Agreement ("PSPA") with the~~ **Mac from the "sponsor" definition with some modifications to extend the exclusion beyond conservatorship,[259] with one suggesting that the exclusion be conditioned on the**

Enterprises retaining their current status as government sponsored entities because the Federal Housing Finance Agency's ("FHFA") oversight sufficiently guards against the types of behavior >that Section 27B is intended to prevent<**.[260] Another commenter suggested that, in addition to the exclusion from the "sponsor" definition, the rule should exclude from the definition of "asset-backed security" any ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the Enterprises while operating under the conservatorship or receivership of the FHFA.[261]**

Some commenters, however, opposed including the Enterprises in the exclusion from the "sponsor" definition.[262] One commenter stated that the >capital support from the United States <**while in conservatorship or receivership is not an explicit government guarantee of the Enterprises' ABS or MBS.[263] Another commenter suggested that the Enterprises should be sponsors for purposes of Rule 192, but that the final rule should permit credit risk transfer ("CRT") transactions regardless of sponsor,[264] which would treat the Enterprises and other market participants alike.**

[259] *See, e.g.*, letters from Fannie and Freddie; SFA II.

[260] *See* letter from Fannie and Freddie.

[261] *See* letter from ABA. As discussed below, the final rule does not include an exclusion from the definition of "sponsor" for the Enterprises while in conservatorship in light of concerns that the proposed exclusion was unclear and concerns regarding the impact of an automatic change to the Enterprises' status immediately upon existing conservatorship. For the same reasons, the final rule does not contain an exclusion >for an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the Enterprises while <**in conservatorship. *See* Section II.A. for more information about the types of ABS that are subject to the final rule.**

[262] *See, e.g.*, letters from HPC; M. Calabria.

[263] *See* letter from M. Calabria. This commenter also stated that an exclusion from the prohibition in Rule 192 would disincentivize or prevent the Enterprises from leaving conservatorship.

[264] *See* letter from HPC.

~~United States Department of the Treasury ("Treasury"). Under each PSPA, Treasury provided capital support to the Enterprises through the purchase of senior preferred stock of each Enterprise.[80] While the Enterprises are in conservatorship, due to the unique nature of the authority and oversight of FHFA over their operations as a result of such status, the Enterprises are not expected to act in a manner that would result in conflicted transactions that would benefit private parties, and, thus, are not expected to engage in the adverse selection of assets for their ABS. Moreover, because of the capital support provided by Treasury under the PSPAs, each Enterprise's guarantee fully protects investors against the risk of credit losses on the underlying assets consistent with the goals and intent of Section 27B. Accordingly, we are proposing to <exclude the Enterprises from the definition of >"sponsor" with respect to Enterprise-guaranteed ABS while the Enterprises are in conservatorship or receivership with capital support from the United States. We recognize the ongoing activity related to reform of the Enterprises and, if appropriate, we may revisit and modify the proposed exception if and when the future of the Enterprises and of the statutory and regulatory framework post-conservatorship for the Enterprises becomes clearer.[81]~~

Because, as proposed, the Enterprise exclusion from the "sponsor" definition would only apply with respect to ABS fully guaranteed by the Enterprises and not with respect to the CRT securities they issue,[265] some commenters expressed concerns that, together with the proposed restriction that the initial distribution of an asset-based security would not be risk-mitigating hedging,[266] the proposed rule would have the effect of prohibiting all Enterprise CRTs as *per se* conflicted transactions.[267] Some commenters stated that, for this reason, the cumulative effect of the proposed approach (*i.e.*, to exclude the Enterprises as sponsors with respect to fully-guaranteed ABS, but not with respect to CRTs, and to exclude CRT transactions from the risk-mitigation hedging exception) was unclear.[268] To address this concern, one commenter requested that either the Enterprises be excluded

from the "sponsor" definition in perpetuity (or until the Commission revisited the exclusion), or that the Enterprises' synthetic ABS issuances (*i.e.*, CRT transactions) be permitted to qualify under the risk-mitigating hedging exception so long as they continue to be government-sponsored enterprises.[269] Alternatively, this commenter requested that the sponsor exclusion remain in place for at least 24 months following the

~~One commenter to the 2011 proposed rule also suggested an exception for the~~ [265] **The** Enterprise~~'~~s **engage i**n security-based credit risk transfer~~("CRT")~~ transactions to allow for efficient mitigation of the Enterprises' retained credit risk associated with their holdings of residential an

~~[264] For a discussion of Enterprise operations under conservatorship or receivership with capital support from the United States, see RR Adopting Release at 77649.~~

~~[265] The RR Adopting Release similarly states <that the application of the >credit risk retention rules to the Enterprises will be revisited and, if appropriate, modified after the future of the Enterprises and of the statutory and regulatory framework for the Enterprises becomes clearer. *See id.* at 77650.~~

d commercial mortgages and MBS[82]. A security-based CRT transaction typically involves the issuance of unguaranteed ABS by a special purpose trust where the performance of such ABS is linked to the performance of a reference pool of mortgage loans that collateralize Enterprise guaranteed-MBS[83]. As a part of a security-based CRT transaction structure, the relevant Enterprise enters into an agreement with the special purpose trust pursuant to which the trust has a contractual obligation to pay the Enterprise upon the occurrence of certain adverse events with respect to the referenced mortgage loans[84]

. ***See* letter from Fannie and Freddie; *see also,*** The proposed exclusion of the Enterprises, subject to certain conditions, from the definition of "sponsor" with respect to Enterprise-guaranteed ABS <should address concerns that, absent such an exception, an Enterprise might be prohibited from engaging in a security-based CRT transaction>, which could be a "conflicted transaction" under the re-proposed rule with respect to an Enterprise's guaranteed ABS.[85] Again, the investors in ABS fully insured or fully guaranteed by an Enterprise would not be subject to credit risk so long as an Enterprise's guarantee is backed by the <full faith and credit of the United States>. As such, we do not believe that such investors bear significant risk of conflicted transactions. Accordingly, under the re-proposed rule, the relevant Enterprise, subject to the conditions discussed above, would not be defined as a "sponsor" of its Enterprise-guaranteed ABS and would, therefore, not be a "securitization participant" under the re-proposed rule with respect to its Enterprise-guaranteed ABS.

[82] *See* comment letter <from Fannie Mae and Freddie Mac >(Dec. 21, 2015) ("Fannie Mae/Freddie Mac Letter") at 3-8.

[83] *See,* *e.g.*, the relevant legal documentation and other related information about Freddie Mac's single-family transactions **transactio**n, *available at* https://capitalmarkets.freddiemac.com/crt/securities/deal-documents.

[84] *See id.*

[85] 266 *See* Section II.<D. for a discussion of what >would be a "conflicted transaction" for purposes of the re-proposed rule**E**.

267 ***See, e.g.*, letters from ABA; Fannie and Freddie; SFA I. Some of these commenters stated that they did not believe that this was the intent in light of the Commission's statement in the Proposing Release that the exclusion from the "sponsor" definition** >should address concerns that, absent such an exception, an

Enterprise might be prohibited from engaging in a security-based CRT transaction<. ***See*** **letters from ABA; SIFMA II.**

[268] ***See, e.g.*****, letters from ABA; Fannie and Freddie; SIFMA II.**

[269] ***See*** **letter from Fannie and Freddie.** ***See also*** **Section II.E. for a discussion of the risk-mitigation hedging exception under the final rule.**

We note, however, that because a CRT security issued in a security-based CRT transaction is not guaranteed by the relevant Enterprise, investors in a CRT security would bear credit risk. Furthermore, because the CRT security is not fully insured or fully guaranteed by an Enterprise, <the proposed exclusion from the definition of "sponsor" for the Enterprises >with respect to Enterprise-guaranteed ABS would not apply to a CRT security itself. Therefore, the Enterprises would be "sponsors" of CRT securities for purposes of the re-proposed rule and would be prohibited from engaging in conflicted transactions that would be prohibited by the re-proposed rule with respect to investors in such CRT securities.

Request for Comment

15. Is the proposed definition of the term "sponsor" overinclusive or underinclusive? Please explain why or why not.
16. We seek comment on the concept in the definition of the term "sponsor" of a person <directing or causing the direction of the structure, design, or assembly of an ABS or the composition of the >pool of assets underlying the ABS. Is this concept, in the context of a person that does not have a contractual right to exercise such direction, overinclusive or underinclusive, and why? In particular, is the reference to "causes the direction of" necessary in order to capture direction given through a third party, or is the reference unnecessary because of the inclusion of the anti-circumvention provision in proposed Rule 192(d)? Why or why not? Are there additional indicia that should be included or referenced for purposes of the facts and circumstances that would be relevant to this determination? What parties that have a role in a securitization could fall within the proposed definition of "sponsor" because they direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets

~~underlying an ABS? Should all of these parties be included? Should other parties be included in the definition of "sponsor"? Which of these parties would not be a sponsor because of the exclusion in paragraph (ii)(C) of the proposed definition of "sponsor" for a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of the ABS or the composition of the pool of assets underlying the ABS? The proposed definition of the term "sponsor" includes, but is not limited to, a sponsor as defined in Regulation AB. If the rule were limited to the Regulation AB definition of "sponsor," would that make the rule underinclusive? Would it be clear how to determine which party or parties would be a sponsor when applying the Regulation AB definition of "sponsor" to the wider population of ABS that are not subject to Regulation AB, but are subject to the prohibitions of Section 27B?[86]~~

~~17. We seek comment on an alternative definition of the term "sponsor" where paragraph (ii) of the proposed definition of "sponsor" would include a contractual rights sponsor described <in paragraph (ii)(A) of the proposed definition of "sponsor" >but would not include a directing sponsor described <in paragraph (ii)(B) of the proposed definition of "sponsor." >Would this alternative definition better address concerns of commenters on the 2011 proposed rule about potential overinclusiveness of the definition of the term "sponsor" by covering only persons with a contractual relationship with the entity that issues the ABS (or with one or more of the other securitization participants)? Would this alternative definition be underinclusive because it would not cover all the parties that could <direct or cause the direction of the structure, design, or assembly of an ABS or the>~~

- ~~*See* <discussion in Section II.A.>~~

composition of the pool of assets underlying the ABS, such as a hedge fund manager or other private fund manager that would have an opportunity to benefit from a bet against the performance of the ABS or the underlying assets? If paragraph (ii) of the definition of "sponsor" were limited to a contractual rights sponsor, even if it might not cover the full range of potentially culpable parties, would it nonetheless prevent most conflicted transactions from occurring because of its interaction with other provisions of the rule? Further, should the definition of the term "sponsor" be limited to refer to only a contractual rights sponsor that has actually exercised its relevant contractual rights?

18. We seek comment on an alternative definition of the term "sponsor" that would include an additional catch-all prong that would include "any other person that makes a material contribution to the design, composition, assembly, sale, or management of an asset-backed security" as suggested by certain commenters to the 2011 proposed rule.[87] Would this catch-all better capture all parties that could engage in conduct prohibited by Section 27B? What parties that have a role in a securitization would be captured by this catch-all that would not otherwise be subject to the re-proposed rule? Should such parties, if any, be subject to the re-proposed rule's prohibition on material conflicts of interest? Please explain why or why not. Would such a catch-all be overinclusive, or would it unduly burden parties that would not have the incentive or ability to engage in conduct prohibited by Section 27B? Please also explain whether and how such a catch-all would be consistent with Section 27B.

19. Is the exclusion in paragraph (ii)(C) of the proposed definition of "sponsor" for a person that performs only administrative, legal, due diligence, custodial, or ministerial acts

[87] *See, e.g.*, Better Markets Letter at 3; Merkley-Levin Letter at 3-4.

related to the structure, design, or assembly of the ABS or the composition of the pool of assets overinclusive or underinclusive, and why? Are there additional administrative activities and functions in the context of ABS that should be addressed? Is it clear whether servicers or other contractual service providers with ongoing managerial or administrative roles with respect to the securitization, but limited discretion over the structure, design, or assembly of the ABS or the composition of the pool of assets underlying the ABS, would qualify for the proposed exclusion? Please explain why or why not. Should the exclusion be modified to provide more detail on the types of activities that can be provided by a party while continuing to qualify for the exclusion from the proposed definition of "sponsor"? If so, please explain how the exclusion should be modified, including which types of activities the exclusion should reference.

20. Should we modify the proposed exception <from the definition of "sponsor>" <for the United States or an agency of the United States with respect to >an <ABS that is fully insured or fully guaranteed >by the United States? If so, describe any suggested modifications or deletions to the exception and explain why they would be necessary and how they <would be consistent with Section 27B>.

21. Should we modify the proposed exception from the definition of "sponsor" <for the United States or an agency of the United States >to apply not only with respect to an ABS that is <fully insured or fully guaranteed by the United States >but also an ABS that is not fully insured or fully guaranteed by the United States? If so, describe any suggested modifications or deletions to the exception and explain why they would be necessary and how they would be consistent with Section 27B.

~~22. The proposed exceptions from the definition of "sponsor" in paragraph (iii) of the proposed definition of "sponsor" are premised on the fact that the United States, and not investors in such ABS, is exposed to the credit risk of the underlying assets because of the credit support provided by the United States. Are there other types of non-credit-related risks, such as interest rate risk or prepayment risk, that we should also address in the context of such fully insured or fully guaranteed ABS transactions for purposes of the prohibition, and if so, how should these proposed exceptions be modified to address such risks?~~

~~23. Should we modify the proposed exception from the definition of "sponsor" in paragraph (iii)(B) of the proposed definition of "sponsor" for the Enterprises with respect to an ABS that is fully insured or fully guaranteed by the relevant entity? Please describe any suggested modifications or deletions to the exception and explain why they would be necessary and how they would be consistent with Section 27B.~~

~~24. The proposed exception from the definition of "sponsor" for the Enterprises in paragraph (iii)(B) of the proposed definition of "sponsor" would apply only for so long as the applicable Enterprise is operating under conservatorship or receivership of FHFA with capital support from the United States. Should it apply beyond that time period? If so, why, and how would that be consistent with Section 27B?~~

~~25. If so, then investors in Enterprise-guaranteed ABS would be relying solely on the Enterprise guarantee due to the lack of the <capital support from the United States>. If the exception were to extend beyond conservatorship, then are there any ways that the rule could address the credit risk related to the Enterprise guarantee and the conflicts that~~ **Enterprises' exit from conservatorship to permit the Commission to make a determination after the nature of the post-conservatorship landscape becomes clear.[270] Relatedly, one commenter stated that permitting the Enterprises to continue their credit risk transfer**

securitization program under the risk-mitigating hedging exception would provide more clarity and certainty for all participants involved than excluding the Enterprises from the "sponsor" definition.[271]

After considering the comments received, we are not adopting the proposed Enterprise exclusion from the "sponsor" definition and, therefore, the Enterprises are sponsors under the final rule with respect to any ABS they issue, whether or not it is fully guaranteed. Although we still believe that>, while the Enterprises are in conservatorship, <**investors in their guaranteed ABS are not exposed to the same types of risk that existed in certain ABS transactions leading up the financial crisis of 2007-2009,[272] that would not be the case once the Enterprises exit conservatorship. In light of the concerns that the cumulative effect of the proposed exclusion from the "sponsor" definition and the proposed exception for risk-mitigating hedging activities was unclear, we have concluded that including the Enterprises as sponsors and permitting Enterprise CRT transactions so long as they meet the conditions enumerated in the risk-mitigating hedging exception,[273] would provide more certainty for the Enterprises and the market. Further, we believe that the revisions to the definition of "conflicted transactions," together with the revised exception for risk-mitigating hedging activities discussed below, sufficiently address commenter concerns with respect to the ability of the Enterprises to continue**

270 *See* letter from Fannie and Freddie.

271 *See* letter from SIFMA II.

272 *See* Proposing Release Section II.B.2.c.

273 *See* Section II.E.

~~could arise from~~**to engage in CRT transactions for purposes of managing their credit risk.[274] As sponsors—and, thus,** securitization participants**—subject to the prohibition in Rule 192(a) against** engaging in conflicted transactions~~? Should the exception for~~**,** the Enterprises ~~be~~**are** subject to ~~any other conditions?~~**the same limitations on such behavior as private market participants.**

~~26. In addition to or in lieu of the proposed exceptions from the definition of "sponsor" in paragraph (iii) of the proposed definition of "sponsor" discussed above, should there be an exception for ABS that is fully insured or fully guaranteed by, or collateralized solely by obligations issued, fully insured, or fully guaranteed by<, the United States or an agency of the United States>? If so, should it be an exception to the definition of "asset-backed security," or should it be an exception to the re-proposed rule's prohibition? Please explain why any such exception would be necessary and what conditions, if any, should apply to the application of that exception. How would such an exception be consistent with Section 27B?~~

c. Affiliates and Subsidiaries

After consideration of commenters' concerns and recommendations, discussed in detail below, we are revising paragraph (ii) of the definition of "securitization participant" to limit which affiliates or subsidiaries[275] are securitization participants. An affiliate or subsidiary is a securitization participant for purposes of the final rule only if it acts in coordination with[276] an underwriter, placement agent, initial purchaser, or sponsor or if it has access to or receives information about the relevant ABS or the asset pool underlying

or referenced by the relevant ABS prior to the date of the first closing of the sale of the relevant ABS.[277]

27. ~~In addition to or in lieu of the proposed exceptions from~~ [274] **As discussed in detail below,** the definition of ~~sponsor" in paragraph (iii) of the proposed definition of "sponsor" discussed above, should there be an exception to the definition of "asset-backed security" <for an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the Enterprises while >operating under the conservatorship or receivership of FHFA with capital support from the United States? If so, please explain why such an exception would be necessary, how such an exception would be consistent with Section 27B, and if any conditions should apply to the application of such an exception.~~**"conflicted transaction" in final Rule 192(a)(3) captures the relevant conflict of interest in the context of the issuance of a new synthetic ABS (*e.g.*, the issuance of a CRT transaction), but such synthetic ABS will be permissible if it meets the conditions for the exception for risk-mitigating hedging activities. Furthermore, the synthetic ABS will be subject to the rule and the related securitization participants will be subject to the prohibition. *See* Sections II.D. and II.E. below**.

28. ~~Are there any other types of government entities, including municipal entities, that should be exempt from the re-proposed rule? Please explain why they should be exempt and how such an exemption would be consistent with Section 27B. If the relevant ABS are not fully insured or fully guaranteed by a government or government-controlled entity,~~

then please explain why <securitization participants that would be >covered by the re-proposed rule should be exempt, including whether the opportunity exists to engage in the type of conduct prohibited by the re-proposed rule.

Affiliates and Subsidiaries

Consistent with Section 27B(a), <the proposed definition of "securitization participant" >in proposed Rule 192(c) would extend to <affiliates and subsidiaries of an underwriter, placement agent, initial purchaser, or sponsor of >an ABS. Including <affiliates and subsidiaries in the >re-proposed rule would help to prevent affiliates and subsidiaries from being used to evade the rule's prohibitions and would also be <consistent with Section 27B.>

Proposed Rule 192 is being proposed under the Securities Act, and the rule refers to the definitions of[275] **For purposes of the final rule,** the terms "affiliate" and "subsidiary" under 17 CFR 230.405 ("**will have the same meaning as in** Securities Act Rule 405" **(17 CFR 230.405)**. Under Securities Act Rule 405, an "affiliate" of a specified person is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified, and a "subsidiary" of a specified person means an affiliate controlled by such person directly, or indirectly through one or more intermediaries.[88] Also, under Securities Act Rule 405, **also defines** the term "control" is defined to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.[89] **17 CFR 230.405.**

We believe that these definitions are commonly understood by market participants and would help to prevent evasion of the re-proposed rule. The re-proposed <rule is designed to prevent >securitization participants from entering into <transactions that are bets against the >ABS

[276] **As suggested by one commenter, an affiliate or subsidiary would be acting in coordination with a named securitization participant if it (i) directly engages in the structuring of or asset selection for the securitization, (ii) directly engages in other activities in support of the issuance and distribution of the ABS, or (iii) otherwise acts in concert with its affiliated securitization participant through, *e.g.*, coordination of trading activities. *See* letter from ABA.**

[88][277] 17 CFR 230.405.

[89] *Id.* **230.190(c).**

that they create or sell to investors, and it would be inconsistent with the intent of the re-proposed rule if the prohibition did not extend to cover a transaction structure where a securitization participant directs, either directly or through one or more intermediaries, an affiliate or subsidiary to enter into such <a bet against the relevant ABS. >We believe that, to cover the various ways in which an affiliate or subsidiary relationship may be effectuated, the re-proposed rule should cover such a scenario whether the securitization participant's ability to direct the management and policies of the relevant entity are through the ownership of voting securities, by contract, or otherwise.

The inclusion of affiliates and subsidiaries in the re-proposed rule means that persons in addition to <underwriters, placement agents, initial purchasers, >or sponsors of an ABS would be securitization participants for purposes of the re-proposed rule if they are <an affiliate or subsidiary of an underwriter, placement agent, initial purchaser, or sponsor >of an ABS. For example, a servicer that is a sponsor's affiliate would fall within the scope of the re-proposed rule even if the servicer's role in connection with the securitization would not meet the re-proposed rule's definition of the term "sponsor."[90]

We received comments to the 2011 proposed rule that including affiliates and subsidiaries would be overinclusive and that it would impose an unduly burdensome impact on certain persons.[91] Certain commenters to the 2011 proposed rule suggested that <the use of information barriers >would mitigate the re-proposed rule's potential overinclusion of affiliates

[90] We understand that servicers are often affiliated with the sponsor of an ABS. *See, e.g.*, 2004 Regulation AB Adopting Release at 1511 (stating that because the issuing entity is designed to be a passive entity, one or more "servicers," often affiliated with the sponsor, are generally necessary to collect payments from obligors of the pool assets, to carry out the other important functions involved in administering the assets, and to calculate and pay the amounts net of fees due to the investors that hold the ABS to the trustee, which actually makes the payments to investors).

While some commenters supported the proposal to include >affiliates and subsidiaries of underwriters, placement agents, initial purchasers, and sponsors <**as securitizations**

participants,[278] many commenters expressed concerns that the proposed approach would hinder market participants' ability to effectively comply with the rule's prohibition.[279] Commenters stated that compliance with Rule 192 as proposed could interfere with securitization participants' ability to comply with existing information barriers, including those that may be required by other applicable Federal- and State-level laws, in order to effectively implement a compliance program designed to monitor for, and prevent the occurrence of, potentially conflicted transactions.[280] Some of these commenters acknowledged that Section 27B >specifies that the prohibition applies to <**affiliates and subsidiaries of other named securitization participants[281] and many supported such application in circumstances in which affiliates or subsidiaries have direct involvement in, or knowledge of, the covered ABS or are otherwise acting in coordination with the named securitization participant.[282] Commenters recommended various approaches to address their stated concerns, which can generally be grouped into three categories, which we discuss below.**

First, several commenters requested that the rule exclude affiliates and subsidiaries from the definition of "securitization participant" and instead treat a securitization participant's use of

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[278] *See, e.g.*, letters from AARP dated Mar. 23, 2023 ("AARP"); Better Markets.

[279] *See, e.g.*, letters from ABA; AIC; AFME; AIMA/ACC; ICI; LSTA III; LSTA IV; MFA II; SFA I; SIFMA I.

[280] *See, e.g.*, letters from ABA; AIC; AFME; ICI; MFA II. Some commenters also expressed concern that, without recognizing information barriers or including other limitations on the rule's applicability to affiliates and subsidiaries, the prohibition could apply to foreign affiliates and subsidiaries of U.S.-based securitization participants regardless of their participation in the transaction. *See, e.g.*, letters from AFME; AIC. We believe that, together with the >discussion in Section II.A.<**3.c. above about the cross-border application of Rule 192, the definition of "securitization participant" with respect to affiliates and subsidiaries, as discussed in greater detail below, will appropriately limit such application only to those affiliates and subsidiaries who have direct involvement in, or access to information about, a covered ABS, which should mitigate these concerns.**

[281] *See, e.g.*, letters from ABA; SFA I; SFA II.

[282] *See, e.g.*, letters from ABA; AFME; ICI; LSTA III; SFA II; SIFMA I; SIFMA II.

an affiliate or subsidiary to indirectly engage in a conflicted transaction as an evasion of the prohibition in Rule 192(a).[283] To implement this recommendation, commenters suggested that the proposed anti-circumvention provision could be revised to make clear that a securitization participant could not engage in a transaction >as part of a plan or scheme to evade the prohibition <**of the rule, whether directly or indirectly, including through the use of affiliates and subsidiaries.[284] Section 27B, however, states that** >affiliates and subsidiaries of an underwriter, placement agent, initial purchaser, or sponsor of <**a relevant ABS are subject to the prohibition in their own right, not merely that the other parties to the transaction are prohibited from engaging in conflicted transactions directly or indirectly through an affiliate or subsidiary. Accordingly, we believe that the suggested revision to treat a securitization participant's use of an affiliate or subsidiary to engage in a conflicted transaction as an evasion of the prohibition would not be appropriate or** >consistent with Section 27B.<

Second, some commenters requested that the rule exclude affiliates and subsidiaries bound by, and operating consistent with, fiduciary duties from the definition of securitization participant.[285] These commenters stated that funds advised by the same asset manager should not be considered affiliates to the extent that the manager is bound by fiduciary duties to the issuing entity for the securitization and/or its investors and that the term "securitization participant" should exclude any entity acting in its capacity as an investment adviser, as well as that entity's advisory clients.[286] For the reasons stated in Section II.B.3.b.ii. above, we believe

[283] ***See, e.g.*, letters from ABA; AIC; ICI; SFA I.**

[284] ***See, e.g.*, letter from AIC.**

[285] ***See, e.g.*, letters from ABA; AIC; ICI; LSTA IV; SIFMA I. *See also* Section II.B.3.b.ii., above, for a discussion of comments requesting an exclusion from the definition of "sponsor" for any person operating pursuant to a fiduciary duty.**

[91] [286] *See, e.g.,* **letters from** ABA ~~Letter at 11-12~~; SIFMA ~~Letter at 12-15~~**I**.

~~and subsidiaries of securitization participants.[92] One commenter to the 2011 proposed rule specifically supported the use of an information barriers regime with respect to investment companies and investment advisers that are affiliates or subsidiaries of securitization participants.[93] However, other commenters opposed the use of information barriers to manage material <conflicts of interest in connection with the >2011 proposed rule for reasons such as perceived permeability, limited utility, and difficulties associated with monitoring and enforcing information barriers in addition to their weakening impact on the prohibition <set forth in Section 27B>.[94]~~

that permitting a fiduciary duty-based exclusion from the rule is inconsistent with the rule's objective.[287]

Finally, while some commenters agreed that the rule should not include an exemption for affiliates and subsidiaries dependent on the use of information barriers,[288] other commenters requested that the final rule permit the use of information barriers or other indicia of separateness to mitigate potential conflicts of interest.[289] In support of this request, these commenters referenced the Proposing Release statements[290] acknowledging that the Commission has recognized information barriers in other Federal securities laws and the rules thereunder.[291] Some of these commenters requested that we adopt a specific information barrier exception in the final rule and offered suggestions for modifications to the conditions for such an exception as discussed in the Proposing Release,[292] but several others articulated concerns that the conditions

[287] *See* Section II.D. for a discussion of why the rule does not include a similar exclusion from the definition of "conflicted transactions" for transactions that such securitization participants may enter into pursuant to a fiduciary duty.

[288] *See, e.g.*, letters from AARP; Better Markets.

[289] *See, e.g.*, letters from ABA; AIMA/ACC; AFME; AIC; ICI; LSTA II; LSTA III; LSTA IV; MFA II; Pentalpha; SFA I; SIFMA I; SFA II; SIFMA II. Some of these commenters also recommended that, in the alternative, the final rule could specify that any transaction described in paragraph (a)(3) of the final

rule, entered into at the direction of a related person, would be presumed to be a conflicted transaction unless that person demonstrates that it had no substantive role in structuring, marketing, or selling the ABS or in the selection of the asset pool underlying or referenced by the relevant ABS. *See* letters from SFA II; SIFMA II.

~~Information barriers, in the form of written, reasonably designed policies and procedures, have been recognized in others areas of the Federal securities laws and the rules thereunder. For example,~~[290] ***See* Proposing Release Section II.B.c.3. The Proposing Release noted as an example that** brokers and dealers have used information barriers to manage the potential misuse of material non-public information to ~~adhere to Section 15(g) of the Exchange Act.~~[95] ~~Also,~~ **comply with Exchange Act 15(g) (**>17 U.S.C. 78*o*(g)<**) and that** Regulation M contains an exception for affiliated purchasers if, among other requirements, the affiliate maintains and enforces written policies and procedures reasonably designed to prevent the flow of information to or from the affiliate that might result in a violation of Regulation M.~~[96]~~ **(17 CFR 242.100-105; 17 CFR 242.100(b)). *Id.***

~~92~~ [291] *See, e.g.*, **letters from** ABA ~~Letter at 11-12; ASF Letter at 10-11; comment letter from The Financial Services Roundtable (Feb. 13, 2012) ("Roundtable Letter") at 10~~**; AIMA/ACC; AFME; AIC; ICI; LSTA II; LSTA III; MFA II; Pentalpha; SFA I**; SIFMA ~~Letter at 14-15~~**I**.

[292] ***See, e.g.*, letters from ICI; Institute of Internal Auditors dated Mar. 27, 2023 ("IIA"); Pentalpha. See Proposing Release Section II.B.3. and Requests for Comment 29-38 for a discussion of potential conditions for an information barrier exception. The modifications suggested by these commenters include:** >to specify that policies and procedures <**must be "reasonably designed," that an internal audit group be allowed to conduct the required independent assessment, and that the independent assessment should be conducted with respect to individual securitizations rather than on a corporate platform basis. While one of these commenters supported**

~~93~~ ~~*See, e.g.*, ICI Letter at 5-7.~~

~~94~~ ~~*See* Barnard Letter at 2 (stating that, although information barriers and disclosure may be useful to mitigate conflicts of interest, short transactions should be absolutely prohibited); Better Markets Letter at 9 n.23 (stating that history had proved that information barriers are not reliable and are difficult for regulators to monitor and enforce); comment letter from Public Citizen (Feb. 13, 2012) ("Public Citizen Letter") at 1, 4-5 (stating that information barriers invite abuse and present major enforcement problems); Tewary Letter 1 at 13-14 (stating that academic studies have found that, even where information barriers are erected, regulators are routinely unaware of when such barriers have been breached).~~

~~95~~ ~~<17 U.S.C. 78*o*(g)>.~~

~~96~~ ~~17 CFR 242.100-105; 17 CFR 242.100(b).~~

would be too burdensome or expensive.[293] Instead, many commenters suggested that the final rule should consider the presence or absence of information barriers (and the robustness and effectiveness thereof) as part of a multi-factor analysis as a preferred alternative to affirmatively requiring the use of prescriptive information barriers.[294] To highlight the challenges that would be presented by a prescriptive information barrier exception, some commenters stated that several securitization participants already use information barriers and similar mechanisms to ensure compliance with various laws and that requiring these entities to establish new information barriers tailored to Rule 192 could lead to inconsistent, intersecting, and/or conflicting information barriers that compromise rather than facilitate compliance.[295] Other commenters stated that, while some securitization participants may have existing information barriers for compliance with other securities laws, such as the Volcker Rule,[296] not all securitization participants subject to the prohibition in Rule 192 are necessarily subject to such laws, and therefore a prescriptive information barrier exception (including one modeled on such an exception to another securities law) would disproportionately increase costs of compliance for those entities.[297]

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the inclusion of an information barrier exception subject to certain conditions in the final rule, the commenter also requested that investment funds and advisers be exempt from the conditions to qualify for such exception. *See* letter from ICI.

293 *See, e.g.*, letters from ABA; AFME; AIC; LSTA III; MFA II; SIFMA I.

294 *See, e.g.*, letters from LSTA III; LSTA IV; SFA II; SIFMA I. Other commenters similarly indicated that a final rule that merely permits the use of existing information barriers would be sufficient to address their concerns. *See, e.g.*, letters from ABA (stating that it is critical for the final rule to acknowledge information barriers); MFA II (noting that any information barriers permitted must be workable).

295 *See, e.g.*, letters from AFME; SIFMA I.

296 17 CFR 255.

297 *See, e.g.*, letter from AIC (noting as an example that investment funds and portfolio companies are not subject to the Volcker Rule).

While it is true that the Federal securities laws recognize the use of information barriers in certain situations, we do not believe that an information barrier exception would be appropriate in the context of Rule 192 for several reasons. First, we are concerned that an information barrier exception has the potential to become a "check-the-box" exercise that could result in an emphasis on form over function or effectiveness of such information barriers. Due to the wide range of securitization participants subject to the prohibition in Rule 192, any prescriptive information barrier exception would have to be drafted in such a way as to be generally applicable to the various types of securitization participants, which could result in standards that are either too permissive for one type of securitization participant (resulting in weakened protections for ABS investors) or too difficult for another to satisfy due to limitations such as numbers of employees, regulatory regimes applicable to certain types of securitization participants, etc.[298] Additionally, as demonstrated by the commenter concerns discussed above, an information barrier exception could have the unintended consequence of potentially compromising various existing compliance programs or disadvantaging certain securitization participants.[299] For these reasons, Rule 192 does not include an information barrier exception. However, we acknowledge commenters' concerns about their ability to concurrently comply with the prohibition in Rule 192 with respect to various affiliates and subsidiaries, as well as other applicable Federal- and State-level laws that may permit or require information barriers or

[298] For example, while it may be relatively easy for large multi-service firms to implement information barriers by establishing completely separate teams of employees to prevent the flow of information where necessary, smaller securitization participants may not have a sufficient number of employees to do so, and therefore such persons may need to employ different mechanisms to prevent such flow of information.

[299] For example, larger multi-service entities may have many different business units already subject to various regulatory provisions related to the unit's particular business and that may require compliance programs involving information barriers. A prescriptive information barrier exception in Rule 192,

therefore, has the potential to overlap and/or interfere with those existing compliance programs, which could potentially increase compliance burdens.

The re-proposed <rule does not include the >use of information barriers as <an exception for affiliates and subsidiaries >because we are concerned about the potential to use an affiliate or subsidiary to evade the re-proposed rule's prohibition. However, we seek comment below on whether an exception utilizing information barriers to exclude affiliates and subsidiaries could be implemented in a way that would be consistent with Section 27B. Responses to such questions would provide further insight on commenters' views on the 2011 proposed rule that supported the use of information barriers, including whether such an approach would be appropriate with respect to investment companies and investment advisers that are affiliates or subsidiaries of certain securitization participants.[97]

An information barriers exception could contain conditions that must be met to qualify for such exception, which would help ensure that the relevant affiliates or subsidiaries of a securitization participant would not engage <in transactions that would involve or result in a material conflict of interest. >For example, an information barrier-based exception could contain a condition requiring that an <underwriter, placement agent, initial purchaser, or sponsor of an ABS >establish, implement, maintain, enforce, and document written policies and procedures to prevent the flow of information to and from such underwriter, placement agent, initial purchaser, or sponsor and its affiliates and subsidiaries that might result in a violation of the re-proposed rule. Such written policies and procedures could aid the underwriter, initial purchaser, placement agent, and sponsor in monitoring and enforcing the applicable information barriers. For example, the policies and procedures could include a physical separation of personnel which could help to restrict information flow, for example, <between a securitization participant and >its affiliates and subsidiaries, and could promote a barrier between activities related to securitization

[65] ~~*See, e.g.*, ICI Letter at 5-7.~~

other similar firewalls. The revisions we are adopting to the definition of "securitization participant," as discussed in greater detail below, are aimed at alleviating commenters' concerns with respect to the scope of the rule's prohibition, while also obviating the need for a prescriptive information barrier exception, avoiding potential additional costs associated with establishing policies and procedures to satisfy conditions imposed by such an exception.

~~and other activities <that are unrelated to the >creation and distribution of ABS. Additionally, policies and procedures could restrict the activities~~**As adopted, an affiliate or subsidiary** of an underwriter, placement agent, initial purchaser, or sponsor ~~in <the context of an ABS >transaction to only those activities necessary for it to act in such capacity, such that the~~**will only be a** securitization participant ~~would be further limited in its ability to engage in activity that Section 27B is designed to prevent.~~

if the affiliate or subsidiary acts in coordination with a securitization participant or has access to, or receives, ~~A second condition to an information barriers exception could be to require that an underwriter, placement agent, initial purchaser, or sponsor of an ABS establish, implement, maintain, enforce, and document a written internal control structure governing the implementation and adherence to the policies and procedures required under the information barriers exception. An internal control condition would aid the underwriter, initial purchaser, placement agent, and sponsor in monitoring, identifying, and remediating non-compliance with the applicable information barriers. For example, an internal control structure would help identify whether policies and procedures would need to be modified so that they achieve their intended purpose.~~**information about a covered ABS or the asset pool underlying or referenced by the relevant ABS prior to the date of first closing of the sale of the covered ABS.**[300] >This approach is consistent with <**the commenter suggestions, as noted above, that affiliates or subsidiaries should only be subject to the prohibition if they have direct**

involvement in, or access to information about, the relevant ABS or are otherwise acting in coordination with the named securitization participant.[301] This approach is also consistent with commenter recommendations that the final rule permit securitization participants to demonstrate lack of involvement or control through the presence and effectiveness of information barriers or other indicia of separateness.[302]

~~A third condition could be that the securitization participant obtains an annual, independent assessment of the operation of the policies and procedures and internal control structure required under the information barriers exception. This condition would also aid the underwriter, initial purchaser, placement agent, and sponsor in monitoring, identifying, and remediating non-compliance with the applicable information barriers that are not identified by the internal control structure.~~

Whether an affiliate or subsidiary acts in coordination with a securitization participant or had access to, or received, information about ≥an ABS or its underlying asset pool ≤**or referenced asset pool prior to the closing date will depend on the facts and circumstances of a particular**

[300] 17 CFR 230.192(c).

[301] *See, e.g.*, letters from ABA; AFME; ICI; LSTA III; LSTA IV; SFA II; SIFMA I; SIFMA II.

[302] *See, e.g.*, letters from AIC; LSTA III; SFA II; SIFMA I; SIFMA II.

transaction.[303] Therefore, an affiliate or subsidiary may not be a "securitization participant" if the named securitization participant, for example:

- **Has effective information barriers between it and the relevant affiliate or subsidiary (including written policies and procedures designed to prevent the flow of information between relevant entities, internal controls, physical separation of personnel, etc.),[304]**
- **Maintains separate trading accounts for the named securitization participant and the relevant affiliate or subsidiary,**

~~A fourth condition could be that the affiliate or subsidiary has no~~• **Does not have common** officers (or persons performing similar functions) or employees (other than clerical, ministerial, or support personnel) ~~in common with the <underwriter, initial purchaser, placement agent, or sponsor >and~~**between the named securitization participant and the relevant affiliate or subsidiary,**

- **Is engaged in an unrelated business from the relevant affiliated entity and does not, in fact, communicate with such relevant affiliated entity,[305] or**
- **Has personnel with oversight or managerial responsibility over accounts of both the named securitization participant and the affiliate or subsidiary, but such persons do not**

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[303] If an affiliate or subsidiary receives information—or has access to information—after the closing of the first sale of the ABS, then—absent coordination with the securitization participant—the affiliate or subsidiary will not be a securitization participant as defined by the final rule.

[304] It will not be inconsistent with this example if the relevant entity has a shared research desk that provides research to the named securitization participant and an affiliated fund but the named securitization participant and the affiliated fund themselves do not share information with each other.

[305] **As an example, one commenter stated that, if affiliated entities operate as independent businesses, notwithstanding their common control by a shared manager, such entities may have no relationship or communication with one another. *See* letter from AIC. As stated above, whether the operation as independent businesses, despite common control, is sufficient to effectively prevent the flow of information between the named securitization participant and the affiliate or subsidiary will depend on the facts and circumstances of the particular transaction.**

have authority to (and do not) execute trading in individual securities in the accounts or authority to (and do not) pre-approve trading decisions for the accounts.[306]

Any such mechanisms must effectively prevent the affiliate or subsidiary from acting in coordination with the named securitization participant or from accessing or receiving information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS.[307]

By revising the definition of "securitization participant" in this way, the final rule aims to capture the range of affiliates and subsidiaries with the opportunity and incentive to engage in conflicted transactions without frustrating market participants' ability to meet their obligations under other Federal- and State-level laws that require the use of information barriers or other such firewalls. Rather than an information barrier exception potentially becoming a "check-the-box" exercise, securitization participants will be incentivized to regularly assess their compliance

306 This list is not exhaustive and simply includes examples of the types of barriers that could be used by securitization participants and their affiliates and subsidiaries. We are not endorsing any one of these methods over another mechanism that may be used to prevent the flow of information between the relevant entities. While it is possible that one of these methods (or another method not listed here) may be sufficient for compliance with the final rule, securitization participants may find that they need to utilize a combination of methods to establish an effective compliance program.

307 A securitization participant generally should consider the structure of its organization and the ways in which information is shared to assess what mechanisms should be employed to comply with Rule 192. If, for example, a securitization participant employs an information barrier, and the barrier fails, whether the affiliate or subsidiary is a securitization participant under Rule 192 will depend on the facts and circumstances. On one hand, if the failure was accidental, was quickly remedied upon discovery, and the affiliate did not use the information to influence the assets included in the ABS, then the affiliate would likely not be a securitization participant under Rule 192. On the other hand, even if the failure was accidental, but the access to information led to the affiliate using the information to influence the assets included in the ABS, then that affiliate would likely be a securitization participant for purposes of Rule 192. Additionally, if the affiliated entity did not meet the terms of the definition of affiliate and subsidiary, as adopted, at the time that it enters into the conflicted transaction (*i.e.*, it did not act in coordination with the named securitization participant and did not have information (or access to information) about the ABS or the asset pool prior to closing), such affiliated entity would not then

retroactively become a securitization participant upon the subsequent receipt of such information. For example, if an affiliate or subsidiary receives information—or has access to information— after having previously engaged in a conflicted transaction, whether the affiliate or subsidiary would then be a securitization participant under the final definition depends on the facts and circumstances as they existed leading up to and at the time of the entry into the conflicted transaction.

~~was not involved in the creation, distribution, origination of the assets, or otherwise providing services with respect to the related ABS. For example, originators and servicers that are affiliates or subsidiaries of <an underwriter, placement agent, initial purchaser, or sponsor >would not meet the elements of this condition. This condition would recognize that it would be nearly impossible to have an effective information barrier to prevent the flow of information if the affiliates or subsidiary shared common officers or employees, was involved in the creation, distribution, or origination of the assets, or is otherwise providing services related to the ABS.~~

~~A fifth condition could be that the information barriers exception would not be available if, in the case of any specific securitization, the underwriter, initial purchaser, placement agent, or sponsor knows or reasonably should know that, notwithstanding meeting the conditions described above, the transaction would involve or result in a material conflict of interest. We seek commenters' views on an information barriers exception with the conditions described above. We also seek comment on other or different conditions below.~~

~~*Request for Comment*~~

~~29. Is it appropriate for the Securities Act Rule 405 definitions of the terms "affiliate," "subsidiary," and "control" to apply for purposes of the re-proposed rule? If not, please explain why and provide alternative definitions of these terms that should be used.~~

~~30. If <a securitization participant that is >an investment adviser "controls" a fund that it manages for purposes of the re-proposed rule, then such fund would be an "affiliate" or "subsidiary" of such investment adviser and subject to the re-proposed rule. Is this appropriate? If not, please explain why, provide alternative definitions of the relevant terms that should be used, and explain how the modifications would be consistent with Section 27B.~~

programs to confirm the presence and effectiveness of their information barriers or other firewalls to prevent a potential violation of Rule 192. Moreover, this approach addresses commenters' concerns with respect to additional compliance burdens for securitization participants by not requiring that they either create new or recalibrate existing information barriers to satisfy a prescriptive set of conditions for Rule 192 compliance. The final rule is designed to provide securitization participants with the flexibility to use information barriers or other mechanisms to prevent coordination or sharing of information with an affiliate or subsidiary, while still achieving the objective of prohibiting securitization participants from engaging in conflicted transactions.

If, however, an information barrier or other tool used to maintain the separation of an affiliate or subsidiary from another named securitization participant failed or was otherwise breached, it would call into question whether the affiliate or subsidiary had access to, or received, information or otherwise acted in coordination with such named securitization participant and such affiliate or subsidiary could therefore be a securitization participant.[308] >This approach is consistent with <**Section 27B and appropriately balances market participants' need for sufficiently clear boundaries to establish effective compliance programs. Further, the final rule acknowledges the role that information barriers play in the financial markets, without the need for a prescriptive exception, which, as noted above, has the potential to prioritize form over function in light of the wide range of securitization participants subject to Rule 192.[309]**

~~31. The proposed definitions of the terms "affiliate" and "subsidiary" could include a~~

~~securitization participant's non-U.S. affiliates and subsidiaries. Would the inclusion <of affiliates and subsidiaries within >the scope of the re-proposed rule result in the rule having an unnecessary and highly burdensome global reach, as suggested by one commenter to the 2011 proposed rule?[98] Why or why not?~~

~~32. As discussed above, information barriers are used as tools to manage conflicts of interest in other areas of the Federal securities laws and the rules thereunder.[99] We seek comment on whether information barriers could be designed to effectively mitigate prohibited conflicts of interest and provide adequate protection in this context, whether the use of such barriers would effectively implement Section 27B, and whether internal information barriers are vulnerable to breach. If the re-proposed rule were to include the use of information barriers, should there be an exception for an affiliate or subsidiary of an underwriter, placement agent, initial purchaser, or sponsor of an ABS if each of the following conditions is satisfied: (1) the underwriter, placement agent, initial purchaser, or sponsor of the ABS establishes, implements, maintains, enforces, and documents written policies and procedures to prevent the flow of information to and from the affiliate or subsidiary that might result in a violation of the re-proposed rule; (2) the underwriter, placement agent, initial purchaser, or sponsor of the ABS establishes, implements, maintains, enforces, and documents a written internal control structure governing the implementation of, and adherence to, the written policies and procedures; (3) the underwriter, placement agent, initial purchaser, or sponsor of the ABS obtains an~~

~~98~~ [308] *See* ~~SIFMA Letter at 15~~ *id*.

~~99~~ ~~*See* Section II.B.3.~~

[309] **This approach also significantly mitigates concerns expressed with respect to both the scope of the rule's applicability to affiliates and subsidiaries and compliance burdens that would be associated with a new prescriptive information barrier requirement. *See* Section IV.**

annual, independent assessment of the operation of such policies and procedures and internal control structure; (4) the affiliate or subsidiary has no officers (or persons performing similar functions) or employees (other than clerical, ministerial, or support personnel) in common with <the underwriter, placement agent, initial purchaser, or sponsor of >the ABS, and was not involved in the creation or distribution of, or otherwise involved in providing services with respect to, the related ABS; and (5) a person may not rely on the exception if, in the case of any specific securitization, the person knows or reasonably should know that notwithstanding satisfying the conditions, a transaction <would involve or result in a material conflict of interest>? How would this exception be consistent with Section 27B?

33. Please identify any additional conditions that would be appropriate for a potential information barriers exception to include in order to help maintain strong conflict of interest protection while permitting normal course business activities for certain affiliates and subsidiaries, and how those conditions would be consistent with Section 27B.

34. Should any of the conditions described in question 32 be modified if the final rule were to include an information barriers exception? For example, should condition (1) be modified <to specify that policies and procedures >such as physical separation of personnel and functions and limitations on the types of permissible activities of an underwriter, initial purchaser, placement agent, or sponsor (and its affiliates and subsidiaries) could satisfy this condition? Should condition (1) be modified to specify that the policies and procedures must take into consideration the nature of the entity's business? Should any of the conditions be deleted? If so, explain why, including why the removal of any such

conditions would be consistent with Section 27B if the final rule were to include an information barriers exception.

35. Should the potential information barriers exception described in question 32 include a condition that the offering document for the ABS must disclose <the types of transactions that >the affiliate or subsidiary could engage in as part of its normal, ordinary course of business? How could any such disclosure condition be structured so that the resulting disclosure would not contain vague boilerplate language? How could such disclosure be provided to investors if the transactions occur after the offering but within <the timeframe of the prohibition>? How would any such disclosure conditions be consistent with Section 27B?

36. Should the potential information barriers exception described in question 32 provide an exception for specific types of businesses that are unrelated to the creation and distribution of ABS such that only affiliates and subsidiaries engaged in those specific businesses would be eligible for the exception? If yes, please explain and provide a list of specific businesses unrelated to the creation and distribution of ABS that should be listed in any such exception (for example, mutual fund asset-management, investment advisers acting on behalf of clients, foreign trading desks facilitating customer trades). Also, please explain how any such exceptions would be consistent with Section 27B. If no, please explain.

37. Should the potential information barriers exception described in question 32 provide an exception <if the affiliate or subsidiary >already would be subject to existing rules and regulation that provide for conflict management or restricting information flow as the requirements of such rules and regulations could help to achieve the policy objectives of

C. ~~the re-proposed rule? Please list specific rules and regulations that provide for managing conflicts of interest or restricting information flow at the affiliate or subsidiary as a condition to qualifying for such exception.~~

~~38. Should the re-proposed rule include an information barriers exception as described by one commenter to the 2011 proposed rule?[100] How would such an exception be consistent with Section 27B? Should any conditions that were suggested by that commenter be added to the information barriers exception described in question 32? In lieu of condition (3) in question 32, should a potential information barriers exception instead require periodic internal audits of compliance with policies and procedures? If so, how often should that assessment be? For example, should it be monthly, annually, or quarterly and why? Is there a particular actor within an organization that should perform the internal audit? If so, who would that be and why?~~

Prohibition Timefram~~ of Prohibition~~e

~~We are proposing in Rule 192(a)(1) that the prohibition on conflicted transactions would~~

1. Proposed Prohibition Timeframe

Section 27B specifies that securitization participants be prohibited from entering into a conflicted transaction at ">any time for a period ending on the date that is one year after the date of the first closing of the sale of the <**asset-backed security," but does not specify the commencement point of that prohibition. The Commission proposed that the prohibition in Rule 192(a)(1) would** commence on the date on which a person has reached, or has taken substantial steps to reach, an ~~agreement[101]~~**agreement** that such person will become a securitization participant ("**proposed** commencement point") and would end one year after the date of the first closing of the sale of the relevant ABS. ~~This end point for the covered timeframe~~

~~is set forth in the statutory language of Section 27B, and the re-proposed rule incorporates that statutory language. The prohibition in the 2011 proposed rule~~

[310] **The Commission did not propose definitions of "agreement"**[311] **or "substantial steps," stating that whether a person has taken "**>substantial steps to reach an agreement to become a securitization participant<**"** >would be a facts and circumstances determination based on the actions of such person in furtherance of becoming a securitization participant.<[312] ~~100 *See* SIFMA Letter at 15 (describing a safe harbor that would permit a financial institution to design its own information barriers).~~

~~101 For purposes of the re-proposed rule, <an "agreement" need not constitute an executed written agreement, such as an engagement letter>. Oral <agreements and facts and circumstances constituting an agreement>, even absent an executed engagement letter, can <be an agreement for purposes of the rule. >We expect that market participants would know <and understand when an agreement has been reached>.~~

would have applied at *any time* for a period ending on the date that is one year after the date of the first closing of the sale of the ABS.

The re-proposed rule's**proposed** approach to the commencement point is**was** designed to reduce the circumstances in which a person could engage in prohibited conduct prior to the issuance of the relevant ABS. We preliminarily believe that the point at which a securitization participant has reached, or has taken substantial steps to reach, an agreement that <such person will become a securitization participant >is the appropriate commencement point for the prohibition in the re-proposed rule because that is **and was aimed at capturing** the point at which a person may be incentivized and/or can**could** act on an incentive to engage in the misconduct that Section 27B is designed to prevent.[313]

[310] ***See* Proposing Release Section II.C.**

[311] **The Proposing Release stated that** >an "agreement" need not constitute an executed written agreement, such as an engagement letter<, **but rather that oral** >agreements and facts and circumstances constituting an agreement <**could** >be an agreement for purposes of the rule. <***See* Proposing Release at 9692, n. 101. Additionally, the Commission requested comment on whether the rule should identify specific indicia of having reached an "agreement," but did not receive feedback in response to that request. *See* Proposing Release at 9693, Request for Comment 41.**

Whether a person has taken <substantial steps to reach an agreement to become a securitization participant ><would be a facts and circumstances determination based on the actions of such person in furtherance of becoming a securitization participant. >For example, a person who has engaged[312] ***See* Proposing Release Section II.C. As an example, the Commission indicated that engaging** in substantial negotiations over the terms of an engagement letter or other agreement to become an underwriter, placement agent, initial purchaser, or sponsor of an ABS would <be subject to the prohibition in >the re-proposed rule by virtue of having taken**constitute taking** substantial steps to reach an agreement to become a securitization participant. The re-proposed rule does not define "agreement" or "substantial steps to reach . . . an agreement" in

[313] ***See* Proposing Release Section II.C.**

2. Comments Received

~~the context of the~~**The Commission received numerous comments on the proposed prohibition timeframe.[314] Several commenters opposed the proposed** commencement point~~.~~ ~~However, we seek comment below on indicia~~**, stating that the determination** of whether a person has ~~reached~~ **taken "substantial steps to reach an agreement" involves too much ambiguity and subjectivity to successfully conform their activities to the rule and ensure compliance.[315] Some commenters further stated that, because the proposed commencement point is backward-looking (*i.e.*, a person can become a securitization participant with respect to a relevant ABS before the ABS is created and sold), the ambiguity introduced by the "substantial steps" standard would make it particularly difficult to determine when a person becomes subject to the rule's prohibition.[316] One of these commenters stated that it is unclear what would constitute taking substantial steps related to the use of warehouse facilities for the financing of assets or for securitizations using master trust structures where a pool of assets can be assembled in a trust months or years before any particular ABS offering is contemplated.[317] Another commenter further stated that, with respect to the statement in the Proposing Release that** >the prohibition on material conflicts of interest would not apply to a person that never reaches <an agreement to become a securitization participant~~, or taken substantial steps to reach such an agreement, and whether such indicia should be specified in the rule.~~**[318] it is not clear at what point in**

~~Proposed Rule 192(a)(1) prohibits a securitization participant from <engaging in any transaction that would involve or result in any material conflict of interest >between the securitization participant and an investor in the relevant ABS. In order for the prohibition in~~

proposed Rule 192(a)(1) to apply to a potentially conflicted transaction, an ABS must have been created and sold to one or more investors; in the absence of the creation and sale of an ABS, there would be no investors in an ABS with respect to which a potentially conflicted transaction could involve or result in a material conflict of interest. Additionally, the prohibition in proposed Rule 192(a)(1) applies only to a securitization participant (*i.e.*, an underwriter, placement agent, initial purchaser, or sponsor of an ABS or any affiliate or subsidiary of any such person). Therefore, under the re-proposed rule, <the prohibition on material conflicts of interest would not apply to a person that never reaches >an agreement to become an underwriter, placement agent, initial purchaser, or sponsor of an ABS, even if such person were to take substantial steps to reach such an agreement.[102] However, once a person has become a securitization participant and an ABS has been created and sold, the re-proposed rule's prohibition would apply to such person commencing on the date on which such person reached, or took substantial steps to reach, an agreement to become a securitization participant. As a practical matter, this means that if a person were to enter into a potentially conflicted transaction prior to becoming a securitization participant, *e.g.*, while engaged in negotiations to become a securitization participant, the person could avoid violating the re-proposed rule by withdrawing from the transaction prior to becoming a securitization participant. However, if the person were to become a securitization participant with respect to an ABS after having engaged in a potentially conflicted transaction, the person would be in violation of the re-proposed rule by virtue of being a securitization participant that had engaged in a conflicted transaction during the

[102] We note, however, that if such person were <to direct or cause the direction of the structure, design, or assembly> of an ABS or the composition of the pool of assets underlying the ABS, such person would be a directing sponsor under paragraph (ii)(B) of the proposed definition of "sponsor" (which, by extension, means that such person would be subject to the re-proposed rule's prohibition) even if such person had no contractual right to do so. *See* Section II.B.2.

[314] ***See also*** **Section II.D.1.c.iii for a discussion of the comments received regarding certain pre-securitization activities by securitization participants and the rule's applicability to such activities.**

[315] ***See, e.g.*****, letters from ABA; AIMA/ACC; ICI; SFA II; SIFMA I. One commenter, without expressing support or opposition to the proposed commencement point, stated its belief that the prohibition timeframe should start "at the earliest moment that a covered person could reasonably foresee a conflict of interest with investors," but did not elaborate or provide additional context as to how to identify such a point in time. *See* letter from AFR.**

[316] ***See, e.g.*****, letters from ABA; AIMA/ACC; LSTA III; MFA II; SIFMA I. Relatedly, one commenter stated that, because the proposed timeframe could last for more than one year, it could have the effect of restricting a trader's ability to handle unrelated transactions because its firm is in a potentially conflicted position as it works on a securitization. *See* letter from ASA. We believe that the prohibition timeframe, as revised, together with the final rule's applicability to affiliates and subsidiaries of named securitization participants, should help to mitigate this concern. *See* Section II.B.3.c.**

[317] ***See*** **letter from ABA.**

[318] ***See*** **Proposing Release at 9693.**

time a person would be determined to never have reached an agreement (*e.g.*, date of first sale of the relevant ABS, or some earlier point in time).[319] The Commission also received comment expressing concern that the proposed commencement point is particularly challenging to implement without an information barrier exception because, for example, it is possible that an affiliate or subsidiary of a person who took substantial steps to become a securitization participant would be unaware of such steps due to existing information barriers within a multiservice financial firm.[320] Commenters requested, therefore, that the rule include a more definitive commencement point to enable market participants to effectively implement procedures to govern their compliance with the rule's prohibition.[321] The Commission received one comment on the proposed end date of the prohibition timeframe, which suggested that the prohibition should potentially apply for a longer period of time.[322]

3. Final Rule

In response to comments received, we are revising the prohibition timeframe to begin at a more definitive commencement point and are adopting the end point of the prohibition timeframe as proposed. Under Rule 192(a)(1), the prohibition against entering into conflicted transactions will commence on the date on which such person has reached an agreement to become a securitization participant with respect to an asset-backed security and will end one year

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[319] *See* letter from SIFMA I. This commenter likewise observed that there could be a period of time after which a person has taken "substantial steps," but before it is determined that an agreement to act as a securitization participant was never reached, during which a transaction could be challenged as a conflicted transaction, which further highlights the challenges presented by the "substantial steps" construction.

[320] *See, e.g.*, letter from ICI. See Section II.B.3.c. for a discussion of how Rule 192 will apply to affiliates and subsidiaries and the role of information barriers. We believe that the changes to the definition of "securitization participant" in Rule 192(c) with respect to affiliates and subsidiaries, together with the revised commencement point discussed in this section, address these concerns.

[321] ***See, e.g.*, letters from ABA; MFA II; SFA II; SIFMA I.**

[322] ***See* letter from Pentalpha.**

after the date of the first closing of the sale of the relevant ABS.[323] By omitting the proposed language about taking "substantial steps" to reach an agreement, the final rule will avoid many of the concerns that commenters raised with respect to the scope of the proposed rule. The prohibition timeframe, as revised, together with the changes we are making to the final rule's applicability to affiliates and subsidiaries of named securitization participants, should help to mitigate commenters' concerns about their ability to determine when a person is subject to the rule's prohibition.[324]

The Commission received several commenter suggestions for specific dates as the prohibition's commencement point, including the commencement of marketing or pricing of the ABS,[325] 30 days prior to the first sale of the ABS,[326] 30 days prior to the date of the first closing of the sale of the ABS,[327] the date on which an engagement letter is signed,[328] and once an entity has "actually" become >an underwriter, placement agent, initial purchaser, or sponsor<**.[329] While we understand that such specific dates may be desirable for market participants because they provide a level of certainty with respect to when a person is operating subject to the prohibition against engaging in conflicted transactions, we continue to believe that using specific dates could be underinclusive because a securitization participant could engage in the conduct that Rule 192 is designed to prevent just prior to such commencement points and the rule would, as a result,**

~~period specified in proposed Rule 192(a)(1). We preliminarily believe that this approach to the commencement point would help prevent conduct that the re-proposed rule is designed to prohibit that occurs prior to a person having reached an agreement to become a securitization participant.~~

~~Certain commenters to the 2011 proposed rule supported specific dates as the commencement point (*e.g.*, the date of the first marketing or offering materials for the ABS,[103]~~

~~the pricing date for the ABS,[104] or the point in time when an issuer engages those involved in structuring and marketing the ABS[105]). We also received comment that supported leaving the commencement point unspecified because, for example, specific commencement points may be underinclusive.[106] We believe that a commencement point that begins on the date of the first marketing or offering materials for the ABS, the pricing date for the ABS, or the point in time when an issuer engages those involved in structuring and marketing the ABS could be underinclusive because a securitization participant could engage in the misconduct that Section 27B is designed to prevent just prior to such commencement points and the rule would, as a result, not cover misconduct prior to those dates. Therefore, we believe that the commencement point should begin at an early point in time when a securitization participant may first have the opportunity to engage in the misconduct that Section 27B is designed to prevent.~~

~~103 *See* ASF Letter at 24; SIFMA Letter at 23~~[323] **17 CFR 230.192(a)(1)**.

~~104 *See* SIFMA Letter at 23.~~

~~105 *See* ASF Letter at 24.~~

~~106 *See* AFR Letter at 7; Barnard Letter at 3; Better Markets Letter at 5; Merkley-Levin Letter at 6.~~

[324] *See, e.g.*, notes 319 and 320 and accompanying text. The revision to the commencement point also will address the commenter concern noted above that the proposed commencement point did not make clear when a person would no longer be subject to the rule if it >never reaches an agreement to become <**a securitization participant because the prohibition as adopted does not apply until such person has reached an agreement.**

[325] *See, e.g.*, letter from ABA.

[326] *See, e.g.*, letter from SFA II.

[327] *See, e.g.*, letters from LSTA III; MFA II; SIFMA I; SIFMA II.

[328] *See, e.g.*, letter from SFA II.

[329] *See, e.g.*, letters from LSTA III; MFA II.

not cover conduct prior to those dates. Because there is significant variability between securitization structures, the procedures used to originate, acquire, and/or identify collateral for a securitization, and timelines on which market participants operate to structure or assemble ABS and conduct their offerings, selecting a specified date such as those suggested by commenters could, depending on the features of the securitization, fail to capture critical points in time during which a securitization participant may be incentivized and/or could act on an incentive to engage in conflicted transactions. Moreover, such structures, procedures, and timelines employed by market participants today could change as the market evolves and potentially render a prohibition commencement point tied to a specific date ineffective.

For purposes of Rule 192, "agreement" refers to an agreement in principle (including oral agreements and facts and circumstances constituting an agreement) as to the material terms of the arrangement by which >such person will become a securitization participant<**. An executed written agreement, such as an engagement letter, is not required;[330] whether there has been an agreement to become a securitization participant will depend on the facts and circumstances of the securitization transaction and the parties involved.[331] As the Commission stated in the Proposing Release,[332] and as some commenters pointed out,[333] market participants are able to identify** >and understand when an agreement has been reached <**in their ordinary business**

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[330] **While a written agreement (such as engagement letter) is not necessary to establish an "agreement" for purposes of final Rule 192, it will be sufficient, regardless of whether such written agreement includes all material terms of the contractual arrangement. This is because, even in the absence of such material terms, the written agreement will be consistent with an agreement in principle to perform as a securitization participant for purposes of Rule 192.**

[331] **For example, once a person agrees with the** >issuer or selling security holder to <**be the underwriter for the relevant ABS transaction, that underwriter is a securitization participant subject to the prohibition in Rule 192, even if a written agreement has not yet been executed.**

[332] ***See* Proposing Release at 9692 n. 101 and accompanying text.**

[333] ***See, e.g.*, letters from LSTA III; SIFMA I.**

Request for Comment

39. We seek commenters' views regarding the approach to the covered timeframe in the re-proposed rule. Should we modify the proposed covered timeframe in the re-proposed rule, and if so, how and why?

40. In particular, we seek comment on the proposed commencement point of the re-proposed rule's prohibition on material conflicts of interest. Is it appropriate for the re-proposed rule's prohibition to commence at the point at which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant, and why? Are there modifications to the commencement point that might be necessary or advisable to mitigate any unintended consequences? Should the rule specify when a person has reached an agreement to become a securitization participant? For example, should the rule specify that "agreement" refers to a formal, written agreement to become a securitization participant, or should it instead specify that "agreement" refers to an agreement in principle as to the major terms of the arrangement by which such person will become a securitization participant, and why? Should the rule identify specific activities that would constitute "substantial steps" to becoming an underwriter, placement agent, initial purchaser, or sponsor of an ABS? Why or why not? Please provide comment on specific activities that you believe constitute "substantial steps" to becoming an underwriter, placement agent, initial purchaser, or sponsor of an ABS, and whether any or all of such activities should be specified in the rule.

41. We seek comment on whether we should specify additional factors that would indicate when a person has reached an agreement to become a securitization participant. Should an "agreement" arise only through an executed engagement letter or the oral equivalent

of an executed engagement letter, or should <the facts and circumstances of the >situation dictate when an agreement has been reached?

42. We seek comment on the implications of the commencement point of the re-proposed rule's prohibition on affiliates and subsidiaries of a person seeking to become an underwriter, placement agent, initial purchaser, or sponsor of an ABS. How would an affiliate or a subsidiary of such a person know that the person had taken substantial steps to reach an agreement to become a securitization participant, such that a conflicted transaction entered into by the affiliate or subsidiary would be prohibited by the re-proposed rule if the person seeking to become a securitization participant were to ultimately reach an agreement to become a securitization participant? Are there existing information barriers in place within certain regulated firms that would prevent the person seeking to become a securitization participant from informing its affiliates and subsidiaries that it had taken substantial steps to reach an agreement to become a securitization participant? For these or other reasons, should the re-proposed rule be modified to prohibit conflicted transactions by affiliates or subsidiaries of a person seeking to become an underwriter, placement agent, initial purchaser, or sponsor of an ABS only after such person has reached an agreement to become a securitization participant, and why? If so, please explain how the re-proposed rule should be modified, and how such modifications would be consistent with Section 27B.

43. How should the rule treat a person that <never reaches an agreement to become >an <underwriter, placement agent, initial purchaser, or sponsor of an ABS>, despite having taken substantial steps to reach such an agreement? As discussed above, the re-proposed rule's prohibition generally would not apply to a person that does not reach an agreement

~~to become an underwriter, placement agent, initial purchaser, or sponsor of an ABS, even if such person were to take substantial steps to reach such an agreement. However, once a person has become a securitization participant, the rule's prohibition would apply to such person commencing on the date on which such person reached, or took substantial steps to reach, an agreement to become a securitization participant. Would this approach be underinclusive because it would not cover parties that might have had a significant role in determining the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS? Why or why not? Are any such concerns about potential underinclusiveness adequately mitigated by the anti-circumvention provision in proposed Rule 192(d)?~~

operations and, therefore, they will be able to establish effective procedures for determining when they have triggered the prohibition against engaging in conflicted transactions.

While the prohibition against entering into conflicted transactions will commence on the date on which a person has reached an agreement to become a securitization participant with respect to an ABS, if such ABS is never sold to investors, Rule 192 will not apply. As noted above, the >rule is designed to prevent <**the sale of ABS that are tainted by material conflicts of interest by specifically prohibiting securitization participants from engaging in conflicted transactions that could incentivize** >a securitization participant to structure an ABS in a way that <**puts** >the securitization participant's interests ahead of <**ABS investors. In the event that the sale of an ABS is not completed, there will be no investors with respect to which a transaction could** >involve or result in a material conflict of interest<**. Therefore, as adopted, the Rule 192**

prohibition >on material conflicts of interest <**will not apply if the ABS is never actually sold to an investor. If an ABS is created and sold, however, then the rule's prohibition will apply beginning on the date on which there was an agreement to become a securitization participant and will end one year after the date of the first closing of the sale of such ABS.**[334]

Prohibition

Section 27B(a) provides that an underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, of an ABS, including a synthetic ABS, shall not, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security, engage in any transaction that would involve or

[334] **As we noted above, the Commission received one comment suggesting that we consider extending the prohibition beyond one year after first closing of a sale of ABS. *See* letter from Pentalpha Letter. We believe this would be inconsistent with Section 27B, which specifies that the prohibition apply for one year following**> the date of the first closing of the sale of< **the ABS. Therefore, we are adopting the prohibition end date as proposed.**

D.

result in any material conflict of interest with respect to any investor in a transaction arising out of such activity.[107][335]

1. ~~Prohibited Conduct~~**Proposed Prohibition**

Consistent with Section 27B(a), the ~~prohibition~~**Commission proposed** in proposed Rule 192(a)(1) ~~provides~~ that a securitization participant shall not, for a period commencing on the date on which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an ~~asset-backed security~~**ABS** and ending on the date that is

[107] ~~<15 U.S.C. 77z-2a(a).>~~

one year after the date of the first closing of the sale of such ~~asset-backed security~~**ABS**, directly or indirectly engage in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such ~~asset-backed security.~~**ABS.**[336] As set forth in proposed **17 CFR 230.192(a)(2) (“**Rule 192(a)(2)**”)**, engaging in any transaction would involve or result in any material conflict of interest between a securitization participant and an investor if such transaction is a “conflicted transaction” as defined in proposed Rule 192(a)(3). ~~This formulation is <designed to effectuate Section 27B ><by prohibiting a securitization participant from entering into a conflicted transaction that is, in effect, a bet against the ABS that such securitization participant created and/or sold to investors. >We believe that this prohibition in the re-proposed rule, along with the proposed definitions of “conflicted transaction” discussed below,[108] would provide strong investor protection against such misconduct, while also providing an explicit standard for determining which types of transactions would be prohibited by the re-proposed rule in order to address concerns expressed by commenters to the 2011 proposed rule about not unnecessarily prohibiting or restricting <activities routinely undertaken in connection with the securitization process, as well as routine transactions in the types of financial assets underlying covered securitizations.>~~

The ~~prohibition in the re-proposed rule applies to a “conflicted transaction” <entered into by a securitization participant>. This is defined~~**Commission proposed to define this term** under proposed Rule 192(a)(3) to include two main components. One component ~~is~~**was** whether the transaction is:

- ~~A~~**As specified in proposed 17 CFR 230.192(a)(3)(i) (“Rule 192(a)(3)(i)”), a** short sale of the relevant ABS;

~~[108] The proposed definitions of “conflicted transaction” and “material conflict of interest” would apply solely for purposes of the re-proposed rule. *See* proposed Rule 192(a)(2) and (3).~~

- ~~The~~**As specified in proposed 17 CFR 230.192(a)(3)(ii) ("Rule 192(a)(3)(ii)"), the** purchase of a CDS or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of a specified adverse event with respect to the relevant ~~asset-backed security~~**ABS**; or

[335] 15 U.S.C. 77z-2a**(a).**

[336] ***See*** **Proposing Release Section II.D.**

- ~~The~~**As specified in proposed 17 CFR 230.192(a)(3)(iii) ("Rule 192(a)(3)(iii)"), the** purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction through which the securitization participant would benefit from the actual, anticipated, or potential:
    - Adverse performance of the asset pool supporting or referenced by the relevant ABS;
    - Loss of principal, monetary default, or early amortization event on the relevant ABS; or
    - Decline in the market value of the relevant ABS.

The other component ~~relates~~**related** to materiality – *i.e.*, whether there is a substantial likelihood that a reasonable investor would consider the relevant transaction important to the investor's investment decision, including a decision whether to retain the ABS.

The proposed definition was >designed to effectuate Section 27B<**(a)** >by prohibiting a securitization participant from entering into a conflicted transaction that is, in effect, a bet against the ABS that such securitization participant created and/or sold to investors. <**It was also designed to not unnecessarily prohibit or restrict** >activities routinely undertaken in connection with the securitization process, as well as routine transactions in the types of financial assets underlying covered securitizations.<[337]

2. **Comments Received**

Several commenters stated that the phrase "directly or indirectly" should be removed from proposed Rule 192(a)(1).[338] One commenter specifically stated that the rule, as proposed,

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[337] ***See*** **Proposing Release at 9694.**

[338] ***See*** **letters from SFA II; SIFMA II.**

would already apply directly to the affiliates and subsidiaries of a securitization participant.[339] The Commission received no comments on proposed Rule 192(a)(2). With respect to proposed Rule 192(a)(3), commenters generally supported the Commission defining the term "conflicted transaction."[340] Commenters also generally supported prohibiting securitization participants from entering into a short sale of the relevant ABS under proposed Rule 192(a)(3)(i)[341] and from purchasing a CDS or other credit derivative >pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of a <**specified adverse event with respect to the relevant ABS under proposed Rule 192(a)(3)(ii).[342] However, the Commission received a substantial number of comments that proposed Rule 192(a)(3)(iii) would be overly broad and unnecessarily capture a wide range of activities that are essential to the functioning and issuance of ABS and securitization participants' routine risk management activities.[343] Commenters provided numerous examples of transactions that, in their view, would not give rise to a material conflict of interest with ABS investors but that could nevertheless be potentially prohibited** >by proposed Rule 192(a)(3)(iii)<**, including general interest rate and currency exchange rate hedging, the provision of warehouse financing, and the sale or transfer of assets to an ABS**

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339 *See* letter from SIFMA II.

340 *See, e.g.*, letters from Better Markets; ICI.

341 *See, e.g.*, letters from ABA (suggesting that the rule should prohibit a short sale of the relevant ABS); AIC (stating that, on its face, proposed Rule 192(a)(3)(i) was sufficiently clear); SIFMA I (agreeing that a short sale of ABS by a securitization participant may create a conflict of interest between that securitization participant and investors); SFA I (stating that such a transaction is a direct bet against the success of the relevant ABS); SFA II (agreeing that short sales of ABS by securitization participants should be prohibited).

342 *See, e.g.*, letters from SFA I (stating that such a transaction is a direct bet against the success of the relevant ABS); SFA II (agreeing that purchase of a CDS or other derivatives on which the securitization participant would be paid as a result of the occurrence of adverse credit events with respect to the ABS should be prohibited); SIFMA I (agreeing that the entry into a CDS on the relevant ABS by a securitization participant may create a conflict of interest between that securitization participant and investors).

[343] ***See, e.g.*, letters from CREFC I (stating that, when read broadly, the proposal could mean that any component of a securitization transaction could be a conflicted transaction, including ordinary decision-making activities by securitization participants); MFA II (suggesting that the Commission not adopt proposed Rule 192(a)(3)(iii)); SIFMA I (stating that proposed Rule 192(a)(3)(iii) was vague and unworkable on its face).**

issuer.[344] Commenters suggested various formulations of Rule 192(a)(3)(iii) that would, in their view, better align its scope with the discussion of its intended scope in the Proposing Release and avoid unnecessarily restricting customary transactions entered into with respect to securitizations.[345] The Commission also received comment that the materiality standard, as proposed, would be inappropriate,[346] and that the final rule should include a disclosure-based cure mechanism to mitigate material conflicts of interest.[347]

3. Final Rule

We are adopting the prohibition in Rule 192(a) with certain modifications from the proposal in response to comments received. Consistent with the investor protection goals of Section 27B, we are adopting a prohibition that is designed to capture >transactions that are bets against the <relevant ABS or the asset pool supporting or referenced by such ABS. Consistent with the proposal, final Rule 192(a)(1) provides that a securitization participant shall not, for a

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[344] *See, e.g.*, letters from MFA II (requesting that the Commission expressly permit interest rate hedging, currency hedging, and other non-credit related hedging); SFA I (stating that the final rule should not prohibit warehouse financing or the sale of assets into a securitization); SFA II (stating that transactions that are not related to the credit risk of the relevant ABS should not be conflicted transactions, such as transactions "related to overall market movements"); SIFMA I (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); SIFMA II (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); LSTA IV (supporting SIFMA's position); SFA II (requesting a specific exception for such activities).

[345] *See. e.g.*, letter from SFA II (suggesting a formulation to only capture transactions that "substantially replicate" the type of transactions specified in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii)); SIFMA I (suggesting a formulation to only capture transactions that are the "functional trading equivalent" of the type of transactions specified in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii)); SIFMA II (suggesting a formulation to only capture transactions that "substantially replicate" the type of transactions specified in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii)).

[346] *See, e.g.*, letters from SFA I (stating that the proposed reasonable investor standard was designed by the courts "to identify when disclosures are inadequate, so it is very difficult to divorce from the context of the disclosures that have been made"); SIFMA I (stating that the proposed reasonable investor standard is for disclosure and is not an appropriate standard for a rule that is a prohibition).

[347] *See, e.g.*, letters from ABA (suggesting a disclosure-based standard); AIMA/ACC (stating that it is unclear how a securitization participant would be able to determine what a "reasonable investor" would consider

to be material to an investment decision and, therefore, a disclosure approach would be more effective at addressing conflict of interest concerns).

specified period of time,[348] directly or indirectly engage in any transaction that >would involve or result in any material conflict of interest between the securitization participant and <an investor in such asset-backed security.[349]

As noted above, several commenters suggested that the phrase "directly or indirectly" should be removed from proposed Rule 192(a)(1)[350] with one commenter specifically stating that the rule, as proposed, would already apply directly to the affiliates and subsidiaries of a securitization participant.[351] The final rule will apply to certain affiliates and subsidiaries of a securitization participant, but, as explained in the Proposing Release, a securitization participant could design a transaction structure to route the various payment legs of a short transaction >through a variety of different legal entities that are <deliberately >structured to not be affiliates or subsidiaries of the securitization participant <in an effort >to obscure the ultimate economics of <the relevant transaction.[352] Therefore, we are retaining the phrase "directly or indirectly" in the adopted rule to address this issue, minimize the risk of evasion, and, by extension, achieve the

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348 *See* Section II.C.3. above for a detailed discussion of> the timeframe of the prohibitio<n.

349 *See* Proposing Release Section II.D.

350 *See* letters from SFA II (stating that the inclusion of both "directly or indirectly" and the proposed anti-circumvention provision are overlapping and potentially inconsistent); SIFMA II. We are adopting Rule 192(a)(1) to include the phrase "directly or indirectly." However, as described in further detail in Section II.H below, in a change from the proposal, we are adopting an anti-evasion provision that will apply only with respect to the use of an exception as part of a plan or scheme to evade the rule's prohibition. We believe that this approach should address the concerns of commenters that the inclusion of both the phrase "directly or indirectly" in Rule 192(a)(1) and the proposed anti-circumvention provision could be overlapping and potentially inconsistent.

351 *See* letter from SIFMA II.

352 *See* Proposing Release at 9696. For example, a securitization participant might attempt to arrange a series of transactions through intermediate special purpose entities that are structured with "orphan" ownership structures where such intermediate special purpose entities are not affiliates or subsidiaries of the securitization participant but are instead notionally owned by a corporate services provider or a charitable trust. The inclusion of the phrase "directly or indirectly" in Rule 192(a)(1) is designed to capture this type of indirect activity. As described in further detail in Section II.H below, in a change from the proposal, we are adopting an anti-evasion provision that will apply only with respect to the use of an exception as part of a plan or scheme to evade the rule's prohibition.

investor protection goals of Section 27B. At the same time, we recognize the separate concern of the same commenter that using the phrase "directly or indirectly" in Rule 192(a)(1) could be potentially interpreted to create a misalignment between the scope of the entities subject to the prohibition and the scope of the exceptions to the rule that apply to the activities of a securitization participant.[353] However, as discussed in detail >below in Sections II.E. through II.G.<**, the final rule does not prohibit a securitization participant from using an affiliate or subsidiary as an intermediary, for example, to effect risk-mitigating hedging activity or fulfill a liquidity commitment obligation of the securitization participant consistent with the conditions enumerated in the exceptions to the rule.**

The Commission received no comments on proposed Rule 192(a)(2), and we are adopting it as proposed. Thus, engaging in any transaction would involve or result in any material conflict of interest between a securitization participant and an investor if such transaction is a "conflicted transaction" as defined in final Rule 192(a)(3). A "conflicted transaction" is defined in final Rule 192(a)(3) as any of the following transactions with respect to which >there is a substantial likelihood that a reasonable investor would consider the <**transaction important to the investor's investment decision, including a decision whether to retain the ABS:[354]**

- **As specified in Rule 192(a)(3)(i)**>, a short sale of the relevant <**ABS;**
- **As specified in Rule 192(a)(3)(ii), the purchase of a CDS or other credit derivative pursuant to which** >the securitization participant would be entitled to <**receive payments upon the occurrence of a specified adverse event with respect to the relevant ABS; or**

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[353] ***See*** **letter from SIFMA II.**

[354] ***See*** **Section II.D.3.d. below for a discussion of the materiality standard.**

- **As specified in Rule 192(a)(3)(iii), the purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction that is substantially the economic equivalent of a transaction described in paragraph (a)(3)(i) or (a)(3)(ii), other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk.**

a. Rule 192(a)(3)(i): Short Sales

~~Paragraphs (i) and (ii) of the proposed definition of "conflicted transaction" in proposed Rule 192(a)(3) would capture transactions that constitute direct bets against the relevant ABS itself. In the case of proposed~~**We are adopting** Rule 192(a)(3)(i)~~, such a direct bet~~ **as proposed to prohibit a securitization participant from betting directly** against an ABS ~~would be~~**by engaging in** a short sale ~~where the~~**of the relevant ABS. A short sale occurs when a** securitization participant sells an ABS ~~that~~**when** it does not own **it** (or that it ~~will borrow~~**borrows** for purposes of delivery). In such a situation, if the price of the ABS declines, then the short selling securitization participant could buy the ABS at the lower price to cover its short and make a profit. ~~However~~**As stated in the Proposing Release**, it is not relevant for purposes of the ~~re-proposed~~ rule whether the securitization participant makes a profit on the short sale. It is sufficient that the securitization participant sells the ABS short. ~~In the case of proposed Rule 192(a)(3)(ii), a direct bet against an~~

Commenters generally supported adopting Rule 192(a)(3)(i) as proposed and agreed with the Commission that a short sale of an ABS by a securitization participant could create a conflict of interest between the securitization participant and investors in the relevant ABS.[355] One commenter expressed a concern that "considering all short sales

to be conflicted transactions" would have a disproportionate impact on securitization markets and indicated that a profit should

355 ***See, e.g.*, letters from ABA (suggesting that the rule should prohibit a short sale of the relevant ABS); AIC (stating that, on its face, proposed Rule 192(a)(3)(i) was sufficiently clear); SIFMA I (agreeing that a short sale of ABS by a securitization participant may create a conflict of interest between that securitization participant and investors); SFA I (stating that such a transaction is a direct bet against the success of the relevant ABS); SFA II (agreeing that short sales of ABS by securitization participants should be prohibited).**

be required for a short sale transaction to be a conflicted transaction.[356] Another commenter stated that the practical effect of proposed Rule 192(a)(3)(i) would be to stop all ABS short selling and that such an outcome would be suboptimal for the ABS market.[357]

We believe that it would be inconsistent with the investor protection goals of Section 27B to limit the prohibition in Rule 192(a)(3)(i) to short sales where the securitization participant earns a profit. A short sale of an ABS by a securitization participant is a bet against the relevant ABS regardless of whether the bet is successful, and this is the exact type of transaction that the rule is intended to prohibit in order to remove the incentive for securitization participants to place their own interests ahead of those of investors. We also do not believe that the practical effect of Rule 192(a)(3)(i) will be to prohibit all ABS short selling as the prohibition only applies to parties that are securitization participants with respect to the relevant ABS.[358] Third parties that are not securitization participants, as defined in the final rule, with respect to the relevant ABS are not prohibited from entering into short sales of such ABS.

b. Rule 192(a)(3)(ii): Credit Derivatives

~~ABS would be~~**We are adopting Rule 192(a)(3)(ii) as proposed to prohibit a securitization participant from betting directly against the relevant ABS by** entering into a credit **default swap or other credit** derivative that references such ABS and entitles the securitization participant to receive a payment upon the occurrence of ~~an adverse~~**a specified credit** event with respect to the ABS such as a failure to pay, restructuring or any other ~~adverse~~**specified credit** event that would trigger a payment on the derivative contract. It ~~would be~~**is** irrelevant for the purpose of ~~proposed~~ Rule 192(a)(3)(ii) whether the credit derivative is in the form of a CDS or other credit derivative product because the focus is on the

356 *See* letter from AIMA/ACC.

[357] ***See*** **letter from CreditSpectrum Corp. dated Feb. 22, 2023 ("CreditSpectrum").**

[358] ***See*** **Section II.B.3.**

economic substance of the credit derivative as a bet against the relevant ABS without regard to the specific contractual form or structure of the derivative. ~~Proposed~~ Rule 192(a)(3)(ii) ~~would~~ also ~~capture~~**captures** any credit derivative entered into by the securitization participant with the special purpose entity issuer of a synthetic ~~CDO~~**ABS** where that credit derivative would entitle the securitization participant to receive payments upon the occurrence of a specified ~~adverse~~**credit** event with respect to an ABS that is referenced by such credit derivative and with respect to which the relevant person is a securitization participant under the ~~re-proposed~~ rule.

Commenters generally supported adopting Rule 192(a)(3)(ii) as proposed and agreed with the Commission that a credit default swap or other credit derivative transaction of the type described in the proposal could create a conflict of interest >between a securitization participant and <**the investors in the relevant ABS.[359] One commenter suggested that Rule 192(a)(3)(ii) should be revised to allow for transactions that are designed to offset a loss with respect to a securitization participant's long position in the relevant ABS.[360] We believe that such change is unnecessary as hedging transactions, consistent with Section 27B, are permitted and more appropriately addressed by the risk-mitigating hedging activities exception discussed in detail in Section II.E. below.**

c. Rule 192(a)(3)(iii): Substantially the Economic Equivalent of a Short Sale or Credit Derivative

We are adopting proposed Rule 192(a)(3)(iii) with certain modifications in response to comments received on the proposal. Specifically, final Rule 192(a)(3)(iii) will cover the

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[359] ***See, e.g.*, letters from SIFMA I (agreeing that the entry into a CDS on the relevant ABS by a securitization participant may create a conflict of interest between that securitization participant and investors); SFA I (stating that such a transaction is a direct bet against the success of the relevant ABS);**

SFA II (agreeing that purchase of a CDS or other derivatives on which the securitization participant would be paid as a result of the occurrence of adverse credit events with respect to the ABS should be prohibited).

[360] ***See*** **letter from ABA.**

~~Clause (iii) of the proposed definition of "conflicted transaction" would~~**purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction that is substantially the economic equivalent of transaction described in paragraph (a)(3)(i) or (a)(3)(ii), other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk. The inclusion of this "for the avoidance of doubt" language in the definition of conflicted transaction is not designed to limit the types of transactions that are not conflicted transactions. For example, other transactions unrelated to the idiosyncratic credit performance of the ABS, such as reinsurance agreements, hedging of general market risk, or routine securitization activities (such as the provision of warehouse financing or the transfer of assets into a securitization vehicle) are not conflicted transactions, and thus are not subject to the prohibition in Rule 192(a)(1). By anchoring the catch-all provision in the specific transactions set forth in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii), as opposed to the more general language used in the proposal, the final rule should alleviate concerns that the proposed rule would be unworkable and vague. As explained in the Proposing Release, Rule 192(a)(3)(iii) is intended to** capture the purchase or sale of any other financial instrument or entry into a transaction the terms of which are substantially the economic equivalent of a direct bet against the relevant ABS.~~ Specifically, proposed~~ [361] **Given** >the potential ability of market participants to craft novel financial structures that can replicate the economic mechanics of the types of transactions <**described in** Rule 192(a)(3)(~~iii) would capture <the purchase or sale of any financial instrument (other than the relevant >ABS<) or entry into a transaction >through which the securitization participant would benefit from certain actual, anticipated, or potential adverse events with respect to the relevant ABS or its underlying asset pool. The events specified in items (A) through (C) of proposed~~**i) and (ii) without triggering those prongs, final** Rule 192(a)(3)(iii) ~~would capture the various situations pursuant to which <an ABS or its underlying~~

~~asset pool >could perform adversely, which would include the actual, anticipated, or potential.~~**is designed to alleviate the risk that securitization participants could avoid Section 27B's prohibition** >premised on the form of the transaction rather than its substance <**while also addressing the concerns of commenters regarding the potentially overbroad formulation of Rule 192(a)(3)(iii) as proposed.**

[361] ***See*** **Proposing Release at 9694.**

- ~~Adverse <performance of the asset pool supporting or referenced by the relevant ABS>;~~
- ~~Loss of principal, monetary default, or early amortization event on the relevant ABS; or~~
- ~~Decline in the market value of the relevant ABS.~~

~~Each of these events would be adverse to investors in the ABS as it would negatively impact the distributions on the relevant ABS and/or its market value. Given that, for example, a security-based swap or other contractual agreement could be structured to reference only one of such events occurring, the proposed definition would capture any such event being referenced as a payment trigger.~~

~~The financial instruments captured under~~**Certain commenters stated that** proposed Rule 192(a)(3)(iii) would~~, for example, include <entering into the short side of a derivative >(with the special purpose entity issuer of a synthetic CDO or otherwise) that references the <performance of the pool of assets underlying the >ABS with respect to which the person is a securitization participant under the re-proposed rule <and pursuant to which the securitization participant would benefit if the referenced asset pool performs adversely. >This is intended to address comments to the 2011 proposed rule in support of a definition of the term "transaction" that would include not only a short sale of the relevant ABS or the purchase of CDS protection on the relevant ABS, but would also include the purchase or sale of products that are linked to, or otherwise create an opportunity to benefit from the actual, anticipated, or potential adverse performance of, the pool of assets underlying the relevant ABS.[109] Furthermore, given <the potential ability of market participants to craft novel financial structures that can replicate the economic mechanics of the types of transactions>~~ **be inappropriate because it would extend beyond the "ordinary and natural meaning" of what is a "conflict of interest".[362] These commenters stated that**

the ordinary and natural meaning of a conflict of interest is limited to a conflict between an existing securities law duty of a securitization participant and its own self-interest.[363] For the reasons discussed below, we believe this formulation suggested by commenters misconstrues the nature of the statutory prohibition.

~~109 *See, e.g.*, Merkley Levin Letter at 8 (expressing support for approach that would capture a securitization participant directly or indirectly benefiting from the adverse performance of the relevant asset pool).~~

Final Rule 192(a)(3)(iii) defines conflicted transaction in a way that is consistent with the ordinary and natural meaning of what is a conflict of interest between a securitization participant and an ABS investor. Section 27B(b) requires that the Commission adopt rules to implement the prohibition in Section 27B(a) against a securitization participant >engaging in any transaction that would involve or result in any material conflict of interest <**"with respect to any investor" in a transaction arising out of the ABS activity of a securitization participant.[364] Section 27B therefore specially addresses prohibited material conflicts of interest that arise between the self-interest of a securitization participant and the interests of "any investor" in a transaction arising out of the ABS activity of that securitization participant. The statutory prohibition does not**

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362 ***See*** **letters from ABA (stating that the ordinary meaning of "conflict of interest" is a conflict between a legal duty and a personal interest and that in defining "conflicted transactions" and determining the extent to which the rule should apply to transactions engaged in by affiliates and subsidiaries, it is useful to consider whether and to what extent the personal interest that a sponsor, underwriter, placement agent, or initial purchaser has with respect to a transaction may lead that entity to disregard its duties under the securities laws); LSTA III (stating that the proposed definition is far broader and more encompassing than "conflict of interest" as**> set forth in Section 27B< **and, consequently, the proposed rule captured transactions that do not conflict with the duties that securitization participants have under the securities laws); SIFMA I (stating that the proposed definition seemed to conflate the term "conflict of interest" with the general expression "conflicting interests" and that Section 27B did not create any new underlying securities law duties so the Commission's authority is limited by the ordinary and natural meaning of the term material conflict of interest). As described in this section, commenters generally agreed that the types of transactions specified in proposed Rule 192(a)(3)(i) and Rule 192(a)(3)(ii) are the types of transactions that create the potential for**> a material conflict of interest<.

363 ***See id.***

364 **15 U.S.C. 77z-2a. *See* Section II.D.3.d. below for a discussion of the materiality standard that we are adopting for purposes of Rule 192(a)(3).**

reference a material conflict of interest with respect to existing Federal securities law duties to which securitization participants are currently subject, such as the prohibitions in Section 17(a) of the Securities Act or Section 206 of the Advisers Act. Furthermore, Section 27B is designated as its own section, apart from these other provisions. In our view, it would be inconsistent with the text and statutory placement of Section 27B to limit the scope of the rule to ABS activities that currently constitute a violation of existing Federal securities laws. To do so would render Section 27B superfluous as the statute would have little effect beyond what is already prohibited under existing federal securities laws. This interpretation would not only fundamentally frustrate the purpose of the statute to prevent a securitization participant from placing its own self-interest ahead of ABS investors but would also be inconsistent with other statutes that address conflicts of interest. For example, it would be inconsistent with the meaning of a "conflict of interest" set forth in Section 15E of the Exchange Act, which does not limit the scope of a "conflict of interest" arising in the business of issuing credit ratings by nationally recognized statistical rating organizations ("NRSRO") to conflicts that arise with respect to an existing securities law duty of an NRSRO.[365]

As explained above, commenters generally agreed that the types of transactions specified in proposed Rule 192(a)(3)(i) and Rule 192(a)(3)(ii) are the types of transactions that create the potential for a material conflict of interest,[366] and we are adopting Rule 192(a)(3)(i) and Rule 192(a)(3)(ii) as proposed. By narrowing the scope of Rule 192(a)(3)(iii) from the proposal to capture only, as adopted, transactions that are

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substantially >the economic equivalent of a<

[365] ***See*** **15 U.S.C. 78o-7(h).**

[366] ***See e.g.*****, letters from SIFMA I (agreeing that a short sale of ABS and entry into a CDS on the relevant ABS by a securitization participant may create a conflict of interest between that securitization participant and investors); SFA II (agreeing that short sales of ABS by securitization participants should be prohibited and agreeing that purchase of a CDS or other derivatives on which the securitization participant would**

be paid as a result of the occurrence of adverse credit events with respect to the ABS should be prohibited).

transaction described in final Rule 192(a)(3)(i) or final Rule 192(a)(3)(ii), the final Rule 192(a)(3)(iii) is designed to capture >the types of transactions that <**create a potential for a material conflict of interest between the interest of a securitization participant and the interest of an investor in the relevant ABS. As discussed in further detail below, commenters generally agreed that it would be appropriate for final Rule 192(a)(3)(iii) to function as a catch-all to capture transactions that are, in economic substance, a direct bet against the relevant ABS or the asset pool supporting or referenced by the relevant ABS** >even if they are not <**documented in the same form as a transaction specified in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii).[367] Final Rule 192(a)(3)(iii), as adopted, will specify that such direct bets against an ABS are subject to Section 27B's prohibition regardless of their form in order to remove the incentive for securitization participants to place their own interests ahead of those of ABS investors, as contemplated by the statute.**

Commenters expressed concerns that >proposed Rule 192(a)(3)(iii) would <**be overbroad as drafted and unnecessarily capture a wide range of activities that are essential to the functioning and issuance of ABS and the routine risk management of securitization participants.[368] Commenters provided numerous examples of transactions that, in their view, would not give rise to a material conflict of interest with ABS investors but that could nevertheless be potentially prohibited by proposed Rule 192(a)(3)(iii), including general interest rate and currency exchange rate hedging, the provision of warehouse financing, and the sale or transfer of assets to an ABS**

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[367] *See, e.g.*, letters from AFR; AIC; Andrew Davidson.

[368] *See, e.g.*, letters from CREFC I (stating that, when read broadly, the proposal could mean that any component of a securitization transaction could be a conflicted transaction, including ordinary decision-making activities by securitization participants); MFA II (suggesting that the Commission not adopt proposed Rule 192(a)(3)(iii)); SIFMA I (stating that proposed Rule 192(a)(3)(iii) is vague and unworkable on its face).

issuer.[369] As explained below, these types of transactions will not be captured by final Rule 192(a)(3)(iii) and, as a result, Rule 192(a)(3)(iii) is appropriately focused on transactions that give rise to material >conflicts of interest between a securitization participant and <**ABS investors.**

Commenters suggested various formulations of Rule 192(a)(3)(iii) that would, in their view, better align its scope with the discussion of its intended scope in the Proposing Release and avoid unnecessarily restricting customary transactions entered into with respect to securitizations. Certain commenters suggested that Rule 192(a)(3)(iii) should only capture transactions that are the "functional trading equivalent" of the transactions specified in Rule 192(a)(3)(i) and Rule 192(a)(3)(ii).[370] In a follow-up letter, two of these commenters suggested that Rule 192(a)(3)(iii) be revised to capture ">the purchase or sale of any financial instrument (other than the relevant <**asset-backed security**>) or entry into a transaction <**that substantially replicates one or both of the types of transactions set forth in [Rule 192(a)(3)(i)] or [Rule 192(a)(3)(ii)] by means of the securitization participant's shorting or buying protection on the asset pool underlying or referenced by the relevant asset-backed security."[371] Another commenter initially suggested that Rule 192(a)(3)(iii) be revised to only capture transactions that**

[369] *See, e.g.*, letters from MFA II (requesting that the Commission expressly permit interest rate hedging, currency hedging, and other non-credit related hedging); SFA I (stating that the final rule should not prohibit warehouse financing or the sale of assets into a securitization); SFA II (stating that transactions that are not related to the credit risk of the relevant ABS should not be conflicted transactions, such as transactions "related to overall market movements"); SIFMA I (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); SIFMA II (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); LSTA IV (supporting SIFMA's position); SFA II (requesting a specific exception for such activities).

[370] *See* letters from SIFMA I (suggesting the "functional trading equivalent" formulation); AFME (supporting SIFMA's suggestion); LSTA III (supporting SIFMA's suggestion).

[371] *See* letter from SIFMA II (stating its belief that securitization professionals are able to monitor for the types of transactions that would be captured in its suggested revised paragraph (iii) and that the Commission would have the ability to stop the functional equivalent of short sales and credit default swaps, even if

done via a financial instrument that has not yet been conceived). This commenter also stated that its suggested revision would clarify that non-credit related ancillary or embedded derivatives, such as interest rate or currency swaps, are not implicated by Rule 192; LSTA IV (supporting SIFMA's suggestion).

are the "substantive equivalent" of the types of transactions in Rule 192(a)(3)(i) and Rule 192(a)(3)(ii) and should exclude transactions that are unrelated to the credit risk of the ABS.[372] In a follow-up letter, this commenter suggested that Rule 192(a)(3)(iii) be revised to capture the "purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction that substantially replicates one or both of the types of transactions set forth in [Rule 192(a)(3)(i)] or [Rule 192(a)(3)(ii)] by means of referencing the relevant asset-backed security or the asset pool underlying or referenced by the relevant asset-backed security."[373]

We are revising Rule 192(a)(3)(iii) from the proposal to better capture transactions that are within the intended scope of the rule, that is, transactions that are substantially the economic equivalent of a transaction described in ~~proposed~~**final** Rule 192(a)(3)(i) ~~and (ii) without triggering those prongs, proposed~~**or final Rule 192(a)(3)(ii). This is consistent with the Commission's statements in the Proposing Release[374] and generally consistent with the suggestions from commenters described above that** Rule 192(a)(3)(iii) should ~~help alleviate the risk of any attempted evasion of the rule that is <premised on the form of the transaction rather than its substance>. For example, a security-based swap, such as a total return swap, that, in economic substance, creates an opportunity to benefit from the adverse performance of the relevant ABS or the pool of assets underlying the relevant ABS would be captured by proposed~~**be focused on transactions that are similar in substance to the types of transactions described in** Rule 192(a)(3)(~~iii) regardless of whether the securitization participant attempts to structure such security-based swap in a way to avoid triggering proposed~~**i) or** Rule 192(a)(3)(ii).[375] **However, the rule that we are adopting is more appropriate than the alternative approaches suggested by commenters because these approaches could potentially prioritize the form of a transaction over its economic substance and therefore be under-inclusive.**

This is because only capturing transactions that are the "functional trading equivalent" of a short sale or CDS or a transaction that "substantially replicates" a short sale or

~~In addition to the purchase or sale of such financial instruments, <proposed Rule 192(a)(3)(iii) would >also capture the "entry into a transaction" through which the securitization participant would benefit from certain actual, anticipated, or potential adverse events with respect to the relevant ABS or its underlying asset pool. This should similarly help alleviate the risk of any attempted evasion of the rule that is premised on the form of the transaction rather than its substance. For example, <in certain synthetic ABS structures, the relevant agreement that the securitization participant enters into with the special purpose entity that issues the synthetic ABS may in some circumstances not be documented in the form of a swap; however, the terms of such agreement are structured to replicate the terms of a swap pursuant to which the special purpose entity that issues the synthetic ABS is obligated to make a payment to the securitization participant upon the occurrence of certain adverse events >in respect of the ABS for which the person <is a securitization participant under the >re-proposed rule. Proposed Rule 192(a)(iii) would capture such an agreement based on <the economic substance of the transaction.>~~

~~We received comment to the 2011 proposed rule that the scope of prohibited transactions should be limited to transactions other than those that are an integral part of the creation and sale~~

372 ***See*** **letter from SFA I.**

373 ***See*** **letter from SFA II (in its second letter, SFA also suggested specific exceptions for the following types of transactions: (i) those entered into pursuant to a fiduciary duty, (ii) those entered into by a third-party manager with investment discretion, and (iii) those not related to the credit risk of the ABS.)**

374 ***See*** **Proposing Release at 9694.**

375 ***See*** **discussion above of letters from AFR; AIC; Andrew Davidson; SFA II; SIFMA II.**

CDS could unnecessarily limit the scope of Rule 192(a)(3)(iii) to transactions with payment profiles or terms that are the same as or closely similar in form to a short sale or CDS. Under either such standard, securitization participants could design bets against the relevant ABS or the asset pool supporting or referenced by the relevant ABS that are documented to have payment profiles or terms that are sufficiently different from those of market-standard short sales or CDS in order to not trigger such suggested standards but that are nevertheless bets against the relevant ABS in economic substance. We are therefore adopting a rule that specially focuses on the economic substance of the relevant transaction rather than its form to address this concern.

We disagree with commenters who said that the scope of Rule 192(a)(3)(iii) should be limited to transactions that are entered into >with respect to the relevant ABS or <**the asset pool supporting or referenced by such ABS.**[376] **Such an approach would be underinclusive. For example, it would allow a securitization participant** >to enter into a short <**with respect to a pool of assets with characteristics that replicate the idiosyncratic credit performance of the asset pool supporting the relevant ABS. We do not believe that it would be appropriate to exclude such transactions as securitizations participants would still have an opportunity to bet against the performance of their ABS by being allowed to enter into such transactions. Whether a short transaction entered into with respect to a similar pool of assets is a conflicted transaction under the final rule will be a facts and circumstances determination. If such a short position with respect to a similar pool of assets would be substantially the economic equivalent of a short sale of the relevant ABS itself or a CDS or credit derivative pursuant to which** >the securitization participant would be <**entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS, then it would be a conflicted transaction. However, this standard**

[376] ***See*** **letters from SFA II; SIFMA II.**

is designed to not capture transactions entered into by a securitization participant with respect to an asset pool that has characteristics that are sufficiently distinct from the idiosyncratic credit risk of the asset pool that supports or is referenced by the relevant ABS. Such transactions do not give rise to the investor protection concerns >that Section 27B is designed to address<**.**

As noted above, various commenters agreed with the discussion in the Proposing Release that Rule 192(a)(3)(iii) should capture transactions that are, in economic substance, a bet against the relevant ABS or the asset pool supporting or referenced by the relevant ABS.[377] One of these commenters specifically stated that a conflicted transaction "should be defined in terms of the economic substance, rather than the form or label of the transaction."[378] Another one of these commenters stated that "it would be appropriate for the final rule to include some kind of category that encompasses transactions that substantially replicate the economic effects of a short sale of, or credit default swap on, the relevant ABS."[379] Additionally, another commenter agreed that it would be appropriate for the final rule to prohibit transactions that are "substantially the economic equivalent of a direct bet against the relevant ABS."[380]

Focusing Rule 192(a)(3)(iii) on transactions that are substantially the economic equivalent of a transaction specified in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii), which, as explained above, commenters broadly agreed give rise to a material conflict of interest, is designed to address many of the concerns that commenters expressed regarding the potentially overbroad application of the rule as proposed while still prohibiting ~~securitization participants fr~~om engaging in transactions that result in material conflicts of interest with investors. As

[377] See letters from AFR; AIC; Andrew Davidson.

[378] ***See*** **letter from AFR.**

[379] ***See*** **letter from AIC.**

[380] ***See*** **letter from Andrew Davidson.**

adopted, final Rule 192(a)(3)(iii) will capture the types of transactions through which the securitization participant could, in economic substance, bet against the ABS or the asset pool supporting or referenced by the relevant ABS in the same way as a short sale of the ABS or a CDS referencing the ABS but without regard to the particular form of the relevant transaction. This will help ensure that the rule protects investors from purchasing ABS tainted by material conflicts of interests as markets evolve and new forms of betting against an ABS or its relevant asset pool that are distinct from a short sale or CDS, but which are substantially the economic equivalent of such transactions, may emerge.

The types of transactions that are "conflicted transactions" for purposes of Rule 192(a)(3)(iii) and that will be substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) will include a securitization participant >entering into the short-side of a derivative <**that references the credit** >performance of the pool of assets underlying the <**relevant ABS** >and pursuant to which the securitization participant would benefit if the referenced asset pool performs adversely.<[381] **One commenter stated that taking a short position in the asset pool underlying or referenced by the relevant ABS should not be a conflicted transaction because such short activity does not raise the same material conflict of interest concerns as are raised by shorting the relevant ABS itself.[382] Other commenters stated that taking a short position in some portion of the asset pool underlying or referenced by the relevant ABS should not be a conflicted transaction because such short activity does not raise the same**

[381] **One commenter specifically requested an exception to the final rule for a riskless principal transaction where a securitization participant that is a broker-dealer intermediates a trade for a customer by entering into a conflicted transaction and offsetting that conflicted transaction by entering into a contemporaneous transaction with a third-party. *See* letter from SFA II. This type of activity is eligible for the bona fide market-making activities exception discussed in detail in Section II.G subject to**

satisfaction of the conditions applicable to the exceptio>n. Therefore, we do not believe< **that a separate exception is necessary for this type of activity.**

[382] ***See*** **letter from SIFMA I.**

material conflict of interest concerns as are raised by shorting the relevant ABS itself.[383] In our view, however, a bet against the asset pool supporting or referenced by an ABS should >be captured as a conflicted transaction. <**ABS are cash-flow vehicles that distribute cash to investors based on the performance of the relevant asset pool for such ABS. Therefore, a bet against the relevant asset pool is a bet against the ABS itself, which presents the same type of material conflict of interest raised by a short sale of the relevant ABS or a CDS entered into with respect to the relevant ABS as addressed in Rule 192(a)(3)(i) and Rule 192(a)(3)(ii), respectively. Accordingly, it would not be appropriate to allow a securitization participant to bet against the performance of the relevant asset pool. In** >the context of an ABS <**with an asset pool consisting of a large number of different and distinct obligations, we recognize that a short transaction with respect to a single asset or some non-sizeable portion of the assets in that pool would generally not result in a short position with respect to such asset or assets being substantially the economic equivalent of a short sale of the relevant ABS itself or a CDS or credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS. However, if the relevant assets do represent a sizeable portion of the asset pool supporting or referenced by the relevant ABS, then entering into a transaction with respect to such assets can present the same investor protection concerns that Section 27B was intended to address. Under the final rule, such a transaction can be a conflicted transaction based on the facts and circumstances.[384]**

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383 ***See, e.g.*, letters from AIC (stating its belief that the rule, as proposed, was intended to prohibit taking a short position with respect to a material concentration of the assets underlying the ABS and that an investor would not consider such a position with respect to a single asset or obligor to be material); LSTA II (requesting clarification that the rule does not apply to transactions related to individual assets or a group of assets held by a securitization vehicle).**

384 **Even if such transaction is a conflicted transaction, it could be eligible for the risk-mitigating hedging activities exception if the conditions applicable to the exception are satisfied. *See* the discussion in Section II.E. below.**

Commenters stated that the definition of conflicted transaction should not capture the use of CDS index-based hedging strategies where the relevant ABS only represents a minimal component of the index.[385] Whether or not a transaction with respect to such index is a conflicted transaction under Rule 192(a)(3)(iii) will be a facts and circumstances determination based on the composition and characteristics of the relevant index. In particular, securitization participants will need to determine if a short position with respect to such index is substantially the economic equivalent of a short sale of the relevant ABS itself or a CDS or credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS. If the relevant ABS or the asset pool supporting or referenced by such ABS does not represent a sizeable portion of the index, then entering into a transaction with respect to such index will not present the same investor protection concerns that Section 27B addresses. In such a scenario, the adverse performance of the asset pool supporting or referenced by such ABS would not have enough of an economic impact on the performance of the relevant index for a short position with respect to that index to be substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii).[386] However, if the relevant ABS or the asset pool does

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385 ***See, e.g.***, **letters from AFME (requesting an exception for transactions involving the purchase or sale of an index including ABS where those ABS constitute a de minimis portion of the overall index); ICI (specifically requesting clarification that a fund or adviser, as a fiduciary on behalf of another fund or other client, taking a position on an ABS index that includes ABS of an affiliated securitization participant, would not be a conflicted transaction); SIFMA I (recommending that, if an ABS is referenced in an index, a short position in that index should be carved out of the prohibition as long as the ABS represents less than a threshold percentage of that index and citing the language adopted in Regulation RR, which limits the exclusion to indices where the subject ABS represents no more than 10% of the dollar-weighted average of all instruments in the index).**

386 **For example, a transaction with respect to an index that includes a class of the relevant ABS and that is permissible under 12 CFR 373.12(d) will not be a conflicted transaction for purposes of the final rule given that the restrictions on the composition of the relevant index will not result in a short position with respect to such index being substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). We also believe that it would be inconsistent for an index hedge that is permissible under 12 CFR 373.12(d) to be impermissible under this rule.**

represent a sizeable portion of the index, then entering into a transaction with respect to such index presents the same investor protection concerns that Section 27B addresses. Under the final rule, such a transaction could be a conflicted transaction based on the facts and circumstances.[387]

Although we do not believe that a general interest rate or currency exchange rate hedge will be captured as a transaction that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii), we are specifying in final Rule 192(a)(3)(iii) that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction in order to avoid uncertainty and to not unnecessarily limit or discourage the prudent management of general interest rate and currency exchange risks by securitization participants. The inclusion of this language will also directly address the concerns raised by commenters that the rule as proposed could inadvertently prohibit the hedging of general interest rate and foreign exchange risks by a securitization participant.[388] We do not believe that Section 27B was intended to restrict the ability of a securitization participant to manage its general interest rate and/or foreign exchange risk exposures. The language that we are adding to final Rule 192(a)(3)(iii) expressly allows for a securitization participant's continued ability to hedge general interest rate or foreign exchange exposure, and by extension, a securitization participant will not need to rely on the risk-mitigating hedging activities exception under the final rule to enter into such transactions.[389] The qualifier "general"

387 Even if such transaction is a conflicted transaction, it could be eligible for the risk-mitigating hedging activities exception if the conditions applicable to the exception are satisfied. *See* the discussion in Section II.E. below.

388 *See, e.g.*, letters from MFA II (requesting that the Commission expressly permit interest rate hedging, currency hedging, and other non-credit related hedging); SFA II (stating that hedging transactions that are not related to the credit risk of the relevant ABS should not be subject to the conditions >in the proposed risk-mitigating hedging activities exception<); SIFMA I (focusing on "interest rate, currency or other non-credit related trading and hedging activities").

389 **This approach would** >be generally consistent with the <**suggestion of a commenter that proposed 17 CFR 230.192(a)(3)(iii)(C) should be revised to capture only a** >decline in the market value of the relevant ABS<

has been included to specify that the relevant transaction must relate to overall market movements and not the idiosyncratic credit risk of the relevant ABS. This is consistent with the suggestion of commenters that the definition of "conflicted transaction" should not capture interest rate or currency exchange hedges that are not related to the credit risk of the relevant ABS.[390] As adopted, Rule 192(a)(3)(iii) will permit any transaction that only hedges general interest rate or currency exchange risk. Other transactions unrelated to the idiosyncratic credit performance of the ABS, such as hedging of general market risk, are not conflicted transactions, and thus are not subject to the prohibition in Rule 192(a)(1). The inclusion of this "for the avoidance of doubt" language in the definition of conflicted transaction also does not limit the scope of the risk-mitigating hedging activities exception or any other exception to the final rule. Each of the exceptions to the final rule is discussed in detail below.

Commenters expressed concerns that the rule as proposed would prohibit the ordinary course pre-securitization and issuance activities of market participants, such as the provision of warehouse financing or the transfer of assets into a securitization vehicle.[391] As stated in the Proposing Release, the rule is not designed to hinder routine securitization activities that do not give rise to the risks that Section 27B addresses.[392] This includes the provision of warehouse

relative to similar ABS. We agree that the market value of an ABS can decline due to macro-economic shifts that affect the entire ABS market, such as interest rate changes, that are beyond the control of a securitization participant.

390 *See, e.g.*, letters from MFA II (requesting that the Commission expressly permit interest rate hedging, currency hedging, and other non-credit related hedging); SFA II (stating that transactions that are not related to the credit risk of the relevant ABS should not be conflicted transactions, such as transactions "related to overall market movements").

391 *See, e.g.*, letters from AFME (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); SFA I (stating that the final rule should not prohibit warehouse financing or the sale of assets into a securitization); SFA II (requesting a specific exception for such activities); SIFMA I (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction); SIFMA II (requesting that certain pre-securitization transactions be expressly carved out of the definition of conflicted transaction).

[392] ***See* Proposing Release at 9679.**

financing and the transfer or sale of assets into the relevant securitization vehicle, which are standard activities in connection with the issuance of ABS. Such normal-course activities are not prohibited by final Rule 192(a)(3)(iii) as they are not transactions that are substantially the economic equivalent of a transaction described in final Rule 192(a)(3)(i) or final Rule 192(a)(3)(ii).[393] As described in further detail below, the customary mechanics of secured loans, such as warehouse financing facilities, do not render that financing facility a conflicted transaction under Rule 192(a)(3)(iii) because they do not provide a mechanism for the financing provider to benefit from the adverse >performance of the asset pool supporting or referenced by the relevant ABS<. Similarly, the transfer or sale of assets to a securitization vehicle does not provide the transferor or seller a mechanism for such entity to benefit from the adverse performance of the asset pool supporting or referenced by the relevant ABS as, absent some other transaction that may need to be separately analyzed, such entity no longer has exposure to the performance of such assets.

Similarly, the final rule is not designed to disincentivize an underwriter, placement agent, or initial purchaser from intermediating an ABS transaction for a customer, client, or counterparty where the securitization participant does not take >a short position with respect to the relevant ABS<. Rule 192(a)(3)(iii) captures, in relevant part, the purchase or sale of any financial instrument "(other than the relevant asset-backed security)" or entry into a transaction that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). The inclusion of the language "(other than the relevant asset-backed security)" is designed to specify that merely entering into an agreement to serve as a securitization participant

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[393] >As discussed above in Section II<.B.3., warehouse lenders that are not affiliated with a named securitization participant and that engage only in warehouse lending activity with respect to an ABS are not sponsors under the final rule. However, if the warehouse lender is an affiliate or subsidiary of another securitization participant, it will> be subject to the prohibition in< Rule 192(a).

with respect to an ABS and engaging in a purchase or sale of the ABS as an underwriter, placement agent, or initial purchaser for such ABS is not itself a conflicted transaction.[394]

The Commission received a comment that the prohibition should >not apply to transactions that <**terminate prior to the issuance** of the relevant ABS.[110] ~~We are not including such a standard in the re-proposed rule. Under the re-proposed rule, entering into~~ [395] **As explained above in Section II.C.3.,** >the prohibition on material conflicts of interest <**will not apply if the relevant ABS is never actually sold to an investor. However, if an ABS is created and sold, then the rule's prohibition will apply beginning on the date on which there was** an agreement ~~to serve as~~**by the relevant person to become** a securitization participant with respect to ~~an ABS would not itself be a "conflicted transaction." However, any transaction that the securitization participant enters into with respect to the creation or sale of such ABS (*e.g.*, a transaction whereby a securitization participant takes the short position in connection with the creation of a synthetic ABS) would need to be analyzed to determine if it would be a "conflicted transaction" under the re-proposed rule. Proposed Rule 192(a)(3)(iii) would not capture the purchase or sale of the ABS with respect to which the person is a securitization participant under the re-proposed rule.~~ **the relevant ABS and will end** >one year after the date of the first closing of the sale of <**such ABS. We do not believe that it would be appropriate to allow a securitization participant to bet against the performance of an asset pool while, for example, after reaching an agreement to become a securitization participant, simultaneously marketing an ABS to investors that references or is collateralized by that same asset pool even if the relevant bet is closed out prior to the issuance of the relevant ABS. As discussed in detail in Section II.E.3. below, a securitization participant may rely on the risk-mitigating hedging activities exception for**

transactions entered into prior to the issuance of the relevant ABS when the conditions to >the exception are satisfied.<

The Commission >also received a comment that the <**prohibition should not apply to any transaction relating to all or a portion of the pool of assets underlying the ABS that terminates on or prior to the date on which such assets are included in the securitization.**[396] **Rule 192(a)(3)(iii) as adopted captures a transaction that is substantially the economic equivalent of a short sale of the relevant ABS itself or a CDS or credit derivative pursuant to which the securitization**

394 The short sale of the relevant ABS~~would be~~ **i**s separately covered under~~proposed~~ Rule 192(a)(3)(i~~, and the sale of~~ <ABS to investors by an underwriter, placement agent, or initial purchaser ~~>would not~~ <be captured as a conflicted transaction. ~~>Also, the re-proposed rule is not intended to disincentivize a securitization participant from retaining portions of an ABS that it creates or sells.~~).

~~Under proposed Rule 192(a)(3)(iii), it would not be necessary for the securitization participant to actually benefit from a conflicted transaction. Rather, it would be sufficient that the transaction creates an opportunity for the securitization participant to benefit, for example, from a decline in the market value of the ABS. The relevant transaction would be a "conflicted transaction" even absent such a decline in market value.~~

~~We received comments both in opposition to and in support of including the modifier "directly or indirectly" as used in the relevant interpretation in the 2011 proposed rule[111] when~~

~~110 *See* ASF Letter at 17 (stating that the statutory reference to engaging in "any transaction" was intended to mean a transaction other than the ABS transaction itself, and accordingly, that the rule should not prohibit a firm from taking the short position in connection with the creation of a synthetic ABS).~~

395 *See* letter from SFA II.

396 *See* letter from SIFMA II.

participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS. As discussed above, ABS are cash-flow vehicles that distribute cash to investors based on the performance of the relevant asset pool for such ABS, and, therefore, a bet against the relevant asset pool is a bet against the ABS itself.

In response to the comment, if a securitization participant engages in a transaction with respect to a pool of assets that, during the duration of the transaction, neither underlies the relevant ABS nor is referenced by the relevant ABS, then that transaction will not be substantially the economic equivalent of a transactions described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). Therefore, including a specific exception for such transactions is unnecessary. However, as discussed in detail above, if the transaction is with respect to a pool of assets with characteristics that replicate the idiosyncratic credit performance of pool of assets that is already underlying or referenced by the relevant ABS, then whether such transaction is a conflicted transaction under the final rule will be a facts and circumstances determination.

Several commenters questioned whether the intrinsic feature of certain risk-management transactions documented as synthetic ABS transactions would be captured under Rule 192(a)(3)(iii) and suggested that the final rule should not prohibit balance sheet synthetic securitizations used for risk-mitigation purposes.[397] Another commenter generally stated that the rule should not include any exception from the prohibition for conflicts that are "inherent" to the

[397] *See, e.g.*, letters from ABA (urging the Commission to clarify that CRT transactions are not per se "conflicted transactions" and that they are generally permissible unless they evidence an intentional bet against a separate ABS by a securitization participant for that separate ABS); AFME (noting that synthetic securitizations are important credit risk and balance sheet management tools for banks); Fannie and Freddie (requesting that the Commission> modify the proposed definition of< conflicted transaction to make clear that it does not encompass the Enterprises' entry into the associated transaction agreements necessary to effect CRT securities issuances); HPC (requesting that CRTs, regardless of sponsor, be excluded from the definition of conflicted transaction or, alternatively, that they be allowed under the risk-mitigating hedging exception); IACPM (stating the breadth of proposed

Rule 192(a)(3)(iii) would make credit portfolio management via synthetic ABS functionally untenable); SIFMA I (stating its belief that neither the text of the statute or the legislative history empowered the Commission to ban entire classes or categories of securitization transactions).

securitization.[398] Section 27B specifically applies to synthetic ABS transactions, and, for the reasons discussed below, we are adopting a definition of conflicted transaction that captures the relevant conflict of interest in the context of the issuance of a new synthetic ABS. However, Section 27B also provides an exception for risk-mitigating hedging activity;[399] therefore, we believe that it is consistent with Section 27B to allow for the conflicted transaction that arises in the context of a synthetic ABS as described below to be eligible for the risk-mitigating hedging activities exception if it satisfies the conditions to the exception.

As discussed in the Proposing Release, the relevant material conflict of interest in the context of the issuance of a new synthetic ABS arises when the securitization participant engages in a transaction (such as CDS contract(s) with the synthetic ABS issuer) where cash paid by investors to acquire the newly created synthetic ABS will fund the relevant contract(s) and be available to make a payment to the securitization participant upon the occurrence of an adverse event with respect to the assets included in the reference pool.[400] In economic substance, if the reference pool for the synthetic ABS performs adversely, then the securitization participant benefits at the expense of the investors in the synthetic ABS. Pursuant to the final rule, this arrangement will result in a conflicted transaction with respect to the investors in the synthetic ABS because it is substantially the economic equivalent of a bet against such ABS itself. Additionally, if the reference pool for the synthetic ABS collateralizes a separate ABS with respect to which the relevant securitization participant >is a securitization participant under the<

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398 *See* letter from AFR.

399 15 U.S.C. 77z-2a(a)(1) and >15 U.S.C. 77z-2a(c)(1).<

~~111~~ **400** *See* ~~2011~~ Proposing Release at ~~60330.~~**9695. As discussed above, the inclusion of the language "(other than the relevant asset-backed security)" in Rule 192(a)(3)(iii) is designed to specify that merely entering into an agreement to serve as a securitization participant with respect to an ABS and engaging in a purchase**

or sale of the ABS as an underwriter, placement agent, or initial purchaser for such ABS is not itself a conflicted transaction.

describing benefits accruing to the securitization participant. One commenter stated that, given that the rule applies to affiliates and subsidiaries and that there are many inherent conflicts of interest in securitizations, it is difficult to determine many circumstances where there are indirect benefits and that, if indirect benefits are to be addressed, they should be limited to those that are known or reasonably foreseeable.[112] Another commenter stated that securitization participants have no way to ascertain the scope or meaning of benefiting indirectly from a specified short transaction.[113] However, another commenter stated that securitization participants should not be allowed to perform indirectly what they are barred from doing directly.[114] For example, a transaction structure could route CDS payments to the securitization participant <through a variety of different legal entities that are ><structured to not be affiliates or subsidiaries of the securitization participant >or could attempt to recharacterize such payments in a way so as <to obscure the ultimate economics of >a conflicted transaction. Such a transaction structure would still be captured <by proposed Rule 192(a)(3)(iii) >because the securitization participant is receiving a benefit that can be traced back to the actual, anticipated or potential adverse performance of the relevant ABS or its underlying asset pool. Accordingly, we have not included the modifier <"directly or indirectly" in proposed Rule 192(a)(>3)(iii) when describing benefits accruing to the securitization participant. We believe such reference to be unnecessary because any transaction under which a securitization participant would receive a benefit that can be traced back to the actual, anticipated, or potential adverse performance of the relevant ABS or its underlying asset pool would already be captured by proposed Rule 192(a)(3)(iii). Moreover, we believe that the anti-circumvention language in proposed Rule 192(d) would help to address

[112] ABA Letter at 5–6.

[113] SIFMA Letter at 28.

[114] Tewary Letter 1 at 7.

final rule, this arrangement will result in a conflicted transaction with respect to the investors in the ABS collateralized by such reference pool as being substantially the economic equivalent of a bet against such ABS itself. Such transaction, in economic substance, >is the same as the <**securitization participant entering into a bilateral CDS on the ABS that is collateralized by such reference pool. As discussed in the Proposing Release,** >in certain synthetic ABS structures, the relevant agreement that the securitization participant enters into with the special purpose entity that issues the synthetic ABS may in some circumstances not be documented in the form of a swap; however, the terms of such agreement are structured to replicate the terms of a swap pursuant to which the special purpose entity that issues the synthetic ABS is obligated to make a payment to the securitization participant upon the occurrence of certain adverse events <**with respect to the reference pool.[401] Such an agreement will be a conflicted transaction under Rule 192(a)(3)(iii) due to** >the economic substance of the transaction.<

Like a short sale or credit default swap, the securitization participant stands to benefit at the expense of the investors in the synthetic ABS, and this results >in a material conflict of interest with investors <**and is a conflicted transaction for purposes of the final rule. However, we also understand, as commenters stated, that securitization participants may utilize synthetic ABS structures for hedging purposes. Therefore, as discussed in detail in Section II.E. below, we are adopting a change to the proposed risk-mitigating hedging exception so that the issuance of synthetic ABS that are entered into and maintained for hedging purposes are eligible for the risk-mitigating hedging activities exception. To help ensure that these types of transactions cannot be utilized as a bet by a securitization participant against the credit performance of the reference assets, any such transaction will need to satisfy each of the conditions to the risk-mitigating**

[401] ***See* Proposing Release at 9695.**

hedging activities exception described in Section II.E. If such transaction is not entered into for purposes of hedging an existing long exposure of the securitization participant to the assets included in the reference pool in accordance with the requirements of the risk-mitigating hedging activities exception, then such activity will not qualify for the exception and will be prohibited by the final rule.

Certain commenters also expressed concern that the proposed rule could prohibit the normal-course servicing activity of a securitization participant pursuant to its contractual rights and obligations under the transaction documents for the relevant ABS, particularly with respect to the servicing of distressed assets supporting the relevant ABS.[402] We recognize the role played by servicers over the life cycle of an ABS to help minimize losses for ABS investors with respect to distressed assets and understand that servicers may be entitled to additional income or expense reimbursement when servicing distressed assets that require the servicer to expend more of its time and resources or require specialized skills.[403] Accordingly, the final rule is designed not to impede the ability of servicers to service the assets supporting an ABS in accordance with the contractual covenants applicable to the servicer in the transaction agreements for such ABS. We understand that these covenants are subject to the negotiation of investors prior to the closing of the relevant ABS and that such covenants typically set forth a servicing standard that is designed to direct the servicer to maximize the recovery value of the assets and, by extension,

[402] *See, e.g.*, letters from AIC (requesting that the Commission clarify that the exercise of a securitization participant's rights under the ABS transaction documents does not constitute a conflicted transaction with respect to that ABS); AFME (providing as an example that actions of loan officers related to refinancing, restructuring, or working out a defaulted loan could constitute a conflicted transaction, as proposed); CREFC I (suggesting an additional exception for the exercise of contractual rights granted to, or performance of contractual obligations by, a securitization participant with respect to the underlying assets or the related asset-backed securities pursuant to the agreements governing such transaction); LSTA II (focusing on, among other things in the context of collateralized loan obligations, LIBOR transaction amendments, loan restructurings, and refinancings).

403 ***See*** **letter from CREFC I.**

~~concerns about attempts to evade the re-proposed rule's prohibition if a securitization participant were to route payments through multiple transactions or recharacterize payments so as to obscure the economics of a conflicted transaction.~~

~~In a change from the 2011 proposed rule, the re-proposed rule would not define a conflicted transaction to include the scenario in which a securitization participant would benefit directly or indirectly (*e.g.*, from fees or other forms of remuneration, or the promise of future business, fees, or other forms of remuneration) as a result of allowing a third party, directly or indirectly, to structure the relevant ABS or select assets underlying the ABS in a way that facilitates or creates an opportunity for that third party to benefit from a short transaction.[115] Instead, we are taking a different approach to address possible conflicts by proposing to define the term "sponsor" in a manner such that the re-proposed rule's prohibition on engaging in conflicted transactions would apply directly to most of the parties whose conduct would have been covered by the 2011 proposed rule. The definition of the term "sponsor" is <discussed in Section II.B.>2. above.~~

~~Certain commenters to the 2011 proposed rule requested clarification regarding how prohibited activity would be distinguished from activity undertaken independently of, and not in connection with, a securitization.[116] Other commenters expressed concerns about unnecessarily prohibiting or restricting activities routinely undertaken in connection with the securitization~~

~~115 *See* 2011 Proposing Release at 60331 (explaining that a third party might directly or indirectly select assets underlying an ABS through its relationship with a securitization participant and that such third party, rather than the securitization participant, may attempt <to enter into a short >transaction of the type that <the securitization participant would be >prohibited from entering into itself under the 2011 proposed rule).~~

~~116 *See, e.g.*, comment letter from Commercial Real Estate Financial Council (Feb. 13, 2012) ("CRE Letter") at 45; SIFMA Letter at 6, 25; ASF Letter at 8–10.~~

~~process.[117] The re-proposed rule would address these concerns by providing additional specificity about the scope of transactions that would be covered by the rule through the proposed definition of the term "conflicted transaction." Because the proposed definition of "conflicted transaction" is limited in scope to transactions that are effectively a bet against~~**support the overall performance of the ABS for the benefit of the investors in such ABS.[404] Restricting servicing activity that is conducted in accordance with such servicing standards could, in some cases, not only harm the ABS investors that the rule is intended to protect but also impede the ability of** the relevant ~~ABS or its~~ underlying ~~pool of assets, the re-proposed rule would <not apply to transactions that >are wholly independent of, and not in connection to, the relevant securitization. Moreover~~**obligors to avoid foreclosure or insolvency. As adopted, the final rule will not prohibit such servicing activity as it is not substantially the economic equivalent of a transaction described in final Rule 192(a)(3)(i) or final Rule 192(a)(3)(ii). We also note that**, as discussed above~~, those~~ **in Section II.B.3.b.iii.,** persons that only perform activities that are administrative, legal, due diligence, custodial, or ministerial in nature with respect to an ABS ~~would be~~**are** excluded from the definition of "sponsor."~~118~~

A number of commenters expressed concern that a securitization participant financing an investor's long purchase of an ABS could be a conflicted transaction under the proposed rule.[405] We understand that it is customary for financing arrangements of ABS to include borrowing base mechanics, which are collateral arrangements that require the long purchaser (borrower) to post cash or other collateral in order to maintain a required collateralization level if the value of the financed ABS declines. Customary transactions that are designed to protect the financing provider >from a decline in the value of the <**collateral for its loan would not give rise to the investor protection concerns addressed by Section 27B. In the event of a default by the borrower, any additional**

collateral posted by the borrower would customarily be available to the lender exercising its rights as a secured creditor but would not provide an additional net benefit

[404] *See* letter from CREFC I (explaining that, for example, the servicing standard for CMBS places requirements on the servicer with a view to maximizing the recovery of principal and interest on the mortgage loans).

[405] *See* letters from IACPM (describing the margin posting mechanics of certain financing transactions); SFA I (providing as an example that, in a repurchase transaction, the repurchase buyer (lender) has the right to protect its level of collateralization through the borrowing base mechanics by marking the ABS to market and that, when it does so in a declining market, it often will make a margin call on the repurchase seller (borrower) for additional cash or collateral); SFA II (requesting a specific exception for financing activities); SIFMA II (requesting a specific exception for financing arrangements).

to the lender.[406] These types of customary mechanics of secured loans do not render a financing facility a conflicted transaction under Rule 192(a)(3)(iii) because they do not provide a mechanism for the financing provider to benefit from the adverse >performance of the asset pool supporting or referenced by the relevant <**ABS and are therefore not substantially the economic equivalent of a transaction described in final Rule 192(a)(3)(i) or final Rule 192(a)(3)(ii).**

Some commenters stated that MILNs and similar reinsurance arrangements should not be captured as conflicted transactions.[407] As explained above in Section II.A.3., MILNs and similar reinsurance arrangements do not meet the definition of "asset-backed security" for purposes of the final rule and transactions with respect to such structures are not subject to the prohibition of the final rule. Therefore, no changes to the conflicted transaction definition are required to address the concerns of these commenters.

Some commenters expressed concerns that entities, such as investment advisers, may be in violation of the prohibition if they engage in conflicted transactions on behalf of a client, customer, or counterparty pursuant to a fiduciary duty.[408] We do not believe that a carve-out for conflicted transactions entered into pursuant to a fiduciary duty would be appropriate or necessary. >As discussed above in Section II.<**B.3., Rule 192 will complement the existing Federal fiduciary duties. Final Rule 192(a)(3)(iii) is focused on prohibiting a ~~securitization participant~~**

406 **In such scenario, the lender would customarily apply any such collateral to the satisfaction of the outstanding relevant loan obligations of the borrower.**

407 ***See, e.g.*, letters from MBA (stating that MILNs, which are reinsurance-based note structures, should not viewed as a conflicted transaction); PMI Industry I (stating that MILNs should not be considered conflicted transactions).**

408 ***See, e.g.*, letters from ICI (stated that advisers are fiduciaries and must act in the best interest of their clients, including the funds they manage); SFA I (noting that not** >allowing a securitization participant to <**execute such a transaction could cause it to violate its fiduciary duties imposed by law); SFA II (suggesting that the rule should not apply to any securitization participant with a fiduciary duty to the issuer of the ABS pursuant to the Advisers Act when the transaction is entered into by that securitization participant on behalf of another client, fund or account managed by the securitization participant and**

conducted in accordance with that securitization participant's fiduciary duty to that client, fund or account under the Advisers Act).

from entering into a bet against the ABS or the asset pool supporting or referenced by an ABS. This approach is designed to remove the incentive for a securitization participant to select poor credit quality assets for the asset pool supporting or referenced by an ABS. The final rule, therefore, prohibits an investment adviser from >entering into a conflicted transaction <**to allow a fiduciary client** >to profit from the adverse performance of <**an ABS with respect to which the investment adviser structured and selected the asset pool in order to sell such ABS to long investors. In response to the concerns of commenters, the revised approach to affiliates and subsidiaries described above in Section II.B.3.c. should help address situations that do not involve these same investor protection concerns, such as where there is no coordination or information sharing between the relevant personnel of the investment adviser entering into the relevant client transaction and the relevant investment personnel responsible for the design and composition of the ABS.[409] We recognize that securitization participants, when entering into an agreement to participate in the securitization, will need to consider potential impacts related to their affiliates or subsidiaries (that meet the definition of securitization participant in Rule 192(c)), as the prohibition will restrict those affiliates and subsidiaries from entering into conflicted transactions. A conflicted transaction entered into by such an affiliate or subsidiary may fall within an available exception, but, in any case, will still be covered by this rule. Additionally, as discussed in detail in Section II.E.3. below, the revised scope of the risk-mitigating hedging activities exception is designed to not unnecessarily restrict the ability of an affiliate or subsidiary of a securitization participant to hedge exposures that it originates, retains,**

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[409] ***See*** **letter from LSTA IV (stating that many asset management companies that manage CLOs often employ other strategies managed by different personnel who have fiduciary duties to other clients than the CLO**

and that "[i]ncorporating information barriers into any final rule would solve this problem and comport with other provisions in the U.S. securities laws").

acquires, or finances in connection with the ordinary course of its business but that is unrelated to the securitization activities of the securitization participant (such as its CLO business).

We do not believe that the suggestion of certain commenters that Rule 192(a)(3)(iii) should be limited in scope to only prohibit transactions through which the securitization participant actually profits from its bet against the ABS would be appropriate.[410] As discussed above, final Rule 192(a)(3)(iii) is focused on prohibiting a securitization participant from entering into a >bet against the ABS or the <asset pool supporting or referenced by the relevant ABS. This approach is intended to remove the incentive for a securitization participant to select poor credit quality assets for the asset pool supporting or referenced by the ABS. If the prohibition were limited to transactions through which the securitization participant actually profits from its bet, it would fall short of implementing the statutory prohibition and addressing the incentive to design transactions that are intended to fail. Therefore, under Rule 192(a)(3)(iii), the securitization participant need not ultimately profit from the conflicted transaction in order for it to be prohibited.

Certain commenters stated that the definition of "conflicted transaction" should include an intent or knowledge element in order to narrow the application of the final rule.[411] However, another commenter stated that intent should not be a required element.[412] Section 27B does not include an intent or knowledge element and provides, in relevant part, that a securitization

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410 *See* letters from ABA (suggesting a definition of profit that focuses on income or gain generated as a result of a short position or the settlement of loss protection); MFA II (suggesting that the Commission replace "benefit" with "profit").

411 *See, e.g.*, letters from AIC (stating that a requirement that the securitization participant has actual knowledge of the subject ABS and structures the transaction to fail would align the rule with Section

27B); SFA II (requesting an exception for transactions entered into by a third-party manager on behalf of a securitization participant without the direction of the securitization participant).

[412] ***See*** **letter from AFR.**

participant "shall not . . . engage in any transaction that would involve or result in any material conflict of interest."[413] We believe that narrowing the scope of the final rule to add an element of intent or knowledge is not appropriate because the statute is clear in mandating the prohibition of material conflicts of interest in ABS transactions. Narrowing the scope of the rule to require knowledge or intent would frustrate the statutory mandate of Section 27B. The final rule is intended to prophylactically protect against the sale of ABS tainted by material conflicts of interest; therefore an investor is able to rely on the fact that it is unlawful for a securitization participant to bet against the relevant ABS or the asset pool supporting or referenced by an ABS. Introducing an element of knowledge or intent would not provide the same level of prophylactic protection and would introduce an element of uncertainty that an investor would need to consider with each ABS transaction.

The Commission >also received comment that the <**final rule should include a provision authorizing it to exempt certain transactions from the final rule.[414] As discussed in detail below, we are adopting specific exceptions to the rule's prohibition to implement the exceptions provided for in Section 27B. We are not persuaded that any additional exceptions are necessary in order to implement Section 27B, nor do we believe that it is necessary to include a mechanism to provide such additional exceptions in the future. The changes made from the proposed rule to narrow the scope of the definition of conflicted transaction as described in this section and the changes made from the proposed rule to narrow the scope of the affiliates and subsidiaries of a securitization participant that are ~~subject to the rule as described~~ in Section II.B.3.c. above[415]**

[413] 15 U.S.C. 77z-2a(a).

[414] *See* letters from AIC; SFA II; SIFMA II.

[415] ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a**

should generally ease compliance burdens and mitigate the need for any additional exceptions to the final rule. If the Commission determines that additional exceptions are needed in the future, it can utilize available authorities under its governing statutes, including Section 28 of the Securities Act, to provide such exceptions.

d. Materiality

Consistent with Section 27B's prohibition of conflicts of interest that are "material," ~~the~~**we are adopting, as proposed, a** definition of "conflicted transaction" in ~~proposed~~ Rule 192(a)(3) requires that there is a substantial likelihood that a reasonable investor would consider the relevant transaction important to the investor's investment decision**, including a decision** whether to ~~acquire~~**retain** the asset-backed security. ~~This is similar to the discussion in the release for the 2011 proposed rule,[119] which relied on~~**As stated in the Proposing Release, this is derived from** the "reasonable investor" standard of materiality articulated in *Basic v. Levinson*.~~[120]~~**[416] The Commission received comments stating that this longstanding standard would be inappropriate in this context,[417] and some commenters recommended that the "materially adverse" standard utilized in the Volcker Rule would be more appropriate.[418] However, we continue to believe that the "reasonable investor" materiality standard that is applied throughout the securities laws should be used for purposes of implementing Section 27B. This materiality standard is more appropriate for purposes of implementing Section 27B than the other suggested alternatives as it is focused on**

person described in paragraph (i) of the definition> if the affiliate or subsidiar<**y: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).**

~~117 *See, e.g.*, ASF Letter at 4–6; comment letter from Association for Financial Markets in Europe, Asia Securities Industry & Financial Markets Association, and International Capital Market Association (Feb. 13, 2012) ("AFME/ASIFMA/ICMA Letter") at 6; CRE Letter at 4–5; SIFMA Letter at 8, 18–21; comment letter from Northwest Farm Credit Services, FLCA (Feb. 10, 2012) ("Northwest Letter") at 4; comment letter from Fannie Mae (Jan. 17, 2012) ("Fannie Mae Letter") at 2–8.~~

~~118 *See* Section II.B.2.~~

~~119 See 2011 Proposing Release at 60331 (citing to *Basic v. Levinson* and stating that, in considering whether <there is a substantial likelihood that a reasonable investor would consider the >conflict important to their investment decision, it is not possible to designate in advance certain facts or occurrences as determinative in every instance).~~

~~120~~416 *See Basic v. Levinson*, 485 U.S. 224, 231-32 (1988) (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

417 ***See, e.g.*, letters from AIC (explaining that it would be difficult for a sponsor-affiliated portfolio company to perform a *Basic* analysis); SFA II (stating that the proposed materiality standard would be difficult to apply if the rule does not provide for disclosure as a mitigant of a material conflict of interest); SIFMA II (explaining that there are many non-adverse transactions that a securitization participant enters into which a reasonable investor would want to figure into their investment decision).**

418 ***See* letters from ABA; AFME; SFA II; SIFMA I; SIFMA II.**

the perspective of the reasonable investor in the ABS (not the securitization participant) and, specifically, whether there is a substantial likelihood that such reasonable investor would consider the relevant transaction important to the investor's investment decision whether to acquire or retain the ABS.[419] Also, given that Section 27B was designated as a part of the Securities Act, the existing materiality standard will be more familiar to the broad base of securitization participants that are subject to the rule that engage in the issuance of ABS as opposed to a new standard that is not based on any jurisprudence related to the Securities Act. In this regard, we note that the Volcker Rule and its application relates to >the Bank Holding Company Act, <**which is primarily designed to address safety and soundness concerns applicable to bank holding companies, as opposed to the investor protection focus of the securities laws, including Section 27B.**

~~The use of this~~**As stated in the Proposing Release, the use of the reasonable investor** standard ~~would not~~ in this context **does not** imply that a transaction otherwise prohibited under the ~~re-proposed~~**final** rule would be permitted if ~~there were adequate~~ disclosure **of the conflicted transaction is** made by the securitization participant to the relevant investor.[420] The prohibition ~~would~~**will** apply to transactions that are bets against the relevant ABS whether or not such transactions are disclosed to investors in the ABS. While certain commenters ~~to the 2011 proposed rule supported the use of~~**suggested that** disclosure ~~to manage~~**could adequately mitigate** material conflicts of

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[419] **The transactions specified in Rule 192(a)(3)(i), Rule 192(a)(3)(ii), or Rule 192(a)(3)(iii) are prohibited under the final rule to the extent that there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including whether to retain the ABS. The application of the materiality standard does not, for example, mean that a transaction that only hedges general interest rate or current exchange risk (that is not a conflicted transaction under Rule 192(a)(3)(iii)) is a conflicted transaction.**

[420] **Proposing Release at 9696.**

interest,[121][421] other commenters opposed ~~<the use of disclosure to >manage material conflicts of interest.[122] One commenter to the 2011 proposed rule stated that disclosure alone could not cure material conflicts of interest with respect to synthetic ABS but that disclosure would be sufficient to manage material conflicts of interest in connection with non-synthetic ABS.[123] We~~**any disclosure-based exception to the rule.[422] Consistent with the proposal and the prohibition in Section 27B, we** have not included an exception to the ~~re-proposed~~**final** rule based on disclosure of potential material conflicts of interest because ~~we believe that such disclosure would be insufficient in this context as the re-proposed~~**the final** rule is designed to prevent the sale of ABS that are tainted by material conflicts of interest by prohibiting a securitization participant from entering into a conflicted transaction with respect to ABS that it creates or sells to investors. If the ~~re-proposed~~**final** rule were to include a disclosure-based exception, ~~then~~**compliance with the rule could become a check-the-box exercise that would permit** securitization participants ~~would still be allowed~~ to enter into a transaction ~~that constitutes a~~**prohibited by Section 27B, thereby allowing securitization participants to** bet against the same ABS that they are creating or selling to investors ~~so long as~~**when** such conflicted transaction is disclosed. Even if disclosure of a conflicted transaction ~~would reduce~~**reduced** the

~~[121] *See, e.g.*, ABA Letter at 6–8.~~

~~[122] *See, e.g.*, AFR Letter at 8; Barnard Letter at 2; Better Markets Letter at 8–9; Public Citizen Letter at 2–3; Tewary Letter 1 at 15; Merkley–Levin Letter at 21. Certain of these commenters, however, felt that if providing disclosure were nevertheless permitted to manage conflicts, the disclosure should satisfy strict requirements, including that it should: be in written form; be delivered to investors a specific time period prior to investment; contain particular information; require investor acknowledgment of receipt of such disclosure and consent to the conflict; and be prominent, clear, and comprehensive.~~

~~[123] *See* AII Letter at 3–4.~~

likelihood that an investor would invest in a tainted ABS, the incentive for a securitization participant to enter into the conflicted transaction ~~would not be wholly eliminated. Furthermore, a disclosure-based exception to the re-proposed rule would fail to align with Section 27B given that the proposed prohibition would apply for one year after <the date of the first closing of the sale of>~~**might remain and investors might not benefit from the mandated investor protection of Section 27B. Furthermore, even if the relevant conflict is disclosed to investors, that does not mean that the relevant conflict is not material to the decision of the investor to purchase, retain, or sell** the relevant ABS.

Similarly, **as stated in the Proposing Release,** the use of the reasonable investor standard ~~would~~**does** not imply that a transaction otherwise prohibited by the ~~re-proposed~~**final** rule ~~would~~**will** be permitted if an investor selected or approved the assets underlying the ABS. ~~Although certain commenters to the 2011 proposed rule~~[423] **We are not persuaded, as** suggested **by some commenters,** that the ~~rule~~**prohibition** should not ~~prohibit <conflicts of interest between a securitization participant and >an investor in~~**apply with respect to** an ABS ~~if~~

[421] ***See, e.g.*,** **letters from ABA (stating that, except with respect to certain categories of conflicted transactions such as** >short sales of the relevant ABS, <**disclosure would be appropriate to protect investors where there are inherent conflicts of interest); AIC (stating that disclosure is a valuable tool and should be used where possible to mitigate the materiality of the relevant conflict); MFA II (stating that the rules should permit disclosure as a means of addressing conflicts of interest).**

[422] ***See*** **letters from AFR; Better Markets.**

[423] **Proposing Release at 9697.**

where the investor ~~was involved in selecting the underlying assets or approving the underlying portfolio,[124] <we do not believe that >investor consent would provide adequate protection against misconduct.~~**selects or approves the asset underlying the relevant ABS.[424]** Even if an investor in an ABS is given accurate information about the pool of assets underlying the ABS, and consents to the asset pool on the basis of such information, a securitization participant could nonetheless structure the ABS or construct the underlying asset pool in a way that would position the securitization participant to benefit from the adverse performance of the assets underlying the ABS**, including in ways that investors may not understand**. Additionally, **as explained in the Proposing Release,** we are concerned that an exclusion ~~on the basis of~~**dependent on** investor consent could cause some securitization participants to pressure investors to provide ~~written~~ consent to the portfolio of underlying assets as a condition to participating in an ABS offering, which would undermine the effectiveness and purpose of such disclosure and the meaningfulness of the investor's consent. ~~For these reasons<, we are not including such >an exclusion in the re-proposed rule.~~>**Exception for Risk-Mitigating Hedging Activities**<

E. 1.

Proposed Exception

The Commission proposed to implement the exception for risk-mitigating hedging activity in Section 27B(c) by proposing that the prohibition in proposed Rule 192(a), subject to certain specified conditions, would not apply to the risk-mitigating hedging activities of a securitization participant >in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant arising out of its securitization activities, including <**the** >origination or acquisition of assets <**that it securitizes, except that the initial distribution of an asset-backed security would not be eligible for the exception. The proposed rule was consistent with Section 27B(c), which** >provides that the prohibition in Section 27B(a) does not apply to risk-mitigating hedging

activities in connection with positions or holdings arising out of the underwriting, placement, initial purchase, or sponsorship of an ABS,≤

[124424] *See* ~~Morgan Stanley Letter at 13, 15–17~~ **letters from SFA I**I; SIFMA ~~Letter at 24~~ **I**I.

Also, although certain commenters to the 2011 proposed rule supported limiting the scope of material conflicts of interest <to ABS transactions that are intentionally >designed to fail,[125] other commenters to the 2011 proposed rule were opposed to an intentionally designed-to-fail approach to determine what constitutes <a material conflict of interest.>[126]

Under the re-proposed rule, a securitization participant would be prohibited from designing an ABS to intentionally fail and then <entering into a conflicted transaction >in order <to profit from the adverse performance of >the ABS; however, the re-proposed rule would not apply only to ABS that are intentionally designed to fail. We are not proposing an intentionally designed-to-fail test to determine what constitutes a material conflict of interest because we believe that such a test could lead to attempts to evade the rule. Moreover, the need to prove intent could make enforcement of the rule more difficult, thereby potentially weakening investor protection. We believe <that the proposed definition of ">material conflict of interest" in the re-proposed rule is consistent with Section 27B, which is not limited only to ABS that are intentionally designed to fail.

As discussed below, both the proposed risk-mitigating hedging activities exception and the proposed bona fide market-making activities exception to the re-proposed rule include a requirement that a securitization participant have certain documented policies and procedures in place related to its compliance with the requirements of the relevant exception. However, the re-proposed rule does not include a more generalized requirement that a securitization participant would <be required to have documented policies and procedures in place >that are reasonably

[125] *See* ASF Letter at 11; Fannie Mae Letter at 1-2; SIFMA Letter at 27-28. For example, an ABS transaction in which one or more securitization participants structure the ABS transaction or select the underlying assets with the intent or expectation that the ABS securities will default or decline in value would be intentionally designed to fail.

[126] *See* AFR Letter at 5; Better Markets Letter at 7; Merkley-Levin Letter at 9-10.

designed to prevent the securitization participant from violating the re-proposed rule's prohibition with respect to conflicted transactions regardless of whether the securitization participant is relying on an exception from the re-proposed rule. This is because, unlike the exceptions that would include specific requirements <that would need to be satisfied in order for >securitization participants to meet such exceptions, the prohibition in the re-proposed rule is a general prohibition on entering into conflicted transactions that cannot be waived on the basis of certain documented policies and procedures. We seek comment below on whether such a requirement <should be included in the >re-proposed rule.

Request for Comment

44. Are there any changes we should make to clarify the application of proposed Rule 192(a)? If so, what changes should we make and why? Should we revise the approach to defining the unlawful activity that is subject to the prohibition under the re-proposed rule? If you believe that the approach should be different, please provide an alternative approach and explain why such approach would be preferable and how it would be consistent with the prohibition on material conflicts of interest in Section 27B.

45. Does the re-proposed definition of "material conflicts of interest" accurately capture <the material conflicts of interest ><that Section 27B is designed to address>? If you believe that there is a definition that better identifies the material conflicts of interest that Section 27B is designed to address, please provide a revised definition and an explanation for the revisions. For example, would it clarify the application of proposed Rule 192(a) if the qualification about the transaction being important to a reasonable investor's investment decision were included in the definition of "material conflict of interest" in proposed

Rule 192(a)(2) rather than, or in addition to, in the definition of "conflicted transaction" in proposed Rule 192(a)(3)?

46. Proposed Rule 192(a)(1) refers to "directly or indirectly" engaging in a transaction involving or resulting in a material conflict of interest. Is the reference to "directly or indirectly" necessary in order to capture multi-step transactions or conflicted transactions entered into by a securitization participant through a third party? Is the reference to "directly or indirectly" unnecessary because any such attempts to "indirectly" engage in a conflicted transaction would be covered by the anti-circumvention provision in proposed Rule 192(d)? In your responses to each of these questions, please explain why or why not.

47. Is there activity that securitization participants currently engage in with respect to ABS that would fall within <the definition of "conflicted transaction">? If so, please provide a detailed explanation of such activity, the securitization participants involved with respect thereto, and the frequency as to which such activity is engaged in by such securitization participants. Please describe how that activity is or is not consistent with Section 27B.

48. Is there any activity that you believe would fall <within the scope of the >proposed definition of "conflicted transaction" but is not the type of transaction that Section 27B is intended to prohibit? Please provide a detailed description of how the rule could define this activity and those transactions, and the conditions that should attach to any such exemption in order to protect investors from the misconduct that is targeted by Section 27B.

49. Is there any activity that you believe would not fall within <the scope of the proposed definition of "conflicted transaction>" but that is the type of transaction that Section 27B is

intended to prohibit? If so, please explain why and provide a detailed description of such activity or transactions.

50. Is it appropriate for proposed Rule 192(a)(3)(ii) to cover the purchase of a credit default swap or any <other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant >ABS? Should proposed Rule 192(a)(3)(ii) also apply to the purchase of any security-based swap <pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of a >decline in price of the relevant ABS? Would such an approach be overinclusive or otherwise result in significant overlap with the coverage of proposed Rule 192(a)(3)(iii)?

51. Are there any special considerations regarding the use of total return swaps that should be addressed in the context of the proposed definition of "conflicted transaction"?

52. Please discuss the impact of the proposed definition of "conflicted transaction" on entities with multiple affiliates or subsidiaries, particularly with respect to how a securitization participant would benefit from certain actual, anticipated, or potential adverse events with respect to the relevant ABS or its underlying asset pool under proposed Rule 192(a)(3)(iii). Is the proposed definition of "conflicted transaction" as applied to entities with multiple affiliates or subsidiaries appropriate? If not, please explain why and provide a description of any additional qualifying language or alternative that would be more appropriate and consistent with Section 27B.

53. The re-proposed <rule does not include a >disclosure-based or investor approval-based exception for managing material conflicts of interest. If you believe that the re-proposed rule should allow securitization participants to manage potential conflicts of interest

using disclosure or through obtaining investor approvals, then please explain how disclosure or investor approval of such potential conflicts of interest would adequately protect investors against the risks associated with such conflicts of interest, particularly in light of the concerns expressed in this re-proposal. How could a disclosure exception be structured so that the resulting disclosure would not contain vague boilerplate language? Should the rule also require that a securitization participant disclose that it entered into a transaction that would be a conflicted transaction? How could this disclosure be provided to investors if the securitization participants engage in transactions that occur after the offering but within the timeframe of the prohibition? Please also explain how disclosure or investor approval would be consistent with Section 27B.

54. The re-proposed rule would not be limited to only capturing designed-to-fail transactions and therefore would not include a designed-to-fail standard for what constitutes <a material conflict of interest. >If you believe that a designed-to-fail standard should be the relevant standard instead of the one that is included in the re-proposed rule, then please explain how such standard would adequately protect investors against the risks associated with such conflicts of interest, particularly in light of the concerns expressed in the re-proposal. Please also explain how such a standard would be consistent with Section 27B.

55. As discussed above, the re-proposed rule does not expressly prohibit actions of third parties in the proposed definition of the term "material conflict of interest" and takes a different approach to address possible conflicts than the approach described in the interpretations included in the 2011 Proposing Release by defining the term "sponsor" in a manner that we believe would directly capture most of the parties whose conduct would

have been covered by the 2011 proposed rule.[127] If you believe that, instead of the proposed approach, we should revise the definition of the term "material conflict of interest" to cover the actions of a third party consistent with the 2011 proposed rule, please tell us what activities should or should not be within the scope of "allowing a third party, directly or indirectly, to influence the structure, design, or assembly of the relevant asset-backed security or the composition of the pool of assets underlying the relevant asset-backed security in a way that facilitates or creates an opportunity for that third party to benefit from a conflicted transaction" as described in the release for the 2011 proposed rule and why. Also tell us whether this alternative would directly capture the conduct of parties that the re-proposed rule intends to cover. If you support such a revised definition, please explain whether and how it is consistent with Section 27B.

56. Are there any unintended effects on securitizations from the proposed definitions of the terms "material conflicts of interest" and "conflicted transaction"? If so, please provide alternative definitions designed to minimize such effects, and explain how those alternative definitions would be consistent with Section 27B.

57. Under the re-proposed rule, the issuance of a synthetic ABS where a securitization participant enters into the short side of the transaction with the issuing entity of the synthetic ABS would be a "conflicted transaction" because <the securitization participant would be entitled to >payment if the referenced assets, and thus the ABS, perform poorly. Is this the appropriate result? Please explain why or why not. Are there examples of synthetic ABS where a securitization participant taking the short position in the referenced assets would not necessarily benefit from the adverse performance of the

[127] *See* 2011 Proposing Release at 60331 (describing Item 1(B) of the material conflict of interest test).

underlying asset pool, the loss of principal, monetary default, or early amortization event, or <decline in the market value of the relevant ABS>? If so, should <the definition of "conflicted transaction" >exclude the issuance of such synthetic ABS? If so, please explain how such exclusion would be consistent with Section 27B.

58. Are there <transactions that would be "conflicted transactions" under the >re-proposed rule that occur with respect to municipal ABS? If so, please describe those transactions, the relevant persons that are parties thereto, and the frequency as to which they are entered into by such persons.

59. Should the re-proposed rule <include a requirement that a securitization participant have documented policies and procedures >in place that are reasonably designed to prevent the securitization participant from violating the re-proposed rule's prohibition with respect to conflicted transactions? What should the consequences be for a securitization participant that did not follow such procedures? Would such a requirement provide effective protection for investors? Should such a requirement be in addition to or in lieu of the proposed compliance program requirements discussed below with respect to <the risk-mitigating hedging activities exception and the bona fide market-making activities exception>?

60. If a general compliance program requirement as described in question 59 were to be included in the re-proposed rule, are there any types of securitization participants that should be exempted from such requirement? For example, should government entities (including municipal entities) and/or smaller securitization participants be exempt from such requirement, or should the specific requirements or conditions of such requirement vary based on the type of entity? Alternatively, should the implementation of such

requirement as applied to government entities and/or smaller securitization participants be delayed in order to give such entities more time to comply with the requirement? In your responses, please explain how "smaller securitization participant" should be defined for purposes of any such exemption or delayed implementation.

61. We seek comment on whether the re-proposed rule should include a safe harbor whereby a person that meets the proposed definition of "securitization participant" but nonetheless has no involvement in the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS would be exempt from the re-proposed rule's prohibition on material conflicts of interest. Would such a safe harbor address concerns that the re-proposed rule might unduly burden parties that would not have the incentive or ability to engage in conduct prohibited by Section 27B? Would it weaken the conflicts of interest protection of the re-proposed rule, and if so, how? Are there specific conditions that could be included in the safe harbor in order to address any such concerns? If so, please identify any such conditions. Please also explain whether and how such a safe harbor would be consistent with Section 27B.

62. We seek comment on whether the re-proposed rule should include a safe harbor whereby a securitization participant could rely on the judgment of a governance specialist as to whether a transaction would be a "conflicted transaction" for purposes of the re-proposed rule, in the manner suggested by one commenter to the 2011 proposed rule.[128] Would such a safe harbor minimize any market disruption that might result from any potential ambiguity about whether a transaction would be a "conflicted transaction"? Would it undermine the effectiveness of the re-proposed rule by permitting reliance on the

[128] *See* comment letter from Pentalpha Surveillance LLC (Sept. 1, 2021) ("Pentalpha Letter") at 2.

judgment of a third-party to determine compliance with the rule? How could we help ensure the independence of a third-party specialist that receives compensation directly or indirectly from securitization participants to pass judgment on <whether a transaction is a "> conflicted transaction"? Is this a workable framework to reduce conflicts of interest? Please explain why or why not. If you believe the re-proposed rule should include such a safe harbor, please address the benefits of the safe harbor and identify any conditions that should be included in the safe harbor *(e.g.*, a limitation on the types of entities that could serve as a governance specialist, any minimum qualifications for an entity to qualify to serve in such capacity, and/or a condition that the conclusion reached by the governance specialist be reasonable in light of the facts and circumstances of the transaction). Please provide an estimate of the anticipated costs associated with retaining the services of a governance specialist for this purpose. Please also explain whether and how such a safe harbor would be consistent with Section 27B.

Anti-Circumvention

We received comment on the 2011 proposed rule that the rule should address potential evasion of the rule's prohibition <on material conflicts of interest>, and commenters noted a variety of ways in which a securitization participant might attempt to evade the re-proposed rule's prohibition.[129] We agree with such commenters that potential evasion of the re-proposed rule could weaken the re-proposed rule's conflict of interest protection. Accordingly, we are

[129] *See, e.g.*, Better Markets Letter at 3-5 (stating that the re-proposed rule should include functional definitions and descriptions to prevent evasion of the rule through labeling or the creation of novel financial instruments or novel categories of securitization participants that appear to fall outside the purview of the rule but in reality and substance should be subject to the restrictions in Section 27B); Morgan Stanley Letter at 4 (stating that anti-evasion principles could be applied where counterparties enter into security-based swap transactions solely to avoid application of the prohibition); Tewary Letter 1 at 7 (stating that the Commission would not want to enable securitization participants to perform indirectly what they are barred from doing directly).

proposing Rule 192(d), which provides <that, if a securitization participant engages in a transaction that circumvents the prohibition in proposed Rule 192(a)(1), the transaction >will <be deemed to violate proposed Rule 192(a)(1). >For example, proposed Rule 192(a)(3) defines "conflicted transaction" as three specific categories of transactions because they are common types of transactions that a person might utilize in order to "bet" against the performance of a financial asset. We believe that the re-proposed rule's prohibition should be premised on the substance of the transaction rather than on its form, label, or written documentation. Proposed Rule 192(d) would address a securitization participant circumventing the re-proposed rule's prohibition on material conflicts of interest by structuring one or more transactions to fall outside of the prohibition (including its permitted exceptions) while nonetheless engaging in a transaction that is economically equivalent to a type of transaction specified in the proposed definition of "conflicted transaction."

Request for Comment

63. We seek commenters' views regarding the anti-circumvention provision in proposed Rule 192(d). Is it appropriate for the re-proposed rule to prohibit transactions that circumvent the prohibition in proposed Rule 192(a)(1) by deeming such transactions to violate proposed Rule 192(a)(1)? Why or why not?

64. Should proposed Rule 192(d) be modified such that a transaction circumventing the re-proposed rule's prohibition will only be deemed to violate proposed Rule 192(a)(1) if the securitization participant knows or has reason to know that the transaction is undertaken for the purpose of circumventing the re-proposed rule's prohibition? Please explain why or why not.

65. Should proposed Rule 192(d) be modified in order to address other ways in which a person might attempt to evade the prohibition in the re-proposed rule, including with regard to the proposed exceptions <for risk-mitigating hedging activities, liquidity commitments, or bona fide market-making activities>? If so, how should proposed Rule 192(d) be modified and why?

66. Would proposed Rule 192(d) be overinclusive or otherwise result in potential uncertainty as to the coverage of the re-proposed rule's prohibition, and if so, how should proposed Rule 192(d) be modified to address such concerns? Are there examples of transactions that proposed Rule 192(d) would prohibit but should not? Please explain how any such modifications to proposed Rule 192(d) would be consistent with Section 27B.

67. We seek comment on whether the relationship between proposed Rule 192(d) and <the proposed exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities >should be clarified. If so, please explain what clarifications are necessary, and why.

68. We seek comment on an alternative anti-circumvention provision that would instead provide that, if a securitization participant engages in a transaction or a series of related transactions <as part of a plan or scheme to evade the prohibition >in proposed Rule 192(a)(1), such transaction or series of related transactions will be deemed to violate proposed Rule 192(a)(1). Would this alternative anti-circumvention provision address any concerns about potential overinclusiveness of proposed Rule 192(d), including the absence of a knowledge qualifier?

~~<Exception for Risk-Mitigating Hedging Activities>~~

~~Section 27B(c) <provides that the prohibition in Section 27B(a) does not apply to risk-mitigating hedging activities in connection with positions or holdings arising out of the underwriting, placement, initial purchase, or sponsorship of an ABS, >~~provided that such activities are designed to reduce the specific risks to the underwriter, placement agent, initial purchaser, or sponsor associated with positions or holdings arising out of such underwriting, placement, initial purchase, or sponsorship.[130] ~~Consistent with Section 27B(c)(1), we are proposing that the prohibition <not apply when a securitization participant engages>, subject to certain conditions, in~~ [425] >In order to distinguish permitted <risk-mitigating hedging activities ~~in connection with its securitization activities. The proposed~~ **from prohibited conflicted transactions, the Commission proposed the following three conditions** >that would need to be satisfied in order for <**a securitization participant to rely on the** risk-mitigating hedging activities exception ~~would be conditioned on the securitization participant satisfying all three proposed conditions included in proposed Rule 192(b)(1)(ii), as discussed below.~~**:**

- **That, at the inception of the hedging activity and at the time of any adjustments to the hedging activity, the risk-mitigating hedging activity is** >designed to reduce or otherwise significantly mitigate one or more <**specific, identifiable risks** >arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant<**, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;**
- **That the risk-mitigating hedging activity is subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that the hedging activity satisfies the requirements of the exception and does** >not facilitate or create an

opportunity to benefit from a conflicted transaction <other than through risk-reduction; and

- That the securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements set out in paragraph (b)(1) of the exception, including reasonably >designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored.<

[425] 15 U.S.C. 77z-2a(c)(1).

2. Comments Received

A number of commenters stated that the risk-mitigating hedging exception, as proposed, would be too narrow to facilitate the effective credit portfolio management of securitization participants.[426] In particular, commenters expressed concerns that the exception, as proposed, would restrict the ability of securitization participants to hedge interest rate, foreign exchange, and other risks that are not materially related to the credit risk of the relevant ABS or the asset pool supporting or referenced by the relevant ABS.[427] While certain commenters supported >the proposed conditions applicable to the <**exception,[428] other commenters stated that the proposed conditions would be unnecessarily prohibitive or difficult to implement.[429] The Commission also received comments specifically requesting that synthetic securitizations used for risk-mitigation purposes should be permitted under the risk-mitigating hedging exemption.[430] These comments are addressed in detail below.**

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[426] ***See, e.g.*, letters from AIMA/ACC (stating that is uncertain whether the scope of the exception is sufficiently clear so as to be relied upon); AFME (focusing on CRT transactions); Andrew Davidson (stating its belief that the proposed exception is too narrow); IACPM (stating its belief that, as proposed, the exception is too narrow to facilitate effective credit portfolio management activities); SFA II (expressing concern about**> the ability of securitization participants to< **limit credit, interest rate, and other risks); SIFMA II (stating that the proposed formulation of the exception would unintentionally limit important business activity).**

[427] ***See, e.g.*, letters from HPC (focusing specifically to interest rate risk hedging); MFA II (expressing a preference that the Commission not construe such transactions as conflicted transactions); SIFMA I (stating that these hedging activities are unrelated to the concerns that motivated Section 27B).**

[428] ***See* letters from AARP (describing the proposed conditions and agreeing that exceptions for hedging transactions, to the extent narrowly drawn and clearly defined, are appropriate); AFR (stating that hedge positions must never be greater than the actual exposure of the securitization participant); Better Markets (stating that the compliance program requirement will strengthen the ability of the Commission to police the use of the exception).**

[429] ***See* letters from ABA (expressing concerns that the compliance program requirement would create limitations and confusion given the scope of** >securitization participants that would be <**subject to the rule); AIMA/ACC (expressing concern that the conditions would require facts and circumstances determinations); IACPM (expressing concerns regarding the conditions on the basis that credit portfolio management activities are rarely directed calibrated to the risks of specific securitization activities); SFA I (requesting that the ongoing recalibration requirement be eliminated), SIFMA II (requesting that the ongoing recalibration requirement should be eliminated).**

[430] ***See* letters from AFME (specifically supporting SIFMA's recommendations); Andrew Davidson (suggesting that CRTs be specifically exempted or evaluated against a separate set of rules); Fannie and Freddie (requesting**

3. Final Rule

~~Risk-mitigating~~**We are adopting the risk-mitigating hedging activities exception with certain modifications from the proposal in response to comments received. Consistent with Section 27B, we are adopting a risk-mitigating hedging activities exception that permits securitization participants to continue to hedge their risk exposures. Subject to the conditions discussed in detail below, the final rule provides an exception for risk-mitigating** hedging activities of a securitization participant ~~permitted under the proposed exception would include hedging conducted~~ in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant**, including those** arising out of its securitization activities, ~~including~~**such as** the origination or acquisition of assets that it securitizes.[~~131~~]

Given that the accumulation of assets prior to the issuance of an ABS is a fundamental component of assembling an ABS prior to its sale, ~~the proposed~~**consistent with the proposal, the final** risk-mitigating hedging activities exception ~~would allow~~**allows** for a securitization participant to not only hedge retained ABS positions (in compliance, as applicable, with Regulation ~~RR~~**RR**[431]) but also hedge exposures arising out of the assets that are originated or acquired by the securitization participant

~~130 <15 U.S.C. 77z-2a(c)(1).>~~

~~131 <This standard would not broaden, limit, or otherwise modify the requirements applicable to a securitization participant pursuant to Regulation RR.>~~

in connection with warehousing assets in advance of an ABS issuance. ~~The proposed~~**Also consistent with the proposal, the final** risk-mitigating hedging activities exception ~~would also allow~~**allows** for the relevant hedging activity related to a securitization participant's securitization activity to be done on an aggregated

as one alternative that the Commission amend the exception to permit the Enterprises to continue to engage in CRT issuances following conservatorship); HPC (expressing a preference that credit risk transfer transactions be carved out of the definition of conflicted transactions, but suggesting inclusion as risk-mitigating hedging as an alternative); LSTA III (stating that the risk-mitigating hedging activities exception should include permitted risk transfer transactions); PGGM Credit Risk Sharing dated Mar. 27, 2023 ("PGGM") (advocating for an exception for on-balance-sheet synthetic securitizations); SFA II (requesting that the exclusion of initial distribution of ABS be removed to permit prudent risk transfer transactions); SIFMA II (stating its belief that synthetic securitization should fall under the risk mitigating hedging activities exception under most circumstances).

431 >This standard would not broaden, limit, or otherwise modify the requirements applicable to a securitization participant pursuant to Regulation RR.<

basis and would not require that the exempt hedging be conducted on a trade-by-trade basis. Given the nature of the ABS market and the types of assets that collateralize ABS (such as receivables or mortgages), it may not be possible for a securitization participant to enter into a hedge with respect to an ABS or any of its underlying assets on an individualized basis. **Such hedge may also need to be aggregated with hedges of risks that are unrelated to the relevant ABS and the asset pool supporting or referenced by such ABS.** Therefore, ~~we believe that~~ this approach to the risk-mitigating hedge exception should allow securitization participants sufficient flexibility to design their securitization-related hedging activities in a way that is not unduly complicated or cost prohibitive.

~~<In order to distinguish permitted >risk-mitigating hedging activity under the re-proposed exception from prohibited conflicted transactions that <would constitute a bet against the >relevant ABS, we are proposing certain conditions that would have to be satisfied in order for the risk-mitigating hedging activity exception to apply. We believe that this proposed approach is consistent with views of certain commenters to the 2011 proposed rule that recommended a narrow risk-mitigating hedging activities exception that is designed to reduce specific risks and that includes robust conditions.[132] Each of these conditions is discussed in detail below.~~

~~Under the re-proposed exception, the initial issuance of an ABS, such as a synthetic ABS, would not be risk-mitigating hedging activity.[133] Although we received comment that securitization participants should be permitted to enter into a synthetic ABS transaction pursuant~~

~~[132] *See* Barnard Letter at 2; Better Markets Letter at 9-12; Merkley-Levin Letter at 16-18; Tewary Letter 1 at 10.~~

~~[133] <As discussed above in Section II.D., the >proposed definition of the term "conflicted transaction" does not exclude the issuance of synthetic ABS.~~

~~to~~**In a change from the proposal, the initial issuance of a synthetic ABS will be eligible for** the risk-mitigating hedging activities exception ~~because such transaction is <the economic equivalent of a >bilateral CDS transaction where the counterparty to the CDS is not an ABS issuer,[134] the re-proposed rule prohibits a~~**set forth in the final rule. This change is intended to allow for the initial issuance of a synthetic ABS that the relevant** securitization participant ~~from creating and/or selling~~ **enters into and maintains as a hedge. This change is also consistent with the requests of certain commenters.[432] As discussed above in Section II.D.3., the relevant material conflict of interest** >in the context of the <**issuance of** a new synthetic ABS ~~to hedge a position or holding. In these synthetic ABS transactions, a~~**arises when the** securitization participant ~~is typically a party to a CDS contract with <the issuing entity of the ABS>. We are concerned that such activity would weaken the conflicts of interest protection of the re-proposed rule by <allowing a securitization participant to >engage~~**engages** in a transaction (~~the~~**such as** CDS contract(s) with the **synthetic ABS** issuer) where cash paid by ~~ABS~~ investors to acquire the newly created synthetic ABS would fund the relevant ~~CDS~~ contract(s) and be available to make a payment to the securitization participant upon the ~~occurrence of an adverse event. This type of transaction was the focus of Congressional scrutiny in connection with the financial crisis of 2007-2009.[135] Moreover, the securitization participant would perform a central role in creating, structuring, and/or marketing the relevant synthetic ABS that is being issued and, in connection with such role, would likely obtain additional benefits such as arranger or manager compensation. These factors would go beyond engaging in risk-mitigating hedging activity that is designed to reduce specific risks to the securitization participant in connection with positions or holdings <arising out of its securitization activities >and could raise conflicts of interest with investors in the new synthetic ABS that we believe Section 27B is intended to prohibit.~~

~~**<Specific Risk Identification and Calibration Requirements>**~~

~~We are proposing in Rule 192(b)(1)(ii)(A) that the first condition of the exception be <that, at inception of the hedging activity and at the time of any adjustments to the hedging activity, the>~~

[432] ***See*** **letters from AFME (specifically supporting SIFMA's recommendations); Andrew Davidson (suggesting that CRTs be specifically exempted or evaluated against a separate set of rules); Fannie and Freddie Letter (requesting as one alternative that the Commission amend the exception to permit the Enterprises to continue to engage in CRT issuances following conservatorship); HPC (expressing a preference that credit risk transfer transactions be carved out of the definition of conflicted transactions, but suggesting inclusion as risk-mitigating hedging as an alternative); LSTA III (stating that the risk-mitigating hedging activities exception should include permitted risk transfer transactions); PGGM (advocating for an exception for on-balance-sheet synthetic securitizations); SFA II (requesting that the exclusion of initial distribution of ABS be removed to permit prudent risk transfer transactions); SIFMA II (stating its belief that synthetic securitization should fall under the risk mitigating hedging activities exception under most circumstances).**

occurrence of an adverse event with respect to the assets included in the reference pool.[433] If such activity is not entered into for purposes of hedging an exposure of the securitization participant to the assets included in the reference pool, then such activity will not qualify for the risk-mitigating hedging exception.

However, we understand that the Enterprises and other market participants utilize synthetic ABS structures for hedging purposes. To the extent that such transactions mitigate a specific and identifiable risk exposure of the securitization participant, we agree that such transactions should be permitted under the risk-mitigating hedging exception. Section 27B specifically applies to synthetic ABS transactions and provides an exception for risk-mitigating hedging activity;[434] therefore, we believe that it >is consistent with Section 27B <**to allow a synthetic ABS as described above to be eligible for the risk-mitigating hedging activities exception if it is entered into and maintained for risk-mitigating hedging purposes. We understand that commentators have expressed concerns about the systemic risk implications of CRTs.[435] However, we are adopting this rule pursuant to our congressional mandate under Section 27B, which focuses on investor protection rather than mitigating systemic risk. To ensure that these types of transactions cannot be utilized as a bet by a securitization participant against the performance of the reference assets, the rule as adopted requires any such transaction**

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433 ***See*** **Section II.D.3. (discussing how the inclusion of the language "(other than the relevant asset-backed security)" in Rule 192(a)(3)(iii) is designed to specify that merely entering into an agreement to serve as a securitization participant with respect to an ABS and engaging in a purchase or sale of the ABS as an underwriter, placement agent, or initial purchaser for such ABS is not itself a conflicted transaction).**

434 **15 U.S.C. 77z-2a(a)(1) and 15 U.S.C. 77z-2a(c)(1).**

435 ***See, e.g.,*** **Matt Wirz and Peter Rudegeair, *Big Banks Cook Up New Way to Unload Risk*, Wall Street J. (Nov. 7, 2023), *available at* https://www.wsj.com/finance/banking/bank-synthetic-risk-transfers-basel-endgame-62410f6c.**

to satisfy each of the conditions to the risk-mitigating hedging activities exception described below.

A number of commenters stated that the risk-mitigating hedging activities exception should encompass interest rate, currency, and other hedging activities that are not materially related to the credit risk of the relevant ABS or the asset pool supporting or referenced by the relevant ABS.[436] As described in Section II.D.3., general interest rate hedges and currency exchange hedges entered into by a securitization participant are not conflicted transactions. Furthermore, hedges that are unrelated to the credit performance of the relevant ABS or the asset pool supporting or referenced by the relevant ABS will not be conflicted transactions as they are not substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). Therefore>, we are not including such <**activities in the risk-mitigating hedging exception because securitization participants engaging in such transactions will not need to rely on any exception to the rule.**

In a change from the proposal, the risk-mitigating hedging activities exception will apply to the risk-mitigating hedging activities of a securitization participant in connection with and related to individual or aggregated positions, contracts or other holdings of the securitization, "including those" >arising out of its securitization activities<**, such as the origination or acquisition of assets that is securities, rather than only those positions, contracts or other holding of a securitization participant arising out of its securitization activities. The addition of the phrase "including those" is designed to not unnecessarily restrict the ability of an affiliate or subsidiary**

[436] *See, e.g.*, letters from HPC (referring specifically to interest rate risk hedging); LSTA III (stating the risk-mitigating hedging activities exception should include interest rate, currency, and other non-credit related trading and hedging activities); MFA II (stating that the exception for risk-mitigating hedging

activity should specifically include interest rate and currency hedging, but expressing a preference that the Commission not construe such transactions as conflicted transactions at all).

of a securitization participant to hedge exposures that it may originate, retain, acquire, or finance in connection with the ordinary course of its business but that may be unrelated to the securitization activities of the securitization participant.[437] For example, if an underwriter of an ABS has an affiliate or subsidiary (that is subject to the rule) that acquires, in its ordinary course of business, a long position in such ABS, the affiliate or subsidiary will be able to rely on >the risk-mitigating hedging activities exception to <**hedge that long position, subject to the conditions of the exception. This change is also responsive to the concerns of certain commenters that stated** >that the risk-mitigating hedging activities exception should not <**be limited to the hedging of exposures arising out of a securitization participant's securitization activities.[438]**

Other commenters requested an exception for hedging related to intermediation and financing services provided by a securitization participant.[439] As discussed above in Section II.D.3., providing financing to a long purchaser of an ABS is not a conflicted transaction under Rule 192(a)(3). If the person providing such financing is a securitization participant with respect

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[437] If the relevant affiliate or subsidiary is not a securitization participant under the final rule because it does not act in coordination with the named securitization participant and does not have access to or receive information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS prior to the first closing of the sale of the relevant ABS, then such affiliate or subsidiary will not need> to rely on the risk-mitigating hedging activities exception.< ***See*** **Section II.B.3.c. above (discussing the application of the final rule to affiliates and subsidiaries). By including both a narrower definition of the affiliates and subsidiaries of a securitization participant that are subject to the final rule's prohibition and an expanded risk-mitigating hedging activities exception, the final rule is designed to provide securitization participants with more than one way to approach the compliance of the activities of their affiliates and subsidiaries with the requirements of the final rule.**

[438] *See, e.g.*, letters from IACPM (stating that credit portfolio managers use credit portfolio management transactions to hedge risks wholly unrelated to the institution's securitization exposures); LSTA IV (stating that deleting this requirement is necessary to capture hedging activities that are related to positions that did not arise out of securitization activities); SIFMA II (stating that this requirement could have adverse and unintended effects on everyday operations and risk management practices of financial institutions and their affiliates); SFA II (suggesting that the Commission broaden the exception by deleting this requirement).

[439] *See* letters from IACPM (stating that, if banks are unable to engage in effectively hedging their portfolio, they may simply reduce the activity that gives risk to the risk by reducing lending activities altogether

and thereby constraining access to credit or other financial transactions); SIFMA I (stating that the exception should include transactions that hedge risk where a sponsor serves as an intermediary to facilitate a customer's exposure or when a sponsor provides financing to ABS investors).

to the relevant ABS and desires to enter into a hedge with respect to its financing exposure that would constitute a conflicted transaction under the rule, then such person can enter into that hedge so long as such hedge satisfies the requirements of the risk-mitigating hedging activities exception. The risk-mitigating hedging activities exception applies to the individual or aggregated positions, contracts, or other holdings of the securitization participant, and this risk-mitigating hedging activity will be covered by the exception. Therefore, creating an expanded or separate exception for such hedging activity would be redundant. Intermediary functions of a securitization participant are separately addressed by the bona fide market-making activities exception in 17 CFR 230.192(b)(3) ("Rule 192(b)(3)"), which is discussed in detail in Section II.G. below and addresses the hedging of market-making positions.

Some commenters focused on the hedging of long ABS positions that are purchased by a securitization participant with respect to such ABS and requested that hedging such long positions should be allowed for under the exception.[440] As discussed above in Section II.D.3., the long purchase of an ABS is not a conflicted transaction under Rule 192(a)(3). Also, subject to the conditions discussed below, the exception does not preclude the hedging of a long position in an ABS by a securitization participant. The risk-mitigating hedging activities exception applies to the individual or aggregated >positions, contracts, or other holdings of the securitization participant, and <this risk-mitigating hedging activity will be covered by the exception.

Therefore, creating an expanded or separate exception for such hedging activity would be redundant. Also, as described in Section II.B.3.c. above, we are making changes from

the proposed rule to narrow the scope of the affiliates and subsidiaries that are subject to the rule,

[440] ***See*** **letters from SFA II (focusing on large, diversified financial institutions); SIFMA II (also focusing on large, diversified financial institutions).**

which should mitigate the concerns of commenters regarding the hedging activities >of affiliates and subsidiaries within <**large, diversified financial institutions being unnecessarily restricted.**[441]

One commenter focused specifically on hedging >by a securitization participant in <**the context of tender option bonds ("TOBs") and requested that the risk-mitigating hedging activities exception clearly state that hedges with respect to the underlying asset of a TOB are permissible to the extent that the sponsor either provides credit enhancement on the asset or the ABS issued or where the sponsor assigns, subordinates its right of payment on the hedge to or otherwise provides the benefit of the hedge to the ABS investors ahead of its benefiting therefrom.**[442] >We do not believe that <**a special exception for TOBs is necessary. This is because the risk-mitigating hedging activities exception, subject to the conditions discussed below, generally allows for the risk-mitigating hedging activities of a securitization participant in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant, including those arising out of its securitization activities, such as the origination or acquisition of assets that it securitizes. This includes hedging by a securitization participant of its retained and/or guaranteed exposures arising out of its ABS activity regardless of whether the relevant ABS is a TOB transaction or some or other type of ABS. Therefore, to the extent that the**

441 ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition only** >if the affiliate or subsidiary<**: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).**

442 ***See*** **letter from SIFMA dated Mar. 27, 2023 (making comparisons to the treatment of TOBs under Regulation RR and explaining its belief that "TOBs are a well-known form of securitization, akin to repo and securities lending finance, with unique features and functions, that are formed with high-grade or credit enhanced assets and which do not carry the risks the Proposed Rule is designed to address.")**

In a typical TOB transaction, tax-exempt municipal securities are deposited into a special purpose trust that issues two classes of securities: floating rate securities with a put option marketed to short-term institutional investors, like a municipal money market fund, and inverse floating rate securities which are retained by the trust or marketed to long-term institutional investors.

hedging activity of a securitization participant in connection with a TOB satisfies the conditions applicable to the exception, then such hedging activity will be permitted risk-mitigating hedging activity for purposes of the rule.

As described above in Section II.D.3., one commenter expressed a concern that using the phrase "directly or indirectly" in proposed Rule 192(a)(1) could be potentially interpreted to create a misalignment between the scope of the entities subject to the prohibition and the scope of the exceptions to the rule that apply to the activities of a securitization participant.[443] The final rule does not prohibit a securitization participant from using an affiliate or subsidiary as an intermediary for the purpose of effecting risk-mitigating hedging activity. This is because the risk-mitigating hedging activities exception is available to a "securitization participant," which is defined to include not only the underwriter, placement agent, initial purchaser, or sponsor of an ABS but also any affiliate or subsidiary who is acting in coordination with such person or who has access to or receives information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS.[444] For example, it is not inconsistent with the exception for risk-mitigating hedging activities for an entity to retain a position in an ABS for which it is an underwriter, placement agent, initial purchaser, or sponsor, under the final rule and to hedge that exposure by causing one of its subsidiaries to enter into the relevant hedge and pass through the economics of that hedge back to the parent entity.

Each of the specific >conditions applicable to the risk-mitigating hedging activities exception <**is described in detail below.**

~~134~~443 *See* ~~ASF Letter at 25-26; comment~~ letter from ~~Cadwalader, Wickersham & Taft LLP (Feb. 13, 2012) ("Cadwalader Letter") at 2-6;~~ SIFMA ~~Letter at 22-23~~ II.

~~135 *See* Senate Financial Crisis Report.~~

444 **If the affiliate or subsidiary is not acting in coordination with such person or does not have access to or receive information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS, then such affiliate or subsidiary is not subject to the prohibition of the final rule and does not need to avail itself of the risk-mitigating hedging activities exception.**

a. >Specific Risk Identification and Calibration Requirements<

We are adopting proposed 17 CFR 230.192(b)(1)(ii)(A) ("Rule 192(b)(1)(ii)(A)") as proposed. Therefore, the first condition to the risk-mitigating hedging activities exception is >that, at inception of the hedging activity and at the time of any adjustments to the hedging activity, the <risk-mitigating hedging activity of the securitization participant is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant ~~arising out of its securitization activities~~, based upon the facts and circumstances of the identified underlying and hedging positions, contracts, or other holdings and the risks and liquidity thereof. This condition ~~would be the~~**is an** essential requirement of the ~~proposed~~ exception **to help ensure** that the relevant hedging activity is risk-mitigating. ~~Various activities of a~~

One commenter generally supported a clear standard that the relevant hedging activity must never result in a short position with respect to the relevant ABS.[445] Other commenters stated that the requirement that the relevant hedged risks are "specific, identifiable risks" is unrealistic as securitization participants conduct credit portfolio management on a portfolio basis and that such requirement could unduly limit risk-mitigating activities.[446] One commenter generally stated that is unclear how the condition should be interpreted due to the subjectivity involved in risk assessment and identifying a necessary degree of risk-mitigating hedging in any given circumstance.[447]

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[445] ***See*** **letter from AFR.**

[446] ***See*** **letters from Andrew Davidson (stating that a firm will generally enter into risk mitigating hedges on a portfolio rather than on identified positions); IACPM (stating that credit portfolio management transactions may be designed to address portfolio credit and other risks not related to an institution's securitization exposures).**

[447] ***See*** **letter from AIMA/ACC.**

We recognize that various activities of a securitization participant, such as acquiring a portfolio of assets in anticipation of issuing an ABS or retaining a portion of an ABS issuance with respect to which it is a securitization participant, expose the securitization participant to the risk that such positions could decline in value. ~~Permissible risk-mitigating hedging activity, under the re-proposed rule, would be required~~ We also recognize that securitization participants may currently hedge such risks on an aggregated basis. Therefore, as discussed above, the final exception applies broadly to hedging of the individual or aggregated positions, contracts, or other holdings of the securitization participant. The final exception specifically allows for hedging on an aggregated basis, consistent with the rule as proposed.

~~to be designed to reduce or significantly mitigate such risks[136] and could not "overhedge" such risks in a way that would result in a net short exposure <to the relevant ABS. This >proposed condition is designed to preclude~~ Although the relevant risks are permitted under 17 CFR 230.192(b)(1)(i) ("Rule 192(b)(1)(i)") >to be hedged on an aggregated basis to address more than one exposure<, we continue to believe that such risks need to be specific and identifiable at the inception of the hedging activity, as well as at the time of any adjustments to the hedging activity, and must arise in connection with and be related to identified positions, contracts, or other holdings of the securitization participant. Without this condition>, it would be impractical or impossible to <determine whether the securitization participant has overhedged. This condition will prohibit a securitization participant from engaging in speculative activity that is designed to gain exposure to incremental risk by, for example, entering into a CDS contract referencing a retained ABS exposure where the notional amount of the CDS exceeds the amount of the securitization participant's relevant exposure to that ABS, and any other aggregated exposures, that are intended to be hedged. Such a transaction would provide the securitization participant with an opportunity to profit from a decline in the value of the relevant retained exposure rather than simply to reduce its risk to it.

~~Therefore, although the relevant risks arising from a securitization participant's securitization activity would be permitted <to be hedged on an aggregated basis to address more than one exposure >arising from such activity, such risks would need to be specific~~**For the same reason, we are not persuaded by the suggestion from certain commenters that the final rule allow, under the risk-mitigating hedging activity exception,**

~~136 For example, such risks would include the market risk of the price decline of warehoused assets or the interest rate risk arising between the interest rate accruing on a retained ABS position and any financing used to acquire it.~~

~~and identifiable at the outset of the hedging activity. The proposed requirement that the risks must be specific and identifiable means that a securitization participant would not be permitted to rely on the proposed risk-mitigating hedging activities exception if it were to enter into a CDS contract referencing a retained ABS interest for the purpose of hedging generalized risks that it believes to exist based on non-position specific modeling or other considerations. In order to make a determination of whether the hedge is designed so as not to "overhedge" positions related to a securitization participant's securitization activities, the hedge would need to be tied to specific exposures that exist and are specifically identifiable. Otherwise<, it would be impractical or impossible to >make that determination, and the proposed exception should not apply.~~

~~Whether a risk is "specific" and "identifiable" depends on the facts and circumstances of the <positions, contracts, or other holdings of the securitization participant, and >these terms are not defined in the re-proposed rule. However, we seek comment below on indicia of whether a risk is specific and identifiable, and whether such indicia should be specified in the rule.~~

for the hedging of specific, identifiable positions, contracts, or other holdings of a securitization that do not exist at the time of the hedging activity but that may exist at some point in the future.[448] Under such a standard, a securitization participant would, for example, be allowed to overhedge its exposure to the relevant ABS or the asset pool underlying or referenced by such ABS on the mere basis that it may at some point in the future increase its exposure to such assets even if it ultimately never does so.

One commenter stated that the requirement that the condition apply at the inception of the hedging activity and at the time of any adjustments to the hedging activity should be deleted.[449] We recognize that the risks of the relevant exposures are dynamic and may change over time and that new risks may emerge in a way that would make the hedging activity that was designed at inception less effective. ~~The~~**As explained above in Section II.C.3., the** prohibition of the ~~re-proposed~~ rule only applies for a limited timeframe~~,~~[137] **with respect to the**

relevant ABS,[450] and this ~~proposed~~**first** condition **of the risk-mitigating hedging activities exception** does not restrict **a securitization participant from** making adjustments to a hedge over time. However, ~~in order to prevent evasion,~~**consistent with the investor protection mandate of Section 27B and recognizing that a securitization participant's exposures may change over time, it is important that** the requirements of this ~~proposed~~ condition ~~would~~**, as stated in the Proposing Release, must** apply not only at the inception of the hedging activity but also whenever such hedging activity is subsequently adjusted during the time period in which the prohibition

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[448] ***See*** **letter from SIFMA II (providing, as an example, that this would allow for the hedging of exposures to assets that are not yet included in the asset pool underlying or referenced by the relevant ABS); LSTA IV (stating that, at a minimum, the "identified positions, contracts, or other holdings" need to include not only current positions, contracts, or other holdings, but also future positions, contracts, or other holdings, as hedged are sometimes arranged in advance). As described above in Section II.D.3., a transaction** > entered into by a securitization participant < **that is not entered into with respect to the relevant ABS is only a conflicted transaction under the final rule if it is substantially the economic equivalent of a transaction described in final Rule 192(a)(3)(i) or final Rule 192(a)(3)(ii) with respect to the relevant ABS.**

[449] ***See*** **letter from Andrew Davidson.**

[137~~450~~] *See* Section II.C.**3.** for a discussion of the time period during which the prohibition applies.

applies.~~138~~[451] Therefore, any changed or new risks that are being hedged ~~would~~**, including those being hedging on an aggregated basis, will** need to be specifically identified, and the adjusted hedging activity ~~would need~~**needs** to be ~~tied~~**designed** to **address** them**,** >in order for the exception to apply<.

~~Similarly, we are proposing in~~ **We are adopting 17 CFR 230.192(b)(1)(ii)(B) ("**Rule 192(b)(1)(ii)(B) ~~that~~**") with certain modifications in response to comments received on the proposal. Specifically,** the second condition of the exception ~~be~~**is** that the risk-mitigating hedging activity ~~would be~~**is** required to be subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that such hedging activity satisfies the requirements applicable to the first condition of the exception and does not facilitate or create an opportunity to **materially** benefit from a conflicted transaction other than through risk-reduction. **This condition is designed to prevent a position that initially functions as a hedge to develop into a prohibited bet against the relevant ABS.**

One commenter stated that the rule should provide that the relevant hedging activity must never result in a short position with respect to the relevant ABS.[452] Other commenters expressed concerns that this condition could unduly limit a securitization participant's risk-management abilities.[453]

We continue to believe that the recalibration requirement is a necessary condition to the exception so that subsequent changes to the hedging arrangements do not result in those arrangements functioning as conflicted transactions that would otherwise be prohibited by the

[451] *Id.*

[452] *See* letter from AFR.

[453] *See, e.g.*, letters from Andrew Davidson (stating that it would be difficult and costly for a firm which engages in overall portfolio hedging to comply with this requirement); IACPM (stating its belief that this condition does not accurately reflect the way credit portfolio managers manage risk in the context of credit portfolio management transactions, which can be used to hedge risks wholly unrelated to the

institution's securitization exposures); SFA II (requesting that the ongoing recalibration requirement be replaced with a requirement that the primary benefit of the risk-mitigating hedging activity is risk reduction and not the facilitation or creation of an opportunity to realize some other benefit from a conflicted transaction); SIFMA II (suggesting as an alternative that the primary benefit of the risk-mitigating activity is risk reduction).

final rule. For example, if a securitization participant enters into a hedge that ~~would be~~**is** permitted under the exception **at inception** and ~~subsequent to that hedge,~~ the risk exposure ~~is reduced, under the proposed condition,~~**of** the securitization participant ~~would be required to ensure that it is not "overhedged" so that the position would not constitute~~**is subsequently reduced such that its hedge fails to achieve its designed purpose and constitutes** a bet against the relevant ABS, ~~which could require~~ the securitization participant **should be required** to adjust or recalibrate its hedge~~. We believe that this condition would help minimize <the ability of a securitization participant to >engage in hedging activity that could create material conflicts of interest with investors in the relevant~~ **to continue to rely on the exception. Otherwise, securitization participants could reduce their exposures after entering into a hedge in order to achieve a net short position, which** >would constitute a bet against the <ABS. The second condition ~~does not specify an exact frequency as to which a <securitization participant would be required to >recalibrate its hedge; however, we seek comment regarding this below~~**is designed to prevent that very conduct**.

In a change from the proposal, the risk-mitigating hedging activity is required to be subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that such hedging activity does not facilitate or create an opportunity to "materially" >benefit from a conflicted transaction other than through risk-reduction. <**We recognize that it may not be possible for a securitization participant to immediately recalibrate its hedging positions given the liquidity, maturity, and depth of the relevant market for such hedging positions. For example, if there is an unexpected early prepayment of the relevant positions being hedged, a securitization participant may be unable to immediately reduce its related hedge. The addition of the word "materially" is designed to address this concern and not unduly disrupt normal course hedging activities that do not present material conflicts of interest with ABS investors. We believe that this**

standard is more appropriate than stipulating, as some commenters suggested, that to meet the risk-mitigating hedging activities exception, it is necessary that the "primary benefit" of such activity must be risk reduction.[454] These commenters did not specify how to calculate or otherwise determine whether the primary benefit of a risk-mitigating hedging activity is risk

[454] *See* letters from SFA II (suggesting a requirement that the primary benefit of the risk-mitigating hedging activity is risk reduction and not the facilitation or creation of an opportunity to realize some other benefit of a conflicted transaction); SIFMA II (suggesting a requirement that the primary benefit of the risk-mitigating hedging activity is risk reduction); LSTA IV (supporting SIFMA's suggestion).

~~In addition, both the first and second conditions described above are consistent with comments to the 2011 proposed rule recommending we clarify that speculative or profit-making activity would be inconsistent with activity that should be eligible to qualify for the risk-mitigating hedging activities exception,[139] that risk-mitigating hedging activities should not~~

~~[138] *Id.*~~

~~[139] *See* Tewary Letter 1 at 10.~~

~~result in exposure to incremental risk,[140] and <that the risk-mitigating hedging activities exception should not >permit profiting <from a decline in the value of the >ABS.[141]~~

reduction, and the term "primary benefit" implies that a securitization participant could, as a "secondary benefit" to the activity, materially profit from a net short position with respect to the relevant ABS. This standard would allow a securitization participant to enter into a bet against the relevant ABS in contradiction to the statutory prohibition.

One comment requested that the recalibration requirement only apply with respect to the hedging of aggregated holdings and not an individual position.[455] We believe that the recalibration requirement should apply to both the hedging of individual and aggregate positions as the relevant concerns that a securitization participant should not be able to bet against the relevant ABS are the same regardless of whether the relevant exposures are hedged on an aggregated or individualized basis.

~~The~~**Overall, we believe that the** first and second ~~proposed~~ conditions ~~also set forth a principle-based approach that~~**as adopted** should not unduly disrupt normal course hedging activities that do not present material conflicts of interest with ABS investors and therefore should reduce the compliance burden **from that** of the proposed exception. ~~For example, we received comment to the 2011 proposed rule that a securitization participant may not be able to create a hedge that exactly offsets any exposure arising from a specific risk.[142] The re-proposed exception would not require that a risk-mitigating hedge have an exact negative correlation with the exposure being hedged, as that might create an unattainable standard for securitization participants seeking <to rely on the risk-mitigating hedging activities exception. >Instead, the proposed first and second conditions to the exception are premised on the relevant hedging activity being designed to reduce the specific risks to the securitization participant associated with its positions or holdings and not facilitating or creating an opportunity to benefit from a conflicted transaction other than through such risk-reduction.~~

In response to the comment that there is subjectivity involved in risk assessment and identifying a necessary degree of risk-mitigating hedging in any given circumstance,[456] the final rule does ~~On the other hand, we did receive a comment to the 2011 proposed rule that there should be exact negative correlation between the risk being hedged and the corresponding hedge position rather than rough negative correlation, and if exact negative correlation were impossible, the commenter recommended that the rule require that a securitization participant provide an explanation, certified by the chief executive officer and chief compliance officer of the~~

~~140 *See* AFR Letter at 9.~~

~~141 *See* Merkley-Levin Letter at 17.~~

~~142 *See* AII Letter at 2.~~

~~securitization participant, of the reasons for why exact negative correlation was impossible.[143] We did not add~~**not include** an exact negative correlation standard ~~to~~**in** the ~~re-proposed~~ risk-mitigating hedging activities exception out of concern that such a standard could be unattainable in many circumstances given the potential complexity of positions, market conditions at the time of the hedge transaction, availability of hedging products, costs of hedging, and other circumstances at the time of the transaction that would make a hedge with exact negative correlation impractical or unworkable. For example, a securitization participant may not be able to hedge its exposure

[455] ***See*** **letter from SIFMA I.**

[456] ***See*** **letter from AIMA/ACC.**

on an individualized basis and may have to enter into ~~an index-based~~**a broader-based** hedging transaction. However, the presence of negative correlation ~~would~~**will** generally indicate that the hedging activity reduced the risks it was designed to address~~, and the~~**. The** first and second conditions to the ~~proposed~~ risk-mitigating hedging activities exception ~~would~~**will** serve to promote risk-mitigating hedging activity where there is negative correlation between the risk being hedged and the corresponding hedged position because the relevant risk ~~would~~**will** be required to be specifically identified and the risk-mitigating hedging activity ~~could not~~**cannot** facilitate or create an opportunity to benefit from a conflicted transaction other than through risk reduction. The first and second conditions to the ~~proposed~~ risk-mitigating hedging activities exception ~~would~~ also allow for consideration of the facts and circumstances of the particular exposure or exposures and the related hedging activity, including the type of position being hedged, market conditions, depth and liquidity of the market for the underlying and hedging positions, and type of risk being hedged.

~~We also did not include a condition <in the proposed risk-mitigating hedging activities exception >that no employee receive compensation arising from or related in any way to any~~

~~143 *See* Better Markets Letter at 11.~~

~~income generated by any hedging activity as suggested by one commenter to the 2011 proposed rule[144] because both the first and second conditions would preclude income generating activity by requiring that the risk-mitigating hedging activity could not facilitate or create the opportunity to <benefit from a conflicted transaction other than through risk-reduction.>~~

~~The proposed~~**Consistent with the proposal, the** risk-mitigating hedging activities exception ~~would~~ also **does** not require that a hedge be entered into contemporaneously~~,~~ **(***i.e.*, at the exact time that a risk is incurred or within a prescribed time period after a risk is incurred**)**. Rather, both the first and second ~~proposed~~ conditions are premised on the relevant hedging activity, whenever it is entered into or adjusted, being designed to mitigate a specifically identified risk and not to function as a bet against the relevant ABS. ~~We received a comment to the 2011 proposed rule stating that the duration of the hedge must not exceed the offering period, for instance by the closing of the underwriting book.[145] However, we believe that the more appropriate standard, which we are proposing, is that the~~**The** hedging activity ~~would~~**will** cease to qualify for the ~~re-proposed~~ risk-mitigating hedging activities exception if it ~~were~~**is** no longer reducing a specific risk to the securitization participant in connection with ~~the relevant ABS activity~~**its individual or aggregates positions, contracts, or other holdings**, for example if the securitization participant failed to unwind its risk-mitigating hedging activities after disposing of the position or holding being hedged. This is because the securitization ~~participant would <no longer be engaged in risk-mitigating hedging activities in connection with such position or holding.>~~

~~We also received a comment to the 2011 proposed rule that a securitization participant should be permitted to hedge a retained investment in a cash ABS on a periodic basis (*e.g.*, hedging quarterly or semiannually) consistent with the securitization participant's hedging policy~~

~~[144] *See* Better Markets Letter at 12.~~
~~[145] *See* AFR Letter at 9.~~

and not on an intermittent basis.[146] The proposed risk-mitigating hedging activities exception does not include any specific requirement regarding the timing of when the relevant hedging activity must begin. Instead, the first and second conditions are intended to help ensure that the permitted risk-mitigating hedging activity would be required to hedge specifically identified risks and not function as a bet against the relevant ABS. Therefore, whether periodic hedging of retained ABS interests would qualify for the proposed risk-mitigating hedging activities exception is a facts and circumstances determination, and we are not providing specific guidance as to whether hedging on any specific periodic basis (*e.g.*, monthly, quarterly, or semiannually) would be permissible. Although the intent of the re-proposed exception is not necessarily to require a securitization participant to change its existing schedule for hedging risks associated with its retained ABS interests, to the extent that periodic hedging on a delayed basis results in an "overhedged" position that constitutes a bet against the relevant ABS, then that hedging activity would not satisfy either of the first or second conditions applicable to the exception.

We also received a comment to the 2011 proposed rule asking for clarity that the risk-mitigating hedging activities exception would be available throughout the time period during which the rule is applicable.[147] The risk-mitigating hedging activities exception in the re-proposed rule would be available to a securitization participant throughout the time period during which the re-proposed rule would be applicable, commencing on the date on which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an ABS and ending on the date that is <one year after the date of the first closing of the sale of >the ABS, if the conditions of <the exception are satisfied.>

[146] *See* Cadwalader Letter at 6.

[147] *See* SIFMA Letter at 32.

participant will >no longer be engaged in risk-mitigating hedging activities in connection with such position or holding.<

As an alternative to the first and second conditions, one commenter suggested a condition that the hedging activity relates to an ABS, or any asset or assets supporting or referenced by an ABS, issued under an established and documented risk mitigation program established by the original sponsor of such asset-backed security.[457] We do not believe that this alternative would be appropriate because the suggested alternative condition fails to specify that the relevant activity cannot result in an overhedged position that constitutes a bet against the relevant ABS or the asset pool supporting or referenced by such ABS. This is the exact type of activity that the rule is intended to prohibit.

b. **Compliance Program Requirement**

We are ~~proposing in~~ **adopting 17 CFR 230.192(b)(1)(ii)(C) ("**Rule 192(b)(1)(ii)(C) ~~that~~**") as proposed. Therefore,** the third condition to the exception ~~be~~**is** that the securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements applicable to the exception, including reasonably designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored. This ~~proposed~~ condition is designed to promote robust compliance efforts and to help ensure that activity that would qualify for the ~~re-proposed~~ exception is indeed risk-mitigating while also recognizing that securitization participants are positioned to determine the particulars of effective risk-mitigating hedging activities policies and procedures for their own business. **Additionally, as discussed in Section IV, this condition**

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[457] ***See*** **letter from IACPM.**

will enhance the benefits of the rule by assuring investors that a securitization participant is less likely to engage in activities that are prohibited by Rule 192 if it has a program to monitor ongoing compliance with the rule. We believe it is important that reasonably designed written policies and procedures provide for the specific risk and the risk-mitigating hedging activities to be identified, documented, and monitored to help facilitate the securitization participant's compliance with the conditions specified in ~~proposed~~ Rule 192(b)(1)(ii)(A) and **Rule 192(b)(1)(ii)**(B), which require that the risk-mitigating hedging activity be tied to such risks at inception and over the time period that the prohibition of the ~~re-proposed~~ rule would apply~~. While we recognize that this documentation requirement may result in certain costs,[148] we believe that this requirement would promote compliance with the re-proposed rule.~~ **and that the activity be subject to ongoing recalibration as appropriate, as discussed above.**

A number of commenters expressly supported including a compliance program requirement.[458] However, one commenter stated that the potential confusion regarding this requirement would undercut the ability of securitization participants to rely on the exception and that it is not clear that such condition is within the scope of the congressional intent of Section 27B.[459] Other commenters also stated that the compliance program condition would be unnecessarily burdensome and have the potential to create unintended consequences.[460] In subsequent letters, certain of these commenters requested that the condition should be rephrased so that the compliance program is required to be reasonably designed to "result in" compliance with the requirements of the exception rather than to "ensure" compliance with those

[458] ***See*** **letters from AARP; Better Markets.**

[459] ***See*** **letter from ABA.**

[460] ***See*** **letters from AFME (supporting SIFMA's suggestions); SFA I (expressing concern that the proposed compliance program requirement would apply to a broader range of entities that those subject to the Volcker Rule); SIFMA I (initially suggesting that the compliance program be deleted in its entirety).**

requirements and that the policies and procedures of a securitization participant should not provide for the monitoring of the risk-mitigating hedging activity.[461]

In response to the comment that the compliance program condition would undercut >the ability of a securitization participant to <rely on the exception and that it is not clear that such condition is within the scope of the congressional intent of Section 27B, we recognize that certain securitization participants may need to create a new compliance program to comply with this condition and that this may result in increased compliance costs. However, Section 27B(b) requires that the Commission adopt rules to implement the prohibition in Section 27B(a) against a securitization participant engaging in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of the ABS activity of a securitization participant. The compliance program condition is necessary to help ensure that the activities of a securitization participant relying on the risk-mitigating hedging activities exception are indeed risk-mitigating hedging activities, and not the type of transactions that >would involve or result in a material conflict of interest <between a securitization participant for an ABS and an investor in such ABS. Given that the ABS exposures of a securitization participant and the financial instruments that are utilized to hedge such exposures can be inherently complex, requiring a securitization participant to establish and enforce an internal compliance program will help that entity adequately evaluate and track its ABS exposures and monitor its hedging activity in a way that is reasonably designed to help prevent violations of the rule. Similarly, given that the exposure of a securitization participant can change over time, we continue to believe that it is necessary that securitization participants develop reasonably designed policies and procedures regarding their risk-mitigating hedging activities that provide

[461] ***See*** **letters from SFA II; SIFMA II.**

for the specific activities to be monitored on an ongoing basis. We also believe that it is important for this condition to apply to all securitization participants that seek to rely on this exception given that the focus of Section 27B is investor protection.

However, to avoid imposing a one-size-fits-all requirement that may unduly burden securitization participants that are different in size or that make markets in different financial instruments, this condition recognizes that a securitization participant that engages in risk-mitigating hedging activity is well positioned to design its own individual internal compliance program to reflect the size, complexity, and activities of the securitization participant. This should help ease compliance costs as the relevant securitization participant can tailor its compliance program to its particular business model. As a general matter, we recognize that costs of the final rule potentially may have a proportionally greater effect on small entities, as such costs may be a relatively greater percentage of the total cost of operations for smaller entities than larger entities, and thus small entities may be less able to bear such costs relative to larger entities. However, the potentially less complex securitization activities of small entities and their correspondingly less complex compliance considerations may counterbalance such costs as compared to larger and more diversified securitization participants. In addition, the changes discussed above to refine the scope of >the definition of "conflicted transaction" <**and the scope of covered affiliates and subsidiaries are designed to ease the compliance program burden on securitization participants by narrowing the scope of the types of transactions and relevant entities that are subject to the rule's prohibition.[462] This should also reduce the cost of**

~~148~~ 462 *See* Section ~~IV.~~ **II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) and provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction) and**

Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as

developing policies and procedures regarding the risk-mitigating hedging activity that provide for the specific activity to be identified, documented, and monitored over time.

In response to comments that the compliance program requirement should specify that it would only apply to any securitization participant utilizing the exception,[463] adding that language would be redundant. Rule 192(b)(1)(ii)(C) sets forth a condition to utilizing the exception in Rule 192(b)(1)(i) and does not separately >require that a securitization participant <**satisfy the compliance program requirement if it is not utilizing the exception.**

As described above, certain commenters stated that the compliance program condition should be revised to provide that such program is reasonably designed to "result in" a securitization participant's compliance with the requirements of the exception rather than to "ensure" such securitization participant's compliance because the word "ensure" could be inconsistent with a reasonably designed standard[464] We are adopting the condition as proposed. The reasonably designed to "ensure" formulation is used in numerous other Commission rules, including a similar condition to the risk-mitigating hedging activities to the Volcker Rule.[465] Furthermore, we do not believe that the "ensure" formulation is inconsistent with the rule's "reasonably designed" standard as the two components will work together to require that a securitization participant designs a sufficiently detailed internal compliance program that promotes compliance with the requirements applicable to the exception.

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defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).

463 ***See*** **letters from SFA II; SIFMA II.**

464 ***See*** **letters from SFA II; SIFMA II. These commenters did not also address the same concerns regarding the similar formulation** >of the compliance program condition <**to the** >bona fide market-making activities exception.<

465 ***See, e.g.*****, 17 CFR 255.5(b)(1)(i), 17 CFR 240.17g-8(a), 17 CFR 240.15Fh-5(b), 17 CFR 240.15c3-5(c)(2).**

~~We received a comment to the 2011 proposed rule that any securitization participant~~ **One commenter suggested that any securitization participant** relying on the ~~proposed~~ exception for risk-mitigating hedging activities should be required to affirmatively certify that it is undertaking such activity for the sole purpose of hedging a risk arising in connection with its securitization activities~~,~~ and not for the purpose of generating speculative profits.[1a9] ~~We did not include a certification requirement in the proposed exception, but we seek comment below on whether a certification requirement would be appropriate, and if so, what form such a certification should take and when it should be required to be made. *Request for Comment*~~[466] **Certain commenters also suggested that a responsible party at the securitization participant should be required to certify the effectiveness of the applicable written policies and procedures prior to their implementation and on an ongoing basis.**[467] **Consistent with the discussion of this in the Proposing Release, we did not include certification requirements in the final rule because we believe that the conditions to the risk-mitigating hedging activity exception are sufficiently robust to prevent the exception from resulting in conflicted transactions in contradiction to Section 27B's prohibition.**

~~69. Is the scope of the proposed risk-mitigating hedging activities exception appropriate, or is it overinclusive or underinclusive, and why? Please provide specific examples of any activity that should be included in or excluded from the scope of the exception and provide a justification as to why and how such inclusion or exclusion would be consistent with Section 27B.~~

~~70. Should any of the proposed <conditions applicable to the risk-mitigating hedging activities exception >be modified? If yes, please provide the suggested modification and explain how such modification <is consistent with Section 27B.>~~

~~71. Is the condition in proposed Rule 192(b)(1)(ii)(A) that risk-mitigating hedging activities must be <designed to reduce or otherwise significantly mitigate one or more >"specific,~~

identifiable risks" <arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant >appropriate? Please explain why or why not. Is there sufficient clarity as to what risks are "specific" and "identifiable" for

[189] *See* Better Markets Letter at 11.

purposes of this condition? If not, please identify any specific indicia that should be included or referenced for purposes of this determination.

72. Should the proposed condition regarding a securitization participant's ongoing recalibration of its hedging activities specify how frequently a securitization participant should do such recalibrating? Should the proposed condition specify certain thresholds or triggers for such recalibration? What are the implications for a securitization participant if its hedge counterparty refuses to adjust the hedge?

73. Is it appropriate that the proposed risk-mitigating hedging activities exception would allow for the relevant hedging activity to be conducted on an aggregated basis? Are there any particular evasion concerns that could arise with respect to this approach?

74. Should the proposed risk-mitigating hedging activities exception require that a risk-mitigating hedge have an exact negative correlation with the exposure being hedged? If so, and if exact negative correlation were impossible, should the exception require that a securitization participant relying on the exception provide a certification explaining why exact negative correlation was impossible? If so, what form should such a certification take, and why? For example, should the certification be required to be filed with, or otherwise furnished to, the Commission, or should it instead be required to be retained in the files of the securitization participant in accordance with its written policies and procedures? Should the exception require that such certification be made by the chief executive officer and chief compliance officer of the securitization participant as suggested by a commenter to the 2011 proposed rule,[150] or would it be more appropriate for the certification to be made by some other officer of the securitization participant that

[150] *See* Better Markets Letter at 11.

~~is more familiar with the transaction or transactions at issue and the securitization participant's risk-mitigating hedging activities generally (*e.g.*, the head of the relevant trading desk)? In your responses to each of these questions, please explain why or why not. Please also explain whether such a requirement would be attainable or practical for securitization participants, and how such a requirement would be consistent with Section 27B.~~

~~75. As discussed above, certain of the proposed conditions to the proposed risk-mitigating hedging activities exception are similar to those that are applicable to the equivalent exception to the Volcker Rule's proprietary trading prohibition.[151] What are the potential benefits and drawbacks to having conditions similar to the Volcker Rule prohibition? Should a securitization participant that is in compliance with the conditions applicable to the equivalent Volcker Rule exception be deemed to be presumptively in compliance with the proposed conditions applicable under <the risk-mitigating hedging activities exception to >the re-proposed rule? Are there entities <that are not subject to the Volcker >Rule's proprietary trading prohibition and/or the associated compliance requirements, including smaller securitization participants, that would seek to avail themselves of the risk-mitigating exception to the re-proposed rule and that would be meaningfully disadvantaged by this approach? If so, please explain why and suggest an alternative approach that would be consistent with Section 27B. If your suggested alternative approach includes different compliance requirements for different types of entities, please explain how any such entity types should be defined for purposes of your suggested alternative approach.~~

~~[151] *See* 17 CFR 255.5.~~

76. Should the proposed risk-mitigating hedging activities exception require a securitization participant relying on the exception to affirmatively certify that it is undertaking such activity for the purpose of hedging a risk arising in connection with its securitization activities and that it has complied with the relevant conditions in the re-proposed rule? If so, what form should such a certification take, and when should it be required to be made? For example, should the certification be required to be filed with, or otherwise furnished to, the Commission, or should it instead be required to be retained in the files of the securitization participant in accordance with its written policies and procedures? Should the certification requirement permit a securitization participant to make the required certification on a periodic basis with respect to all risk-mitigating hedging activity occurring during that period, and if so, how frequently should the certification be required to be made? Please explain whether and how such a certification requirement would be practical for securitization participants given that the proposed exception would permit hedging conducted <in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant arising out of its securitization activities, including >its <origination or acquisition of assets >in anticipation of securitization.

77. Should any additional conditions apply to the proposed risk-mitigating hedging activities exception? If yes, please provide a specific description of any such additional condition and how such additional condition would be consistent with Section 27B.

78. Are the proposed <conditions of the risk-mitigating hedging activities exception >adequate to address any potential misuse and evasion of the exception? What are the ways in which a securitization participant could attempt to utilize the proposed exception in order

to disguise speculative activity as risk-mitigating hedging? Are any such concerns about potential misuse or evasion of the exception adequately mitigated by the anti-circumvention provision in proposed Rule 192(d)? Should an explicit anti-abuse provision be added as a condition to the proposed exception requiring that "the hedging activity must not be conducted or designed to evade the requirements" of proposed Rule 192, or would such a provision be unnecessary because of the anti-circumvention language in proposed Rule 192(d)?

79. Is the proposed condition <applicable to the risk-mitigating hedging activities exception >regarding compliance and monitoring appropriate? Should such a condition include more or less stringent requirements? The proposed condition requires reasonably <designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored. >Is there sufficient clarity as to what risks are specific and identifiable at the outset of the risk-mitigating hedging activity? If not, please explain what further guidance or clarification would be helpful in this context. Please identify any additional conditions that should be required as part of the compliance program condition.

80. Should smaller securitization participants be exempt from certain elements of the compliance program condition, such that those elements of the condition would apply only to securitization participants with significant trading assets and liabilities similar to the equivalent exception <to the Volcker Rule, or >should all elements of the compliance program condition apply to all securitization participants in order to adequately protect ABS investors? Alternatively, should the implementation of the compliance program

~~requirement applicable to smaller securitization participants be delayed in order to give such entities more time to comply with the requirement? Why or why not? In your responses, please explain how "smaller securitization participant" should be defined for purposes of any such exemption or delayed implementation.~~

~~81. Are there other potential positive or negative consequences of the proposed risk-mitigating hedging activities exception? How might the proposed risk-mitigating hedging activities exception impact affiliates or subsidiaries of a securitization participant? What investment strategies of affiliates or subsidiaries might be impacted, and how might they be impacted? In particular, how might the proposed exception impact the hedging strategies of affiliated private funds and/or their investment advisers?~~

F. Exception for Liquidity Commitments

1. Proposed Approach

~~Section 27B(c)~~ **The Commission proposed to implement the exception for liquidity commitments in Section 27B(c) by proposing that the prohibition in proposed Rule 192(a) would** >not apply when a securitization participant engages <**in** >purchases or sales of ABS made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for the relevant ABS. <**This approach was consistent with Section 27B(c), which** provides that the prohibition in Section 27B(a) does not apply to purchases or sales of ABS made pursuant to**,** and consistent with**,** commitments of the underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, to provide liquidity for the ABS.[152] ~~Consistent with Section 27B(c)(2)(A), we are proposing in~~ [468]

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[466] ***See*** **letter from Better Markets.**

[467] ***See*** **letters from AARP; Better Markets.**

[468] >15 U.S.C. 77z-2a(c)(2)(A).<

Comments Received

2. ~~proposed Rule 192(b)(2) that the prohibition would not apply when a securitization participant engages in purchases or sales of ABS made~~**A number of commenters supported the proposed exception to exclude transactions** pursuant to~~,~~ and consistent with~~,~~ commitments ~~of the securitization participant~~ to provide liquidity for the relevant ABS. ~~We received comments in response to the 2011 proposed rule that~~**One commenter specifically supported limiting** the exception ~~should permit commitments to provide liquidity through means other than~~ **to "**purchases and sales**"** of ABS.~~[153] We~~ **on the basis that such approach** >would be consistent with Section 27B<**(c).[469] Another commenter supported the Commission statement in the Proposing Release that the prohibition** >in proposed Rule 192(a) would <**not apply to liquidity commitments that promote the full and timely interest payment to ABS investors.[470] One commenter requested that the Commission confirm that "dollar roll" transactions for Enterprise mortgage-backed securities would fall within the exception for liquidity commitments.[471]**

~~[152] <15 U.S.C. 77z-2a(e)(2)(A).>~~

~~[153] *See, e.g.*, ICI Letter at 7-9 (stating that the exception should encompass those liquidity arrangements that are typical in the marketplace <for asset-backed commercial paper ("ABCP") >and that <the rule should specify that >liquidity may be provided through means other than just purchases and sales of ABS); ASF Letter at 26-27 (stating that various forms of liquidity commitments operate to support the relevant ABS and thus serve a valid and important market function that should be permitted by the rule).~~

Final Rule

We are adopting the >exception for liquidity commitments in <**17 CFR 230.192(b)(2) ("Rule 192(b)(2)") as proposed. Specifically, under the final exception, purchases or sales of the relevant ABS made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for such ABS are not prohibited by the final rule. We** understand that commitments to provide liquidity may take a variety of forms in addition to purchases and sales of the ABS, such as commitments to promote full and timely interest payments to ABS investors or to provide financing to accommodate differences in the payment dates between the

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469 ***See*** **letter from Better Markets.**

470 ***See*** **letter from ICI (noting that its concern regarding typical liquidity arrangements** >for asset-backed commercial paper ("ABCP") <**markets would be addressed by the Commission's example that commitments to promote full and timely interest payments to ABS investors would meet the liquidity commitment exception).**

471 ***See*** **letter from Fannie and Freddie.**

ABS and the underlying assets.[154] ~~However, expanding the exception for liquidity commitments to accommodate such activities should not be necessary as the definition of "conflicted transaction" discussed above is already appropriately focused on transactions that constitute a bet against the relevant ABS and would not encompass activity~~[472] **As discussed above in Section II.D.3.,** such as an extension of credit by a securitization participant that functions to support the performance of the securitization rather than to benefit from its adverse performance~~.~~ ~~We received comments in response to the 2011 proposed rule that a broad application of the exception could give rise to abusive conduct if a vast range of activities would qualify for the exception.[155] Without taking a position on whether the specific transactions cited by these commenters would constitute "conflicted transactions" as defined in proposed Rule 192(c), we agree as a general matter that an overly broad application of the exception could give rise to abusive conduct. We are accordingly proposing to limit the exception to purchases and sales of the ABS made pursuant to, and consistent with, commitments of the~~ **will not be a conflicted transaction under the final rule. Therefore, a** securitization participant ~~to provide liquidity for the ABS, consistent with the language of Section 27B(c)(2)~~**will not need to rely on any exception to the rule to enter into such extension of credit**.

With respect to the commenter who raised concerns about "dollar roll transactions," in the context of the Enterprise ABS market, we understand that dollar roll transactions are utilized as a form of short-term financing that are similar to a repurchase agreement; however, unlike a typical repurchase agreement, a similar security may be returned to the seller rather than the original security.[473] As adopted, the liquidity commitments exception will apply when a securitization participant engages in purchases or sales of Enterprise >ABS made pursuant to, and consistent with, <>commitments of the securitization participant to provide liquidity for the <**relevant ABS**>. To the extent that the <**purchases and sales of the relevant Enterprise ABS** >in a dollar roll transaction <**are**

consistent with a commitment of the securitization participant to provide liquidity for the relevant ABS, then such dollar roll transaction will be eligible for the liquidity commitment exception.

As described above in Section II.D.3., one commenter expressed a concern that using the phrase >"directly or indirectly" in proposed Rule 192(a)(<**1) could be potentially interpreted to create a misalignment between the scope of the entities subject to the prohibition and the scope**

~~154~~ 472 For example, a sponsor of ABCP may provide a liquidity facility if a tranche of $3 million of the ABCP matures on the 30th day of the month, yet only $2 million of the underlying receivables match that maturity. If there is an inability to repay the $1 million shortfall by issuing new commercial paper, the sponsor may provide a loan secured by the receivables to provide for the $1 million shortfall.

~~155 *See* Better Markets Letter at 12-13 (stating that it is possible that loan transactions could be structured with terms the would significantly benefit the lending entity upon default or poor performance of the assets); Merkley-Levin Letter at 18-19 (referring to the example of a collateral put provider for a synthetic securitization refusing to acquire new CDS collateral); Tewary Letter 1 at 11-12 (referring to an example of a placement agent structuring a loan transaction in order to effectively be <a short position with respect to the relevant ABS>).~~

473 ***See* Financial Accounting Manual for Federal Reserve Banks, Jan. 2017, Paragraph 40.13, Board of Governors of the Federal Reserve System, available at https://www.federalreserve.gov/federal-reserve-banks/fam/chapter-4-system-open-market-account.htm.**

We <also received a comment that the >term "commitment" should be defined to mean a contractual obligation to provide liquidity.[156] Consistent with Section 27B, however, the re-proposed exception does not require that a liquidity commitment take the form of a contractual obligation. We seek further commenter input on this issue below.

Request for Comment

82. Is the proposed scope of the liquidity commitments exception appropriate, or is it overinclusive or underinclusive? Is further guidance or clarification necessary regarding the meaning of the term "commitment" or the scope of permissible liquidity commitments? Why or why not?

83. Should the proposed exception for liquidity commitments apply only to purchases and sales of the <ABS made pursuant to, and consistent with, >the <commitments of the securitization participant to provide liquidity for the >ABS, as proposed, or should the exception apply to activity other than purchases and sales of the ABS, such as a commitment to provide loans pursuant to a liquidity facility, and why?

84. In addition to the examples provided above, are there other activities that should be covered by the re-proposed exception for liquidity commitments? If so, please describe those activities and explain how such activities would satisfy the requirements of the re-proposed exception.

85. Should the Commission require that a commitment be evidenced by a contractual obligation? Please discuss whether such contractual obligations are a current practice and if there are particular benefits or drawbacks to including such a requirement.

[156] *See* AFR Letter at 9.

of the exceptions to the rule that apply to the activities of a securitization participant.[474] The final rule does not prohibit a securitization participant from utilizing an affiliate or subsidiary as an intermediary for the purpose of fulfilling its liquidity commitment obligations with respect >to the relevant ABS. This <**is because the liquidity commitments exception is available to a "securitization participant," which is defined to include not only** >the underwriter, placement agent, initial purchaser, or sponsor of <**an ABS but also any affiliate or subsidiary who is acting in coordination with such person or who has access to or receives information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS. For example, it is not inconsistent with the exception for liquidity commitments in Rule 192(b)(2) for an entity that it is an underwriter, placement agent, initial purchaser, or sponsor with respect to an ABS under the final rule to provide liquidity for the ABS by causing one of its subsidiaries to engage in** >purchases and sales of the relevant ABS<**.**

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~~86. We received a comment to the 2011 proposed rule inquiring if "dollar roll" transactions in the Enterprise ABS market would qualify for the liquidity commitments exception.[157] Please explain if the Commission should specify in the re-proposed rule that dollar roll transactions in the MBS market or other similar transactions would be <purchases or sales of ABS made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for the relevant ABS. >Please address if such transactions are effected primarily for financing or operational reasons or if such transactions are effected for other purposes.~~

~~87. Could the proposed <exception for liquidity commitments in >the re-proposed rule result in any adverse consequences? If yes, please explain.~~

Exception for Bona Fide Market-Making Activities

Proposed Approach

~~Section 27B(c)~~ **The Commission proposed to implement the exception for bona fide market-making activity in Section 27B(c) by proposing that the prohibition in proposed Rule 192(a), subject to specified conditions, would not apply to** >certain bona fide market-making activities conducted by a securitization participant<**. This approach was consistent with Section 27B(c), which** provides that the prohibition in Section 27B(a) does not apply to purchases or sales of ABS made pursuant to and consistent with bona fide market-making in the ABS.[158] ~~Consistent with Section 27B(c)(2)(B), we are proposing in Rule 192(b)(3) an exception for <certain bona fide market-making activities conducted by a securitization participant >that is <licensed or registered to engage in >such activities in accordance with applicable law <and self-regulatory organization ("SRO") rules>.~~[475] Subject to specified conditions, the proposed exception would apply to bona fide market-making activity, including ~~market-making~~ **market-**

[474] ***See*** **letter from SIFMA II.**

[475] >15 U.S.C. 77z-2a(c)(2)(B)<.

making related hedging, of a securitization participant conducted in connection with and related to an ABS, the assets underlying such ABS, or financial instruments that reference such ABS or underlying assets. In order to distinguish permitted bona fide market-making activity from prohibited conflicted

~~157 *See* Fannie Mae Letter at 5 (stating that, <in a dollar roll transaction>, an investor commits to sell a security at a specified price and to purchase a similar security at a lower price on a specified date in the future).~~

~~158 <15 U.S.C. 77z-2a(e)(2)(B).>~~

transactions, ~~we are proposing to include~~**the Commission proposed the following** five conditions that ~~must~~**would need to** be satisfied in order for a securitization participant to rely on the bona fide market-making activities exception~~. Each of these conditions is <discussed in further detail below.>~~[159]**:**

~~The requirements of the proposed <bona fide market-making activities exception >draw from the concept of market-making in both the Volcker Rule, designed to ensure that banking entities may continue to function <in less liquid and illiquid markets>,~~[160] ~~as well as 15 <U.S.C. 78c(a)(>38), which defines "market maker" for purposes of the Exchange Act.~~[161] ~~In each context the parameters of what constitutes market-making are adapted to the characteristics of the~~

~~159 We received a comment to the 2011 proposed rule seeking clarification as to whether eligibility for the bona fide market-making exceptions of 17 CFR 242.200 through 204 ("Regulation SHO") would be relevant to the bona fide market-making activities exception for ABS securitizations. SIFMA Letter at 34-35. The proposed bona fide market-making activities exception for purposes of the re-proposed rule and the bona fide market-making exception of Regulation SHO are designed to address different circumstances with different purposes<. Activity that might be bona fide market-making activities for purposes of >the re-proposed rule <may not be bona fide market-making for purposes of other rules, including Regulation SHO, and vice versa. >For example, Regulation SHO's bona fide market-making exceptions are intended to be narrow exceptions to allow market makers to facilitate customer orders in a fast moving market without possible delays associated with complying with the Regulation SHO "locate" requirement. *See, e.g.*, *Amendments to Regulation SHO*, Release No. 34-58775 (Oct. 14, 2008) [73 FR 61690 (Oct. 17, 2008)] ("2008 Regulation SHO Amendments") at 61698; *Short Sales*, Release No. 34-50103 (Jul. 28, 2004) [69 FR 48008 (Aug. 6, 2004)] ("2004 Short Sales Release") at 48015 n.67. For example, for purposes of the Regulation SHO exception, factors that indicate a market maker is engaged in bona fide market-making include whether the market maker incurs economic or market risk for a quotation with respect to a security. 2008 Regulation SHO Amendments at 61699. Thus, a market maker that continually executed short sales away from its posted quotes would generally be unable to rely on the bona fide market-making exceptions of Regulation SHO. *See* 2004 Short Sales Release at 48015 n.68. Further, broker-dealers that publish quotations but fill orders at different prices than those quoted would not be engaged in bona fide market-making for purposes of Regulation SHO. *See, e.g.*, *<Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer*, Release No. >34-94524 <(Mar. 28, 2022) [87 FR 23054 (Apr. 18, 2022)] (">Dealer Release") at 23068 n.157.~~

~~160 <*See Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds*, Release No. BHCA-1 (Dec. 10, 2013) [79 FR 5536 (Jan. 31, 2014)] >("Volcker Release") at 5584.~~

~~161 *See* Exchange Act Section 3(a)(38) (providing that "The term 'market maker' means . . . any dealer who, with respect to a security, holds himself out . . . as being willing to buy and sell such security for his own account on a regular and continuous basis."). *See also Self Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change Relating to Close-Out Requirements for Short Sales and an Interpretation on Prompt Receipt and Delivery of Securities*, Release No. 34-32632 (July 14, 1993) [58 FR 39072 (July 21, 1993)] at 39074 (stating that "a bona fide market maker is a broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security").~~

- **That the** >securitization participant routinely stands ready to purchase and sell <**one or more types of the financial instruments set forth in proposed 17 CFR 230.192(b)(3)(i) ("Rule 192(b)(3)(i)") as a part of its market-making related activities in such financial instruments, and is** >willing and available to quote, purchase and sell, or otherwise enter into long and short positions <**in those types of financial instruments, in** >commercially reasonable amounts and throughout market cycles <>on a basis appropriate for the liquidity, maturity, and depth of the market <**for the relevant types of such financial instruments;**
- **That** >the securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments<**;**

- **That the compensation arrangements of the persons performing the market-making activity of the securitization participant are** >designed not to reward or incentivize conflicted transactions<**;**
- **That the** >securitization participant would be required to <**be** >licensed or registered to engage in <**the relevant market-making activity, in accordance with applicable laws** >and self-regulatory organization ("SRO") rules<**; and**

financial instruments and markets involved. For example, under the Volcker Rule, which was adopted under <the Bank Holding Company Act, >the key elements of market-making in a security include that a banking entity "routinely stands ready" to purchase and sell, that it is "<willing and available to quote, purchase and sell, or otherwise enter into long and short positions >for its own account," and that such quoting and trading activity be in "<commercially reasonable amounts and throughout market cycles>, <on a basis appropriate for the liquidity, maturity, and depth of the market>."[162] Under the Exchange Act, a "market maker" is defined as "any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out . . . as being willing to buy and sell such security for his own account on a regular or continuous basis."[163] For example, Regulation SHO's bona fide market-making exceptions, which apply only to equity securities, apply a "regular and continuous basis" requirement to the relatively more liquid market for short sales in order to "facilitate customer orders in a fast moving market."[164] While drawing from both the Volcker Rule and Exchange Act definitions of market-making, the proposed bona fide market-making activities exception is intended to account for and accommodate the unique characteristics of ABS and the ABS market. Therefore, as discussed below, the proposed exception utilizes elements of Volcker Rule market-making given the limited liquidity and decreased reliance on quotation media in parts of the ABS market while adding novel characteristics to accommodate market-making in ABS and the transactions to which the exception can be applied.[165]

[162] 17 CFR 255.4(b)(2)(i).

[163] 15 <U.S.C. 78c(a)(>38).

[164] *See* 2004 Short Sales Release at 48015 n.67.

[165] Activity that would be <bona fide market-making activity under the >proposed exception may not necessarily be market-making for purposes of other laws or regulations, including the Volcker Rule, other provisions of the

- That the securitization participant would be required to have established and must implement, maintain, and enforce an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of the >bona fide market-making activities exception, including <reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of >the risks of its market-making positions and holdings<.

2. Comments Received

Most commenters that addressed this aspect of the final rule provided comments related to the proposed conditions to the exception. Certain commenters supported the proposed conditions.[476] Other commenters focused on the compliance program requirement and stated that it would be unduly burdensome and inappropriate.[477] In subsequent letters, certain of the commenters suggested that the compliance program requirement should only apply to any securitization participant utilizing or relying on the exception and that the license and registration requirement should only apply to a securitization participant to the extent that it is required to be licensed or registered to engage in market-making activity by applicable law and self-regulatory organization rules.[478] The Commission also received comments >that the bona fide market-making activities exception should <be available in the case of the initial distribution of an ABS.[479]

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476 *See* letters from AARP; Better Markets Letter.

477 *See* letters from ABA (stating that the compliance program requirement could be confusing); AIC (stating that compliance would be burdensome for organizations not already subject to the Volcker Rule).

478 *See* letters from SFA II; SIFMA II.

479 *See* letters from SFA II (focusing on synthetic ABS and suggesting the deletion of the exclusion of the initial distribution of an ABS from the >bona fide market-making activities exception<); SIFMA II

(stating that is unclear why the initial distribution of an ABS should not be considered bona fide market-making activity).

3. Final Rule

~~The prohibition < in proposed Rule 192(a) would > apply not only to < short sales of the relevant ABS, > but to a variety of conflicted transactions. For example, the prohibition would also extend~~ **We are adopting the bona fide market-making activities exception largely as proposed, with a technical modification from the proposal to one of the conditions as** >discussed in further detail below. <**Consistent with Section 27B, we are adopting a** >bona fide market-making activities exception <**that is designed to distinguish permitted bona fide market-making activity from prohibited conflicted transactions, while permitting securitization participants to continue providing intermediation services** >in less liquid and illiquid markets<**. Specifically, subject to the specified conditions discussed in detail below, the final rule provides an exception for bona fide market-making activities, including market-making related hedging, of a securitization participant conducted in connection with and related to ABS with respect to which the prohibition in Rule 192(a)(1) applies, the assets underlying such ABS, or financial instruments that reference such ABS or underlying assets or with respect to which the prohibition in paragraph (a)(1) applies, except that the initial distribution of an ABS is not bona fide market-making activity for purposes of Rule 192(b)(3). Consistent with the proposed rule, because the prohibition in Rule 192(a)(1) extends** to transactions such as the purchase of a credit derivative with respect to the relevant ABS or the assets underlying the relevant ABS~~.[166] Therefore, limiting the proposed~~,[480] **the final** bona fide market-making activities exception ~~to only < purchases and sales of the relevant ABS >could result in an inconsistency between the scope of the prohibition and the scope of the exception. Accordingly, the proposed exception would apply~~**applies** to market-making in not only the ABS that ~~would~~**will** be subject to the prohibition of the ~~re-proposed~~**final** rule but, as described in ~~proposed~~ Rule 192(b)(3)(i), also the assets underlying such ABS as well as financial instruments that reference such ABS or the assets ~~underlying such~~

ABS; this <would capture CDS or other credit derivative products with payment terms that are tied to the performance of the ABS or its underlying assets. >This should address the concern of a commenter that if the proposed prohibition is to be applied to restrict transactions not only in the relevant ABS but also transactions in the underlying assets or related derivative exposures, then <the bona fide market-making activities exception >should be applied in a similar manner.[167] Although we received a comment <that the bona fide market-making activities exception should >not apply to market-making in CDS positions that reference

Exchange Act, or the rules and regulations thereunder, such as Regulation SHO, or self-regulatory organization rules.

[166480] Given the nature of the ABS market and that the scope of the prohibition of there proposed rulewould **will** prohibi

t transactions that include not only entering into a short sale of ABS but also entering into CDS on the relevant ABS or the asset underlying such ABS, we areproposing **specifying** that the bona fide market-making activities exceptionextend **extend**s to bona fide market-making activity in financial instruments, such as CDS on the relevant ABS, that are conflicted transactions under there proposed **final** rule. However, under there proposed **final** rule, if the "conflicted transaction" is a short sale of the relevant ABS, then, in order to rely on theproposed exception, such salewould **will** need to constitute bona fide market-making activity in such ABS. Similarly, if the relevant "conflicted transaction" is a purchase and sale of a CDS, then, in order to rely on the exception, such purchase and salewould **will** need to constitute bona fide market-making activity of the securitization participant in such CDS.

[167] Morgan Stanley Letter at 10.

underlying such ABS. This >would capture CDS or other credit derivative products with payment terms that are tied to the performance of the ABS or its underlying assets. <**Consistent with this reasoning, the final bona fide market-making activities exception will also apply to bona fide market-making in any other financial instrument with respect to which the prohibition in Rule 192(a)(1) applies. The addition of this language is designed to more appropriately align the text relating to the scope of the exception with the text relating to the scope of the categories of transactions that are captured by the definition of conflicted transaction. For example, as discussed in Section II.D.3., if a securitization participant engages in a CDS transaction with respect to a pool of assets with characteristics that replicate the idiosyncratic credit performance of the pool of assets that underlies the relevant ABS, then such CDS could be, depending on the facts and circumstances, a conflicted transaction that is prohibited by Rule 192(a)(1) even if it is not a financial instrument that directly references** >the assets underlying the ABS. <**Under** >the bona fide market-making activities exception<**, the relevant securitization participant may rely on the exception to engage in such CDS transaction if it satisfies the conditions to the exception.**

Consistent with the proposed rule, the initial issuance of an ABS does not qualify as >bona fide market-making activity under the <**final exception in Rule 192(b)(3). This means that a securitization participant is not able to rely on the adopted exception for bona fide market-making activities in** >ABS for primary market activities, such as issuing a new synthetic ABS.<[481] **As explained above in Section II.E.3., initial issuances of ABS, including new synthetic ABS, can be eligible for the risk-mitigating hedging activity exception.**

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[48]>[1] Furthermore, the activity would not qualify for the<> exception because even if the securitization participant purchased the CDS protection (*i.e.*, a short position) purportedly as part of its market-making activity, the creation and sale of the new ABS is primary, not secondary, market activity<.

Certain commenters requested >the bona fide market-making activities exception be <available in the case of the initial distribution of an ABS.[482] One of these commenters stated that it is unclear why the initial distribution >of an ABS would not be <considered bona fide market-making activity and that the concerns of the Commission regarding an initial distribution of an ABS set forth in the Proposing Release would already be addressed by the various conditions applicable to the exception and the proposed anti-circumvention provision.[483]

As explained above in Section II.D.3., Rule 192(a)(3)(iii) captures, in relevant part, the purchase or sale of any financial instrument "(other than the relevant asset-backed security)" or entry into a transaction that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). The inclusion of the language "(other than the relevant asset-backed security)" is designed to specify that merely entering into an agreement to serve as a securitization participant with respect to an ABS and engaging in a purchase or sale of the ABS as an underwriter, placement agent, or initial purchaser for such ABS is not itself a conflicted transaction. Therefore, as explained above in Section II.D.3., the final rule is not designed to disincentivize an underwriter, placement agent, or initial purchaser from intermediating a synthetic ABS transaction for a customer, client, or counterparty where the securitization participant does not take a short position with respect to the investors in the relevant synthetic ABS. Accordingly, the sale of a synthetic >ABS to investors by an underwriter, placement agent, or initial purchaser <where such securitization participant does not take a short position in the

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[482] *See* letter from SFA II (focusing on synthetic ABS and suggesting that the bona fide market-making activities

exception should cover the initial distribution of an ABS); SIFMA II (stating that is unclear why the initial distribution of an ABS should not be considered bona fide market-making activity).

[483] *See* letter from SIFMA II.

relevant synthetic ABS is not a conflicted transaction and such activity does not need to be eligible for any exception to the final rule.

However, in cases where the securitization participant enters into a conflicted transaction as a component of the initial distribution of the synthetic ABS, we do not believe that it would be appropriate to allow that conflicted transaction to be eligible for the bona fide market-making activities exception. The relevant conflicted transaction in the context of the initial distribution of a synthetic ABS arises when a securitization participant engages in a transaction (such as >CDS contract(s) with the issuer) where cash paid by investors to acquire the newly created synthetic ABS would fund the relevant <>contract(s) and be available to make a payment to the securitization participant upon the occurrence of an adverse event with respect to <**the assets included in the reference pool. If such activity is not entered into for purposes of hedging an exposure of the securitization participant to the assets included in the reference pool in accordance with the** >conditions of the risk-mitigating hedging activities exception <**as described above, then such activity is a bet by the securitization participant against the performance of the relevant reference assets. This type of material conflict** >of interest with investors in the new synthetic ABS <**is** >the same as those raised by the synthetic CDO transactions that were the subject of Congressional scrutiny in connection with the financial crisis of <**2007-2009.[484] The final** >rule is designed to prohibit <**such conflicted transactions unless they are entered into for hedging purposes in accordance with the requirements of the risk-mitigating hedging activities exception, and they are accordingly not eligible for the bona fide market-making activities exception. In response to the comment that our concerns regarding these transactions could be addressed by the other**

[484] ***See*** **Wall Street and The Financial Crisis: Anatomy of a Financial Collapse, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, United States Senate (Apr. 13, 2011).**

conditions that were proposed for the bona fide market-making activities exception or by the anti-evasion provision, we do not believe that these other conditions are adequate to address our concerns >that these types of transactions <**can only be utilized for hedging purposes and cannot be utilized as a bet against the relevant ABS in the same way as they were during the financial crises of 2007-2009.** [485] **The conditions to the bona fide market-making activities exception do not require that the relevant transaction be entered into only for hedging purposes, and the anti-evasion provision does not set forth any standard that the relevant transaction be entered into only for hedging purposes.**

Some commenters generally stated that the requirements of the bona fide market-making activities exception would be confusing, unduly burdensome, and unnecessary.[486] **Although commenters did not explain what specific aspects of the requirements would be burdensome or confusing, we do not think that these conditions will be unduly difficult for securitization participants to satisfy, as discussed in further detail below. Furthermore, we believe that the conditions to the exception are necessary to distinguish permitted bona fide market-making activity from prohibited conflicted transactions. Without the inclusion of such conditions, the scope of the** >bona fide market-making activities exception could be <**susceptible to misuse by securitization participants and give rise to conflicted transactions in contradiction of Section 27B's prohibition.**

At the same time, we acknowledge the important role played by securitization participants that are market makers in less liquid financial instruments and that unduly burdensome conditions could potentially impede market-making activity in less liquid financial

[485] ***See* letter from SIFMA II.**

[486] ***See* letters from ABA; AIC.**

instruments. Consistent with the reasons stated in the Proposing Release, in order to not discourage such valuable activity, the conditions to the exception as adopted specifically take into account >the liquidity, maturity, and depth of the market for the relevant financial instruments<**, which may vary across different types of financial instruments. In response to the commenter that stated that the exception requires certain facts and circumstances determinations that may increase compliance costs,[487] we believe that considering the relevant facts and circumstances of the relevant market is necessary in order to avoid imposing an overly restrictive one-size-fits-all standard on market participants that may be confusing for market-makers with different business models to comply with and, as a result, unnecessarily impede market-making activity. As discussed in Section IV below, we acknowledge that a securitization participant availing itself of the exception will incur certain costs to do so.[488]**

~~the relevant ABS,[168] bona fide market-making activities in CDS positions where the relevant securitization participant is responding to customer demand does not implicate the <types of material conflicts of interest >the re-proposed <rule is designed to address >because the securitization participant is making a market in such positions for its customers rather than <betting against the relevant ABS >for its own account.~~

Furthermore, ~~the~~**as** proposed**, the adopted** bona fide market-making activities exception does not include a requirement to analyze the applicability of the exception on a trade-by-trade basis. ~~Similar to the Volcker Rule, the proposed~~[489] **The adopted** bona fide market-making activities exception **in 17 CFR 230.192(b)(3)(ii)(B) ("Rule 192(b)(3)(ii)(B)")** is instead focused on the overall market-making related activities of a securitization participant in assets that would otherwise be conflicted transactions, with a condition that those activities are related to

satisfying the reasonably expected near term demand of the securitization participant's customers. The ~~proposed~~**adopted** exception ~~is~~

[487] ***See*** **letters from AIMA/ACC.**

[488] ***See*** **Section IV.**

[489] **This approach differs from the requirements under Regulation SHO, whereby the market maker must be engaged in bona fide market-making in the security at the time of the short sale for which it seeks the exception. *See* Amendments to Regulation SHO, 34-58775, 73 FR 61690, 61699 n.103 (Oct. 17, 2008) (citing Rules 203(B)(1) and 203(B)(2)(iii) of Regulation SHO)**>. Activity that might be bona fide market-making activities for purposes of <**Rule 192** >may not be bona fide market-making for purposes of other rules, including Regulation SHO, and vice versa.<

also ~~designed~~**encompasses market-making related hedging in order** to give a securitization participant that is a market maker the flexibility to acquire positions that hedge ~~a~~**the** securitization participant's market-making inventory.

~~We received a comment to the 2011 proposed rule expressing concern that the 2011 proposed rule would prohibit hedging as part of permitted market-making, resulting in curtailed market-making and a reduction in market liquidity.[169] Under the re-proposed exception~~**As adopted**, hedging the risk of a price decline of ~~market-making related~~**market-making related** ABS positions and holdings while the market maker holds such ABS ~~would qualify for the re-proposed exception without the additional complexity of~~ **qualifies for the adopted bona fide market-making activities exception so long as the** >conditions of the bona fide market-making activities exception <**are satisfied. Therefore, with respect to such activity, a securitization participant does not need to** separately ~~needing to qualify for~~**rely on** the risk-mitigating hedging activities exception ~~in paragraph (b)(1)~~, which is principally designed to address the hedging of retained exposures rather than market-making positions that are entered into in connection with customer

~~[168] Tewary Letter at 12.~~

~~[169] *See* SIFMA Letter at 32.~~

demand. To facilitate monitoring and compliance, as discussed below in the context of the compliance program ~~requirement~~**condition in 17 CFR 230.192(b)(3)(ii)(E) ("Rule 192(b)(3)(ii)(E)")**, a securitization participant relying on the ~~proposed~~ exception for bona fide market-making activities ~~would be~~**is** required to have reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its positions and holdings~~. This approach is similar to that set forth in the Volcker Rule[170] and~~ **arising from its market-making activity. This** should allow securitization participants that are market makers to determine how best to manage the risks of their market-making activity without causing a reduction in liquidity, wider spreads, or increased trading costs for market makers and their customers.[490]

As described above in Section II.D.3., one commenter expressed a concern that using the phrase "directly or indirectly" in Rule 192(a)(1) could be potentially interpreted to create a misalignment between the scope of the entities subject to the prohibition and the scope of the

[490] **Market-makers will generally already have certain policies and procedures in place to promote compliance with other securities laws applicable to them.**

~~We also received comment to the 2011 proposed rule in support of grounding <the bona fide market-making activities exception >in the secondary market and excluding a securitization participant's initial recommendations and sales of a new ABS from qualifying for the exception.[171] This is consistent with the re-proposed exception under which the initial issuance <of an ABS would not be >bona fide market-making activity, which would mean that a securitization participant would not be able to rely on the re-proposed exception <for bona fide market-making activities in ><ABS for primary market activities, such as issuing a new synthetic ABS.>[172] This also is consistent with the view of a commenter that the exception should not~~

~~apply to taking a short position in a synthetic ABS that a securitization participant itself created.~~[173]

~~[170] See Volcker Release at 5581 n.588.~~

~~[171] See, e.g., Merkley Levin Letter at 20.~~

~~[172] < Furthermore, the activity would not qualify for the > re proposed < exception because even if the securitization participant purchased the CDS protection (i.e., a short position) purportedly as part of its market making activity, the creation and sale of the new ABS is primary, not secondary, market activity.>~~

~~[173] See, e.g., Merkley Levin Letter at 21.~~

We <also received comment that the >bona fide market-making exception should permit a securitization participant to issue a synthetic securitization and purchase the CDS protection through such issuance.[174] We are concerned, however, that such activity would weaken the conflicts of interest protection of the re-proposed rule by allowing a securitization participant to engage in a transaction (the <CDS contract(s) with the issuer) where cash paid by investors to acquire the newly created synthetic ABS would fund the relevant >CDS <contract(s) and be available to make a payment to the securitization participant upon the occurrence of an adverse event with respect to >a cash ABS that it created or sold to other investors. Furthermore, the integral role played <by a securitization participant in >structuring and/or marketing the relevant ABS and the compensation associated with such new issuance activity would go beyond the scope of secondary market bona fide market-making activity and could raise material conflicts <of interest with investors in the new synthetic ABS >that would be <the same as those raised by the synthetic CDO transactions that were the subject of Congressional scrutiny in connection with the financial crisis of >2007-2009.[175]

We also received comment to the 2011 proposed rule suggesting that the <bona fide market-making activities exception could be >strengthened to prevent misuse through an anti-abuse provision prohibiting use of the exception to circumvent the statutory prohibition.[176] The re-proposed rule does not include such an anti-abuse provision. Instead, the re-proposed rule sets forth certain conditions that would be required to be satisfied <in order for the exception to apply>, which is designed to permit only activity that is indeed bona fide market-making activity and not speculative activity disguised as market-making.

[174] *See* Morgan Stanley Letter at 13.

[175] *See* Senate Financial Crisis Report.

[176] *See* Merkley-Levin Letter at 21.

exceptions to the rule that apply to the activities of a securitization participant.[491] **The final rule does not prohibit a broker-dealer affiliate or subsidiary of a securitization participant from engaging in bona fide market-making activities. This is because** >the bona fide market-making activities exception <**is available to a "securitization participant," which is defined to include not only the** >underwriter, placement agent, initial purchaser, or sponsor of an ABS <**but also any affiliate or subsidiary who is acting in coordination with such person or who has access to or receives information about the relevant ABS or the asset pool underlying or referenced by the relevant ABS. For example, it is not inconsistent with the exception** >for bona fide market-making activities in <**Rule 192(b)(3) for a broker-dealer affiliate or subsidiary of an entity that is a securitization participant with respect to an ABS under the final rule to engage in bona fide market-making activity with respect to that ABS.**

Each of the specific conditions in Rule 192(b)(3) >applicable to the bona fide market-making activities exception <**is described in detail below.**

a. **Requirement to Routinely Stand Ready to Purchase and Sell**

~~We are proposing in Rule 192~~**The Commission did not receive comments to proposed 17 CFR 230.192**(b)(3)(ii)(A)~~ that~~**, and we are adopting it as proposed. Therefore,** the first condition to the **final** exception ~~be~~**is** that the securitization participant routinely stands ready to purchase and sell one or more types of the financial instruments set forth in ~~proposed~~ Rule 192(b)(3)(i) as a part of its market-making related activities in such financial instruments, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of such financial instruments. ~~However, similar to other rules,~~[177]

~~<the mere provision of liquidity >would not necessarily be <sufficient for a securitization participant to >qualify for the proposed <bona fide market-making activities exception.>~~[178]

[491] ***See*** **letters from SIFMA II.**

This "routinely stands ready" standard ~~is based on the standard set forth in the Volcker Rule[179] and would help ensure that the relevant market-making activity is indeed bona fide while also taking~~**takes** into account the actual liquidity and depth of the relevant market for ABS and financial instruments related to ABS described in ~~proposed~~ Rule 192(b)(3)(i), which may be less liquid than, for example, listed equity securities. This "routinely stands ready" standard, as opposed to a more stringent standard such as "continuously purchases and sells,"[~~180~~**492**] is designed

to avoid having a [~~177~~] ~~*See, e.g.*, discussion at note 159.~~

~~178 For example, because market makers typically provide liquidity on the opposite side of the market, if a security is experiencing significant downward price pressure, market makers engaged in bona fide market-making activities will tend to respond to market demand by buying not selling the security. *See, e.g.*, *Amendments to Regulation SHO*, Release No. 34-61595 (Feb. 26, 2010) [75 FR 11232 (Mar. 10, 2010)] at 11273-4. *See also* 2008 Regulation SHO Amendments at 61699 (stating that a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers would generally be an indication that a market maker is engaged in bona-fide market-making activity).~~

~~179 17 CFR 255.4(b)(2)(i).~~

~~180 <For example, under Regulation SHO's bona fide market-making >exceptions<, the relevant broker-dealer should generally be holding itself out as standing ready and willing to buy and sell the relevant security by>~~

~~to not have a~~ chilling effect on a person's ability to act as a market maker in a less liquid market. ~~We therefore preliminarily believe that the proposed~~**The** "routinely stands ready" standard is appropriate for bona fide market-making activities in ABS and related financial instruments described in ~~proposed~~ Rule 192(b)(3)(i) because market makers in such illiquid markets likely do not trade continuously but trade only intermittently or at the request of customers.

However, ~~this proposed~~ >the mere provision of liquidity <**is not necessarily** >sufficient for a securitization participant to <**satisfy this condition. This** condition is ~~also~~ designed to help ensure that activity that ~~would~~**will** qualify for the exception in the ~~re-proposed~~**final** rule ~~would~~**will** not apply to a securitization participant only providing quotations that are wide of (in comparison to the bid-ask spread) one or both sides of the market relative to prevailing market conditions. In order to satisfy this condition, the securitization participant ~~would need~~**needs** to have an established pattern of providing price quotations on either side of the market and a pattern of trading with customers on each side of the market. Furthermore, a securitization participant ~~would need~~**needs** to be willing to facilitate customer needs in both upward and downward moving markets and not only when it is favorable for the securitization~~< participant to do so in order for it to "routinely stand ready" to purchase and sell the relevant financial instruments throughout >market cycles. <This approach is consistent with >certain comments received on the 2011 proposed rule that securitization participants must be willing to buy and sell throughout market cycles, including market cycles with adverse market~~

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[492] >For example, under Regulation SHO's bona fide market-making< **exceptio**>n, the relevant broker-dealer should generally be holding itself out as standing ready and willing to buy and sell the relevant security by< continuously posting widely disseminated quotes that are near or at the market, and must be at economic risk for such quotes. *See* 2008 Regulation SHO Amendments at 61690, 61699 (citing indicia including whether the market maker incurs any economic or market risk with respect to the securities (*e.g.*, by putting~~their~~ **its** own capital at risk to provide continuous two-sided quotes)); *see also*> Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, Release No.< **34-94524**> (Mar. 28, 2022) [87 FR 23054 (Apr. 18, 2022)] (<"Dealer Releas~~, *supra* note 159~~,**e"**) at 23068 n.157 (stating that broker-dealers that do not publish continuous quotations, or publish quotations that do not subject the

broker-dealer to such risk (*e.g.*, quotations that are not publicly accessible, are not near or at the market, or are skewed directionally towards one side of the market) would not be eligible for the bona fide~~market maker exceptions~~ **market-making exception** under Regulation SHO).

~~conditions[181] and not simply take a position on one side of the~~ >participant to do so in order for it to "routinely stand ready" to purchase and sell the relevant financial instruments throughout <market **cycles**.[182] ~~-~~ Also, in this context, "commercially reasonable" amounts ~~would mean, similar to the equivalent concept in the Volcker Rule,[183]~~**means** that the securitization participant ~~would need to~~**must** be willing to quote and trade in sizes requested by market participants in the relevant market. This ~~would be~~**is** indicative of the securitization participant's willingness and availability to provide intermediation services for its clients, customers, or counterparties that is consistent with bona fide market-making activities in such market.

b. Limited to Client, Customer, or Counterparty Demand Requirement

~~We are proposing in~~**The Commission did not receive comments to proposed** Rule 192(b)(3)(ii)(B) ~~that~~**, and we are adopting it as proposed. Therefore,** the second condition to the **final** exception ~~be~~**is** that the securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments~~. This proposed condition is the same as that included in the Volcker Rule, which is designed to identify activity that is characteristic of~~ **discussed in Rule 192(b)(3)(i) (permitted** bona fide market-making ~~activity and not speculative trading while still allowing subject entities to continue to make a market across less liquid asset classes.[184] This is similar <to the purpose of the >condition <in the context of the >re-proposed rule, which~~**activities). The purpose of this condition** is to distinguish activity that is characteristic of bona fide market-making activities from a securitization participant entering into a conflicted transaction to bet against the relevant ABS for the benefit of its own account,

while still allowing securitization participants to make a market in ABS and the related financial instruments

[181] *See* Merkley-Levin Letter at 20; *see also* Better Markets Letter at 13.

[182] *See* Merkley-Levin Letter at 20.

[183] *See* Volcker Release at 5597.

[184] *See id.* at 5606.

described in ~~paragraph~~ **Rule 192**(b)(3)(i), which may be relatively illiquid. ~~In order to achieve these objectives, this would be~~**Under the final rule, this is** a facts and circumstances determination that is focused on an analysis of the ~~near term~~**reasonably expected near-term** demand of customers while also recognizing that the liquidity, maturity, and depth of the relevant market may vary across asset types and classes. The

recognition of these differences in the ~~proposed conditions~~**condition** should avoid unduly impeding a market maker's ability to build or retain inventory in less liquid instruments. The facts and circumstances that ~~would~~**will** be relevant to determine compliance with this ~~proposed~~ condition ~~would~~ include, but **are** not ~~be~~ limited to, historical levels of customer demands, current customer demand, and expectations of ~~near term~~**near-term** customer demand based on reasonably anticipated near term market conditions, including, in each case, inter-dealer demand. For example, a securitization participant facilitating a secondary market credit derivative transaction with respect to an ABS in response to a current customer demand ~~would~~**will** satisfy this ~~proposed~~ condition. However, if the securitization participant builds an inventory of CDS positions in the absence of current demand and without any reasonable basis to build that inventory ~~expected~~**based** on either historical demand or anticipated demand based on ~~excepted~~**expected** near term market conditions, there ~~would~~**will** be no reasonably expected near term customer demand for those positions and that transaction ~~would~~**will** fail to satisfy this ~~proposed~~ condition. ~~This condition to the re-proposed exception aligns with a comment received in response to the 2011 proposal stating that requiring activity to be client-driven can help avoid a securitization participant providing a cover for activity that is not client-driven but rather is a bet against an ABS, which is activity that would not be designed to meet reasonably expected near term demand. While we received comment that trading activity should be required to be "reasonably substantial relative to the size of the market for the securities" to qualify for a bona~~

c. Compensation Requirement

~~fide market-maker exception,[185] the re-proposed standard focusing on the relevant transactions being entered into based on the reasonably expected near term demand of the relevant market, and not solely on the size of the trade in relation to the size of the market, is a more appropriate standard for distinguishing between <bona fide market-making activities and >speculative trading. This is because it would be unclear what a trade being "reasonably substantial relative to the size of the market for the securities" would mean in the context of ABS markets where the relevant cumulative outstanding amount of securities for the relevant ABS type may exceed a trillion dollars.[186] Facilitating a trade in or related to a portion of an ABS tranche pursuant to a current client request should satisfy this condition even if the size of the trade is small relative to the overall outstanding principal amount of the relevant ABS issuance or the cumulative outstanding principal amount of the relevant ABS sponsored by the same person on an aggregated basis.~~ **~~Compensation Requirement~~**

~~We are proposing in Rule 192~~**The Commission received no comments regarding proposed 17 CFR 230.192**(b)(3)(ii)(C)~~ that~~**, and we are adopting it as proposed. Therefore,** the third condition of the **final** exception ~~be~~**is** that the compensation arrangements of the persons performing the market-making activity of the securitization participant are designed not to reward or incentivize conflicted transactions. ~~It~~**For example, it** would be consistent with this ~~proposed~~ condition if the relevant compensation arrangement is designed to reward effective and timely intermediation and liquidity to customers. It would be inconsistent with this ~~proposed~~ condition if the relevant compensation arrangement is instead designed to reward speculation in, and appreciation of, the market value

of market-making positions that the securitization participant enters into for the benefit of its own account. This approach is similar to that taken for purposes of the Volcker Rule.[187] ~~We seek comment below~~[493]

~~185. *See* AFR Letter at 9.~~

~~186. *See* Section III.~~

~~187. *See* Volcker Release at 5619.~~

~~on whether this condition should provide additional specificity regarding what it would mean for a compensation arrangement to be <designed not to reward or incentivize conflicted transactions>, including examples of acceptable and unacceptable compensation arrangements.~~

d. Registration Requirement

We are ~~proposing in Rule 192~~**adopting proposed 17 CFR 230.192**(b)(3)(ii)(D) **largely as proposed to provide** that the fourth condition of the exception ~~be~~**is** that the securitization participant ~~would be required to be~~**is** licensed or registered**, if required,** to engage in the relevant market-making activity, in accordance with applicable laws and SRO rules. This condition is designed to limit persons relying on the ~~proposed~~ exception for bona fide market-making activities to only those persons with the appropriate license or registration to engage in such activity in accordance with the requirements of applicable laws and SRO rules for such activity—unless the relevant person is exempt from registration or excluded from regulation with respect to such activity under applicable law and SRO rules.[~~188~~][494] **In a change from the proposal, the addition of the phrase "if required" specifies that** >a securitization participant that is <**so exempt from registration or excluded from regulation is still eligible to use the exception. This is also consistent with the suggestion of the comments that the Commission received with respect to this condition.**[495]

Persons engaged in market-making activity in the securities markets in connection with ABS may be engaged in dealing activity~~, and~~**. If** so, absent an exception or exemption, **these persons** are required to register as "dealers" pursuant to Section 15(a) of the Exchange Act, as "government securities dealers" pursuant to Section 15C of the Exchange Act, or as "~~security-based <swap dealers" pursuant to Section 15F(a) of the Exchange Act.>~~[~~189~~] ~~<A securitization participant that is a registered broker-dealer >would satisfy the~~**security-**

[493]>*See Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds*, Release No. BHCA-1 (Dec. 10, 2013) [79 FR 5536 (Jan. 31, 2014)]< **at 5619.**

~~188~~[494] For example, a person meeting the conditions of the *de minimis* exception in Exchange Act Rule 3a71-2 would not need to be a registered security-based swap dealer to act as a market maker in security-based swaps. *See* 17 CFR 240.3a71-2.

[495] ***See*** **letters from SFA II; SIFMA II; LSTA IV.**

based >swap dealers" pursuant to Section 15F(a) of the Exchange Act.<[496] >A securitization participant that is a registered broker-dealer <**will satisfy the market-making exception's registration condition.**[497] >Similarly, a securitization participant licensed as a bank or registered as a security-based swap dealer in accordance with applicable law <**will** >also be eligible for the exception.<

e. Compliance Program Requirement

We are adopting proposed Rule 192(b)(3)(ii)(E) as proposed. Therefore, the fifth and final condition to the exception is that the securitization participant is >required to have established and must implement, maintain, and enforce an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of the bona fide market-making activities exception, including reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its positions and holdings.<

~~189~~[496] *See*, *e.g.*, *Definition of Terms in and Specific Exemption for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, Release No. 34-46745 (Oct. 30, 2002) [67 FR 67496 (Nov. 5, 2002)] at 67498–67500; *see also Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,*" Release No. 34-66868 (Apr. 27, 2012) [77 FR 30596 (May 23, 2012)] at 30616-30619**. *See also* Dealer Release, *supra* note 492**.

~~market-making exception's registration condition.[190] <Similarly, a securitization participant licensed as a bank or registered as a security-based swap dealer in accordance with applicable law >would <also be eligible for the exception.>~~

~~Compliance Program Requirement~~

~~We are proposing in Rule 192(b)(3)(ii)(E) that the fifth and final condition to the exception be that the securitization participant would be <required to have established and must implement, maintain, and enforce an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of the bona fide market-making activities exception, including reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its positions and holdings. >This proposed condition is designed to help ensure that the activities of a securitization participant relying on the bona fide market-making activities exception are indeed bona fide market-making activities, and not the type of transactions that would involve or result in a material conflict of interest between a securitization participant for an ABS and an investor in such ABS. This condition also <recognizes that a securitization participant that is a market maker in ABS and related financial instruments described in paragraph (b)(3)(i) is well positioned to design its own>~~

~~190 Note, however, that the proposed~~[497] **The** bona fide market-making activities exception in the ~~re-proposed~~**final** rule is narrower than market-making activity that may require a person to register as a dealer. In other words, a securitization participant who does not meet all conditions of the ~~re-proposed~~ rule's bona fide market-making activities exception may still be required to register as a broker-dealer. *See id.*; *see also* 15 U.S.C. 78c(a)(38) (defining the term "market maker" to mean any specialist permitted to act as a *dealer*, any *dealer* acting in the capacity of block positioner, and any *dealer* who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis). Further, ~~definitions~~**defined terms** and the determination of eligibility for the bona fide market-making activities exception in the ~~re-proposed~~**final** rule are distinct from those available under other rules, such as Regulation SHO and recently proposed rules to include certain significant market participants as "dealers" or "government securities dealers." *See*, *e.g.*, Dealer Release, *supra* note ~~159~~**492**, at 23068 n.131 (distinguishing the determination of eligibility for the bona fide market-making exceptions of Regulation SHO from the determination of whether a person's trading activity indicates that such person is acting as a dealer or government securities dealer under the rule proposed in that Exchange Act Release).

A number of commenters expressly supported including a compliance program requirement.[498] However, one commenter stated that the potential confusion regarding this requirement would undercut the ability of securitization participants to rely on the exception and that it is not clear that such condition is within the scope of the congressional intent of Section 27B.[499] One commenter initially requested that the compliance program requirement be omitted in its entirety because it would be unduly burdensome and unnecessary.[500] However, this commenter subsequently requested that the compliance program requirement instead specify that it would only apply to any securitization participant utilizing the exception.[501] Another commenter suggested a similar revision.[502]

In response to the comment that the compliance program condition would undercut the ability of a securitization participant to rely on the exception and that it is not clear that such condition is within the scope of the congressional intent of Section 27B, we recognize that certain securitization participants may need to create a new compliance program to comply with this condition and that this may result in increased compliance costs.[503] However, Section 27B(b) requires that the Commission adopt rules to implement the prohibition in Section 27B(a) against a securitization participant engaging in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of the ABS activity of a securitization participant. The compliance program condition is necessary to help ensure that the activities of a securitization participant relying on the bona fide market-making

[498] *See* letters from AARP; Better Markets.

[499] *See* letter from ABA.

[500] *See* letter from SIFMA I.

[501] *See* letter from SIFMA II.

[502] *See* letter from SFA II.

[503] ***See* Section IV.**

activities exception are indeed >bona fide market-making activities and <**not the type of transactions that would involve or** >result in a material conflict of interest between a securitization participant <**for an ABS and an investor in such ABS. The market-making activity of a securitization participant in ABS and related financial instruments described in Rule 192(b)(3)(i) can be inherently complex. Therefore, requiring a securitization participant to establish and enforce an internal compliance program will help that entity adequately evaluate and track its market-making activity in a way that is reasonably designed to help prevent violations of the rule. Additionally, as discussed in Section IV, this condition will enhance the benefits of the rule by assuring investors that a securitization participant is less likely to engage in activities that are prohibited by Rule 192 if it has a program to monitor ongoing compliance with the rule.**

To avoid imposing a one-size-fits-all requirement that may unduly burden securitization participants that are different in size or that make markets in different types of financial instruments, this condition >recognizes that a securitization participant that is a market maker in ABS and related financial instruments described in paragraph (b)(3)(i) is well positioned to design its own <>individual internal compliance program to reflect the size, complexity, and activities of the securitization participant. <**This should help ease compliance costs as the relevant securitization participant can tailor its compliance program to its particular business model. As a general matter, we also recognize that costs of the final rule potentially may have a proportionally greater effect on small entities, as such costs may be a relatively greater percentage of the total cost of operations for smaller entities than larger entities, and thus small entities may be less able to bear such costs relative to larger entities. However, the potentially less complex securitization activities of small entities and their correspondingly less complex compliance considerations may counterbalance such costs as compared to larger and more**

diversified securitization participants. We also believe that the changes discussed above to refine the scope of the definition of "conflicted transaction" [504] and the scope of covered affiliates and subsidiaries[505] are designed to ease the compliance program burden on securitization participants by providing greater certainty regarding the types of transactions and relevant entities that are subject to the rule's prohibition.

In response to comments that the compliance program requirement should specify that it only applies to any securitization participant utilizing the exception,[506] it is unnecessary to do so because the requirement applies only if the securitization participant is relying on the exception. Rule 192(b)(3)(ii)(E) sets forth a condition to utilizing the exception in Rule 192(3)(i) and does not separately require that a securitization participant satisfy the compliance program requirement if it is not utilizing the exception.

~~<individual internal compliance program to reflect the size, complexity, and activities of the securitization participant. >~~~~In order to create uniformity and predictability for~~**In order to assist** a securitization participant ~~to determine~~**in determining** whether it satisfies the first and second conditions of the ~~proposed~~ exception, **we observe that** a reasonably designed compliance program of the securitization participant **generally** should set forth the processes by which the relevant trading personnel ~~would~~**will** identify the financial instruments described in Rule 192(b)(3)(i) related to its securitization activities that the securitization participant may make a market in for its customers and the processes by which the securitization participant ~~would~~**will** determine the

504 ***See*** **Section II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) and provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction).**

505 ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or**

receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).

[506] ***See*** **letters from SFA II; SIFMA II.**

reasonably expected near term demand of customers for such products. The identification of such instruments and the processes for determining the reasonably expected near term demand of customers for such instruments in the compliance program ~~would~~**should** help prevent trading personnel at the relevant securitization participant from taking positions in conflicted transactions that are not positions that the securitization participant expects to make a market in for customers or that are in an amount that would exceed the reasonably expected near term demands of customers. Furthermore, ~~in order to create uniformity and predictability for~~**to assist** a securitization participant ~~to determine~~**in determining** whether it satisfies the first and second conditions of the ~~proposed~~ exception on an ongoing basis, **we observe that** a reasonably designed compliance program of the securitization participant **generally** should also establish internal controls and a system of ongoing monitoring and analysis that the securitization participant ~~would~~**will** utilize in order to effectively ensure the compliance of its trading personnel with its policies and procedures regarding permissible market-making under the ~~re-proposed~~**final** rule.

~~We also believe it~~**It** is important that the reasonably designed written policies and procedures demonstrate a process for prompt mitigation of the risks of a securitization

participant's positions and holdings that arise from market-making in ABS and the related financial instruments described in Rule 192(b)(3)(i), such as the risks of aged positions and holdings, because doing so ~~would~~**should** help to prevent a securitization participant from engaging in a transaction and maintaining a position that is adverse to the relevant ABS that remains open and exposed to potential gains for a prolonged period of time. ~~The re-proposed rule does not define "prompt" mitigation in this context.~~ While mitigating the risks of such positions and holdings ~~would~~**is** not ~~be~~ required to be contemporaneous with the acquisition of such positions or holdings, prompt mitigation ~~would mean~~**means** that the mitigation occur without **an unreasonable** delay that ~~would~~**will** facilitate or create an opportunity to benefit from a conflicted transaction remaining in the securitization participant's ~~market-making inventory. We seek comment below on more precise indicia of "prompt" mitigation of such risks, and whether such indicia should be specified in the rule.~~

market-making inventory considering the liquidity, maturity, and depth of the market for the relevant types of financial instruments.

The ~~proposed~~ requirement that a process for such risk mitigation activity be included in a securitization participant's written policies and procedures ~~would~~**should** help ~~ensure that activity is not~~**prevent** speculative activity **being** disguised as market-making by establishing the processes by which the relevant trading personnel ~~would~~**will** enter into, adjust, and unwind ~~such hedging positions with respect to its market-making inventory. This approach is consistent with certain comments to the 2011 proposed rule supporting the inclusion of a compliance condition in the bona fide market-making activities exception[191] and including a written policies and procedures requirement.[192]~~**positions and holdings that arise from market-making in ABS.**

~~We received a comment to the 2011 proposed rule that any securitization participant relying on the proposed exception for bona fide market-making activities should be required to affirmatively certify that it is undertaking such activity for the sole purpose of market-making in~~

One commenter suggested that any >securitization participant relying on the exception <**for bona fide market-making activities should be required** >to affirmatively certify that it is undertaking such activity for the <**sole purpose of market-making** >and not for the purpose of generating speculative profits.<[507] **Certain commenters also suggested that a responsible party at the securitization participant should be required to certify the effectiveness of the applicable written policies and procedures prior to their implementation and on an ongoing basis.[508] Consistent with the Proposing Release, we did not include certification requirements in the final rule because we believe that the conditions to the bona fide market-making activities exception are sufficiently robust to prevent the exception from resulting in conflicted transactions in contradiction to Section 27B's prohibition.**

Anti-Evasion

Proposed Rule

To address concerns that the potential circumvention of the proposed rule could undermine the investor protection goals of Section 27B, the Commission proposed Rule 192(d)

~~191~~507 *See* ~~Tewary Letter 1 at 12~~ **letter from Better Market**s.

~~192~~508 *See* **letters from AARP;** Better Markets ~~Letter at 14~~.

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~~connection with the securitization, <and not for the purpose of generating speculative profits.>[193] We did not include a certification requirement in the proposed exception, but we seek comment below on whether a certification requirement would be appropriate, and if so, what form such a certification should take and when it should be required to be made.~~

to provide >that, if a securitization participant engages in a transaction that circumvents the prohibition in proposed Rule 192(a)(1), the transaction <**would** >be deemed to violate proposed Rule 192(a)(1).<

2. ~~*Request for Comment*~~Comments Received

One commenter supported the proposed anti-circumvention provision and stated that "it should remain broad to give the Commission ample authority to enforce efforts by market participants to evade the prohibition."[509] However, other commenters stated that anti-circumvention provision, as proposed, would make it difficult for market participants to understand the scope of the proposed rule and requested that the Commission delete the provision.[510] As an alternative, certain commenters suggested that the Commission should replace the provision with an anti-evasion provision, with some of these commenters stating that such anti-evasion standard should apply only with respect to the use of an exception to the rule as part of a plan or scheme to evade the rule's prohibition.[511]

3. Final Rule

We are adopting Rule 192(d) with certain modifications in response to comments received on the proposal. In a change from the proposal, the anti-evasion provision will only apply with respect to the use of an exception as part of a plan or scheme to evade the

rule's prohibition. Specifically, Rule 192(d) will provide that if a securitization participant engages in

~~88. Is the scope of the proposed bona fide market-making activities exception appropriate or is it overinclusive or underinclusive? Please provide specific examples of any activity that should be included in or excluded from the scope of the exception and provide a justification as to why and how that modification would not compromise investor protection. For example, is it appropriate for the proposed exception to apply to market-making in the financial instruments described in proposed Rule 192(b)(3)(i) or should the scope of financial instruments be narrowed or expanded? Does market-making in CDS in response to customer demands implicate the types of material conflicts of interest that the re-proposed rule is designed to address?~~

~~89. Should any of <the proposed conditions applicable to the >proposed bona fide market-making activities exception be modified? If yes, please provide the suggested modification and explain how such modification would be consistent with statutory authority and how that modification would not compromise investor protection. For example, should <the bona fide market-making activities exception be >modified to align more closely with market-making in the context of Regulation SHO? If so, please explain how the exception should be modified and why, and how doing so would not compromise investor protection. Should the bona fide market-making activities~~

~~193~~[509] *See* **letter from** Better Market ~~Letter at 11~~s.

[510] ***See*** **letters from AIMA/ACC; AIC (alternatively requesting that an anti-evasion provision only apply to a securitization participant's intentional use of an affiliate or subsidiary to accomplish an otherwise prohibited result).**

[511] ***See*** **letters from ABA (stating that the Federal securities laws generally include anti-evasion provisions and not anti-circumvention provisions and expressing its belief that an anti-evasion standard would be more appropriate because it would be tied to the actions of the securitizations participant rather than the effect of the transaction); AFME (supporting the approach suggested by SIFMA); LSTA III (supporting the approach suggested by SIFMA); SFA II (suggesting an anti-evasion standard); SIFMA I (suggesting an anti-evasion standard that applies to the exceptions).**

~~exception in the re-proposed rule include a condition that the securitization participant analyze the applicability of the exception on a trade-by-trade basis? Is the proposed condition that <the securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near-term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments >sufficient to prevent a securitization participant from providing a cover for activity that is not client-driven but rather a bet against the relevant ABS? Should this condition include any additional requirements, such as the requirement that the securitization participant's market-making activities are driven by customer trading, customer liquidity needs, customer investment needs, or risk management by customers?~~

~~90. Is it appropriate to consider <the liquidity, maturity, and depth of the market for the relevant financial instruments >in determining whether a <securitization participant routinely stands ready to purchase and sell >such financial instruments for purposes of the proposed bona fide market-making activities exception? Would such considerations potentially allow a securitization participant to characterize only sporadic trading in illiquid financial instruments as market-making in an effort to evade the intent of the re-proposed rule? Are any such concerns about potential misuse or evasion of the exception adequately mitigated by the anti-circumvention provision in proposed Rule 192(d)? If you believe that there are unique characteristics of the ABS market that should be considered in the context of bona fide market-making activities in ABS and related financial instruments, such as lack of liquidity or increased settlement times compared to other asset classes, then please describe those in detail, provide supporting data, and~~

a transaction or a series of related transactions that, although in technical compliance with one of the exceptions described in Rule192(b), is part of a plan or scheme to evade the

prohibition in Rule 192(a)(1), that transaction or series of related transactions will be deemed to violate Rule 192(a)(1). As discussed below, this anti-evasion provision is important for helping to ensure the effectiveness of the final rule's prohibition, and we do not believe that the provision, when considered together with the other changes we are making from the proposal, will make it difficult for market participants to understand the scope of the final rule.

Rule 192(d), as adopted, is generally consistent with the suggestion of certain commenters that we adopt an anti-evasion provision as opposed to an anti-circumvention provision.[512] We are persuaded that an anti-circumvention provision could have the potential to be both overinclusive and vague in this particular circumstance given the other elements of the rule, and that an anti-evasion standard that focuses on the actions of the securitization participants as part of scheme to evade the rule's prohibition would be more appropriate. We are also persuaded by the suggestion of certain commenters that the anti-evasion provision should only apply to a securitization participant's claimed compliance with one of the exceptions to the rule.[513] This is because the prohibition in Rule 192(a), as adopted, includes certain provisions that are designed to prevent attempted evasion of the rule. For example, the prohibition in Rule 192(a)(1) captures a securitization participant "indirectly" engaging in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such ABS. Additionally, Rule 192(a)(3)(iii) captures any transaction that is

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[512] *See* letters from ABA (stating that the Federal securities laws generally include anti-evasion provisions and not anti-circumvention provisions and expressing its belief that an anti-evasion standard would be more appropriate because it would be tied to the actions of the securitizations participant rather than the effect of the transaction); SFA II (suggesting an anti-evasion standard).

[513] *See* letters from SIFMA Letter I (suggesting an anti-evasion standard that applies to the exceptions); AFME (supporting the approach suggested by SIFMA); LSTA III (supporting the approach suggested by SIFMA).

substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii). Therefore, we do not believe that it is necessary to apply the anti-evasion provision to the prohibition itself.

We disagree with commenters' suggestions that the final rule should not include any anti-circumvention or anti-evasion provision.[514] The anti-evasion provision is designed to address those situations in which securitization participants engage in efforts to evade the rule's prohibition by claiming technical compliance with one of the exceptions to the rule when, in fact, such securitization participant's conduct constitutes part of a plan or scheme to evade the rule's prohibition. Such evasion would undermine the investor protection mandate of Section 27B. Compliance Date

I. The final rule is effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Under the compliance date that we are adopting in this release, any securitization participant must comply with the prohibition and the requirements of the exceptions to the final rule, as applicable, with respect to any ABS the first closing of the sale of which occurs [INSERT DATE 18 MONTHS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

Numerous commenters addressed the compliance period for the final rule, with many of these commenters suggesting at least 12 months following the date that the final rule is published in the *Federal Register*.[515] These commenters cited operational challenges and systems changes, particularly with respect to the compliance program requirements applicable to the risk-

~~explain if the proposed <bona fide market-making activities exception, including >the proposed conditions, is appropriate given such characteristics.~~

91. ~~Should the compensation condition to the proposed <bona fide market-making activities exception >provide additional specificity regarding what it would mean for the compensation arrangements to be designed not to reward or incentivize conflicted transactions? If so, please explain what specific indicia or metrics would be appropriate for purposes of that determination and why, and please provide examples of acceptable and unacceptable compensation arrangements.~~

92. ~~Are the proposed <conditions of the bona fide market-making activities exception >adequate to address any potential misuse and evasion of the exception? What are the ways in which a securitization participant could attempt to utilize the proposed exception in order to disguise speculative activity as bona fide market-making? Are any such concerns about potential misuse or evasion of the exception adequately mitigated by the anti-circumvention provision in proposed Rule 192(d)? Should an explicit anti-abuse provision be added as a condition to the proposed exception requiring that "the market-making activity must not be conducted or designed to evade the requirements" of proposed Rule 192, or would such a provision be unnecessary because of the anti-circumvention language in proposed Rule 192(d)?~~

93. ~~As discussed above, certain of the conditions of the proposed bona fide market-making activities exception are similar to those that are applicable to the equivalent exception to the Volcker Rule's proprietary trading prohibition.[194] What are the potential benefits and drawbacks to this approach? If a securitization participant is subject to the Volcker Rule~~

~~194~~[514] ~~*See* 17 CFR 255.4(b)~~ **letters from AIMA/ACC; AI**C.

[515] ***See*** **letters from ICI Letter; LSTA III (requesting that the compliance period begin at least 12 months following the date that the final rule is published in the *Federal Register*); MFA II (requesting a transition period of at least 12 months); SFA I; SIFMA I (requesting that the compliance period begin at least 12 months following the date that the final rule is published in the *Federal Register*).**

and would also be subject to the re-proposed rule, should a securitization participant that is in compliance with the conditions applicable to the equivalent Volcker Rule exception be deemed to be presumptively in compliance with the conditions applicable under the bona fide market-making activities exception to the re-proposed rule? Or are the purposes of the Volcker Rule and Section 27B sufficiently different that additional or different conditions are necessary for the re-proposed rule? Are there entities that are not subject to the Volcker Rule's proprietary trading prohibition and/or the associated compliance requirements, including small broker-dealers, that would seek to avail themselves of the proposed bona fide market-making activities exception to the re-proposed rule and that would be meaningfully disadvantaged by this approach? If so, please explain why and suggest an alternative approach that would be consistent with Section 27B. If your suggested alternative approach includes different compliance requirements for different types of entities, please explain how any such entity types should be defined for purposes of your suggested alternative approach.

94. Is the proposed condition <applicable to the bona fide market-making activities exception >

regarding compliance and monitoring appropriate? Should such a condition include more or less stringent requirements? For example, should the condition <require that a securitization participant >have reasonably designed policies and procedures in place that specifically identify, document, and monitor <the risks of its market-making positions and holdings >(including an accounting of any positions or holdings that would constitute conflicted transactions under the re-proposed rule <in the absence of the proposed >exception for bona fide market-making activities) and the actions taken to demonstrably mitigate promptly those risks? Please identify any additional conditions that should be

mitigating hedging activities exception and the bona fide market-making activities exception, which would necessitate time to adopt and implement. One commenter recommended a compliance period of 18 to 24 months based on concerns regarding the scope of the proposed definition of conflicted transaction and the proposed application of the rule to affiliates.[516] We recognize that certain persons subject to the rule will need to update their operations and systems in order to comply with the final rule, and we are adopting the compliance date of 18 months after adoption. This delayed compliance date is designed to provide affected securitization participants that intend to utilize the risk-mitigating hedging activities exception and the bona fide market-making activities exception with adequate time to develop the internal compliance programs that are required to satisfy the conditions of such exceptions as well as adequate time to develop any internal compliance mechanisms that the securitization participant decides to implement in order to address the scope of its affiliates and subsidiaries that are subject to the final rule. We are not persuaded that any additional time is needed because we believe that the changes made from the proposed rule to narrow the scope of the definition of conflicted transaction[517] and the scope of the affiliates and subsidiaries of a securitization participant that

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[516] ***See*** **letter from SFA II.**

[517] ***See*** **Section II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule**

192(a)(3)(i) or Rule 192(a)(3)(ii) and provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction).

required as part <of the compliance program condition>. Is there sufficient clarity as to whether <mitigation of the risks of >market-making positions and holdings would be considered "prompt" as required by the proposed condition? If not, please explain what further guidance or clarification would be helpful in this context, including any specific indicia that should be included or referenced for purposes of this determination.

95. Should the proposed bona fide market-making activities exception require a <securitization participant relying on the exception ><to affirmatively certify that it is undertaking such activity for the >purpose of market-making in financial instruments permitted under the proposed exception and that it has complied with the relevant conditions in the re-proposed rule? If so, what form should such a certification take, and when should it be required to be made? For example, should the certification be required to be filed with, or otherwise furnished to, the Commission, or should it instead be required to be retained in the files of the securitization participant in accordance with its written policies and procedures? Should the certification requirement permit a securitization participant to make the required certification on a periodic basis with respect to all bona fide market-making activity occurring during that period, and if so, how frequently should the certification be required to be made? Please explain whether and how such a certification requirement would be practical for securitization participants.

96. Should smaller securitization participants be exempt from certain elements of the compliance program condition, such that those elements of the condition would apply only to securitization participants with significant trading assets and liabilities similar to the equivalent exception to the Volcker Rule, or should all elements of the compliance program condition apply to all securitization participants in order to adequately protect

are subject to the rule[518] generally are expected to ease compliance burdens and mitigate the need for a compliance period longer than 18 months after adoption.[519]

~~ABS investors? Alternatively, should the implementation of the compliance program requirement applicable to smaller securitization participants be delayed in order to give such entities more time to comply with the requirement? Why or why not? In your responses, please explain how "smaller securitization participant" should be defined for purposes of any such exemption or delayed implementation.~~

~~97. What are the positive or negative consequences of the bona fide market-making activities exception in the re-proposed rule?~~

~~**General Request for Comment**~~

A. ~~We request and encourage any interested person to submit comments <on any aspect of the >re-proposed rule, other matters that might have an impact on the re-proposed rule, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our re-proposal where appropriate.~~

III. ~~Economic Analysis~~ OTHER MATTERS

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act, the >Office of Information and Regulatory Affairs <has designated this rule as a "major rule," as defined by 5 U.S.C. 804(2).

IV. ECONOMIC ANALYSIS

Introduction

This ~~re-proposed~~**final** rule ~~would implement~~**implements** the requirements of Section 27B,[~~195~~520] as mandated ~~under~~**by** the Dodd-Frank Act. As discussed above, Section 621 of the Dodd-Frank Act added Section 27B to the Securities Act. Section 27B prohibits an underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, of an ABS, including a synthetic ABS, from engaging in any transaction that would involve or result in certain material conflicts of

[518] ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).**

[519] **With respect to the compliance date, one commenter requested the Commission to consider interactions between the proposed rule and other recent Commission rules. In determining compliance dates, the Commission considers the benefits of the rules as well as the costs of delayed compliance dates and potential overlapping compliance dates. For the reasons discussed throughout the release, to the extent that there are costs from overlapping compliance dates, the benefits of the rule justify such costs. *See* Section IV for a discussion of the interactions of the final rule with certain other Commission rules.**

[520] >15 U.S.C. 77z-2a.<

interest.[196][521] Section 27B also includes exceptions from this prohibition for certain

[195] <15 U.S.C. 77z-2a. ><
>[196] <*See* Section II.A.>

risk-mitigating hedging activities, bona fide market-making activities, ~~and~~ liquidity commitments~~.~~[197] ~~The re-proposed rule also would exclude from the definition of "sponsor" the United States, agencies of the United States, and the Enterprises, in each case with respect to an ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the relevant entity.~~[198]**, and a foreign transaction safe-harbor provision.** [522]

As discussed above in ~~Section~~**Sections** I**.A. and I**.B., Section 27B requires that the Commission issue rules for the purpose of implementing the prohibition in Section 27B~~, and Section 27B specifies the ABS <transactions and securitization participants to >be covered by the re-proposed rule, as well as the timeframe of the re-proposed rule's prohibition~~. We are sensitive to the economic impact, including the costs and benefits, imposed by ~~its rules.~~[199]**this rule.**[523] This section presents an analysis of the ~~particular~~ expected economic effects—including costs, benefits, and impact on efficiency, competition, and capital formation—that may result from the ~~re-proposed~~**final** rule, as well as possible alternatives to the ~~re-proposed~~**final** rule. ~~Some~~**Many** of these effects, costs, and benefits ~~would~~ stem from statutory mandates, while others ~~would be~~**are** affected by the discretion exercised in implementing these mandates.

Where possible, we have sought to quantify the benefits, costs, and effects on efficiency, competition, and capital formation expected to result from the ~~re-proposed~~**final** rule. However, we are unable to reliably quantify many of the economic effects due to limitations on available data. Therefore, parts of the discussion below are qualitative in nature, although we try to describe,> where possible, the direction of these effects. We further note that even in cases where we have some data regarding certain economic effects, the quantification of these effects is particularly challenging due to the number of assumptions that we need to make to forecast

how the ABS issuance practice <**will** >change in response to the <**final** >rule, and how those responses <**will, in turn,**

521 ***See* Section I.A.**

~~197~~522 *See* Sections II.E. through II.G.

~~198 *See* <Section II.B.2.c.>~~

~~199~~523 Section 2(b) of the Securities Act ~~[~~(15 U.S.C. 77b(b)~~]~~) requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

~~<where possible, the direction of these effects. We further note that even in cases where we have some data regarding certain economic effects, the quantification of these effects is particularly challenging due to the number of assumptions that we need to make to forecast how the ABS issuance practice >would <change in response to the >re-proposed <rule, and how those responses >would, in turn,~~ affect the broader ABS market. For example, the ~~re-proposed~~ rule's effects ~~would~~**will** depend on how sponsors, borrowers, investors, and other parties to the ABS transactions (*e.g.*, originators, trustees, underwriters, and other parties that facilitate transactions between borrowers, issuers, and investors) adjust on a long-term basis to this new rule and the resulting ~~evolving~~ market conditions. The ways in which these parties ~~could~~**may** adjust, and the associated effects, are complex and interrelated. As a result, we are unable to predict some of them with specificity or ~~are unable to~~ quantify them ~~at all. We are soliciting comment and requesting data to assist it with assessing and quantifying economic effects of the re-proposed rule.[200]~~ **.**

B.

The Commission received comments related to various aspects of the economic analysis of the proposed rule. The Commission has considered and responds to these comments in the sections that follow.

Economic Baseline

The baseline against which the costs, benefits, and the effects on >efficiency, competition, and capital formation <**of the final rule are measured consists of the current state of the ABS market, current practice as it relates to securitization participants, and the current regulatory framework. The economic analysis considers existing regulatory**

requirements, including recently adopted rules, as part of its economic baseline against which >the costs and benefits of the <**final rule are measured.**[524]

[524] ***See, e.g.***, ***Nasdaq v. SEC***, **34 F.4th 1105, 1111-15 (D.C. Cir. 2022). This approach also follows SEC staff guidance on economic analysis for rulemaking.** ***See*** **Staff's "Current Guidance on Economic Analysis in SEC Rulemaking" (Mar. 16, 2012),** ***available at*** **https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf ("The economic consequences of proposed rules (potential costs and benefits including effects on efficiency, competition, and capital formation) should be measured against a baseline, which is the best assessment of how the world would look**> in the absence of the proposed< **action."); *Id.* at 7 ("The baseline includes both the economic attributes of the relevant market and the existing regulatory structure."). The best assessment of how the world would look in the absence of the proposed or final action typically does not include recently proposed actions, because doing so would improperly assume the adoption of those proposed actions.**

One commenter requested the Commission consider interactions between >the economic effects of the <proposed rule and other recent Commission proposals.[525] The commenter indicated there could be interactions between this rulemaking and three proposals that have since been adopted:[526] the Beneficial Ownership Reporting Release,[527] the Private Fund Advisers Adopting Release,[528] and the Short Position Reporting Release.[529] In addition, the commenter identified one rule that had recently been adopted prior to the commenter's letter, the May 2023

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525 *See* letter from MFA III ("We urge the Commission to evaluate the costs and benefits of the Proposals, in the aggregate, for private fund advisers, their investors, and the markets generally.").

526 *Modernization of Beneficial Ownership Reporting*, Release No. 33-11030 (Feb. 10, 2022), 87 FR 13846 (Mar. 10, 2022) (*see* letter from MFA III, at 14-15); *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-5955 (Feb. 9, 2022), 87 FR 16886 (Mar. 24, 2022) (*see* letter from MFA III, at 10-12); *Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-94313 (Feb. 25, 2022), 87 FR 14950 (Mar. 16, 2022) (*see* letter from MFA III, at 15-16).

527 *See Modernization of Beneficial Ownership Reporting*, Release Nos. 33–11030; 34–94211 (Oct. 6, 2023) ("Beneficial Ownership Reporting Release"). Among other things, the amendments generally shorten the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G, and require that Schedule 13D and 13G filings be made using a structured, machine-readable data language. The new disclosure requirements and filing deadlines for Schedule 13D are effective 90 days after publication in the Federal Register. The new filing deadline for Schedule 13G takes effect on Sept. 30, 2024, and the rule's structured data requirements have a one-year implementation period ending Dec. 18, 2024. *See* Beneficial Ownership Reporting Release, Section II.G.

528 *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-6383 (Aug. 23, 2023), 88 FR 63206 (Sept. 14, 2023) ("Private Fund Advisers Adopting Release"). The Private Fund Advisers Adopting Release includes new rules designed to protect investors who directly or indirectly invest in private funds by increasing visibility into certain practices and restricting other practices, along with amendments to the Advisers Act books and records rule and compliance rule. The amended Advisers Act compliance provision for registered investment advisers has a Nov. 13, 2023, compliance date. The compliance date is Mar. 14, 2025, for the rule's quarterly statement and audit requirements for registered investment advisers with private fund clients. For the rule's adviser-led secondaries, restricted activity, and preferential treatment requirements, the compliance date is Sept. 14, 2024, for larger advisers and Mar. 14, 2025, for smaller advisers. *See* Private Fund Advisers Adopting Release, Sections IV., VI.C.1.

529 *See Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-98738 (Oct. 13, 2023), 88 FR 75100 (Nov. 1, 2023) ("Short Position Reporting Release"). The new rule and related form are designed to provide greater transparency through the publication of short sale-related data to investors and other market participants. Under the new rule, institutional investment managers that meet or exceed certain specified reporting thresholds are required to report, on a monthly basis using the related form, specified short position data and short activity data for equity securities. The compliance date for the rule is Jan, 2, 2025. In addition, the Short Position Reporting Release amends the national market system plan governing the consolidated audit trail ("CAT") to require the reporting of

reliance on the bona fide market making exception in the Commission's short sale rules. The compliance date for the CAT amendments is July 2, 2025.

SEC Form PF Amending Release.[530] These rules were not included as part of the baseline in the Proposing Release because they were not adopted at that time. In response to commenters, this economic analysis considers potential economic effects arising from any overlap between the compliance period for the final rule and each of these recently adopted rules.[531]

The ~~baseline we use to analyze <the economic effects of the >re-proposed rule is the current set of rules, regulations, and market practices. To the extent that they are not consistent with current market practices, the proposed requirements would impose new costs. The proposed requirements would~~**requirements of the final rule will** affect ABS market participants, including securitization participants**, as defined in Rule 192,** and investors in ABS, and ~~would~~ indirectly affect loan originators, consumers, ~~and~~ businesses**, municipal entities, and nonprofits** that seek access to credit. The costs and benefits of the ~~proposed~~ requirements depend largely on the current market practices specific to each securitization market. The economic significance or the magnitude of the effects of the ~~proposed~~ requirements also depend on the overall size of the securitization market and the extent to which the requirements ~~could~~ affect access to, and the

~~200 *See* Section III.G.~~

cost of, capital. Below, we describe our current understanding of the securitization markets that ~~would~~**will** be affected by ~~this re-proposed~~**the final** rule.

[530] ***See Form PF; Event Reporting for Large Hedge Fund Advisers and Private Equity Fund Advisers; Requirements for Large Private Equity Fund Adviser Reporting*, Release No. IA-6297 (May 3, 2023), 88 FR 38146 (June 12, 2023) ("May 2023 SEC Form PF Amending Release"). The Form PF amendments require large hedge fund advisers and all private equity fund advisers to file reports upon the occurrence of certain reporting events. For new sections 5 and 6 of Form PF, the compliance date is Dec. 11, 2023; for the amended, existing sections, it is June 11, 2024. *See* May 2023 SEC Form PF Amending Release, section II.E.**

[531] **In addition, one commenter indicated there could also be overlapping compliance costs between the final amendments and proposals that have not been adopted. *See*, letter from MFA III. To the extent those proposals are adopted, the baseline in those subsequent rulemakings will reflect the existing regulatory requirements at that time. One of the proposals identified by the commenter, *Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions*, Exchange Act Release No. 93784 (Dec. 15, 2021), [87 FR 6652, 6678 (Feb. 4, 2022)], has been partially adopted. *See Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers*, Release No. 34-97656 (June 7, 2023), [88 FR 42546 (June 20, 2023)] ("Security-Based Swaps Release"). However, the commenter focused their comments on the portion of that proposal that has not yet been adopted (i.e., reporting of large security-based swap positions), and the adopted rule would not have any significant effects from overlapping compliance periods because that rule was effective Aug. 23, 2023.**

1. Overview of the Securitization Markets

The securitization markets are important for the U.S. economy and constitute a large fraction of the U.S. debt market.[~~201~~532] Securitizations play an important role in the creation of credit by increasing the amount of capital available for the origination of loans and other receivables through the transfer of those assets—in exchange for new capital—to other market participants. The intended benefits of the securitization process include reduced cost of credit and expanded access to credit for borrowers, ability to match risk profiles of securities to investors' specific demands~~,~~ and increased secondary market liquidity for loans and other receivables.[~~202~~533]

Since the ~~re-proposed rule would apply to any person from the point at which it~~**final rule applies to a securitization participant commencing on the date on which such person** has reached~~, or has taken substantial steps to reach,~~ an agreement to become a securitization participant until one year after the date of the first closing of the sale of the ABS, **we generally** >use ABS issuance information rather than information on ABS <**amounts outstanding** to estimate the number of affected parties and the size of the affected ABS market~~, we <use ABS issuance information rather than information on ABS>~~**. Information presented regarding securitized asset fund advisors is instead based on** amounts outstanding **due to data availability**. For the purposes of establishing an economic baseline and to estimate affected market size, we ~~use data covering the~~

[~~201~~532] *See*, *e.g.*, SEC Staff Report, U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock (Oct. 2020), *available at* https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf. Among other things, the report provides an overview of the various parts of the securitization markets and their connections to the broader U.S. financial markets. This is a report of the staff of the U.S. Securities and Exchange Commissio~~, which~~**n. This repor**t represents the views of Commission staff, and is not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of this report and, like all staff statements, it has no legal force or effect, does not alter or amend applicable law, and creates no new or additional obligations for any person.

[202533] *See*, *e.g.*, Board of Governors of the Federal Reserve System, Report to the Congress on Risk Retention (Oct. 2010), *available at* https://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf~~, and~~**;** Financial Stability Oversight Council, Macroeconomic Effects of Risk Retention Requirements (Jan. 2011)~~.~~**, *available at* https://www.lexissecuritiesmosaic.com/gateway/treasury/pr/Documents_Section_20946_20Risk_20Retention_2 0Study 20 20(FINAL).pdf.**

use data covering the most recent full calendar year ~~2021~~**2022** to avoid any seasonal effects on estimates ("baseline period").[~~203~~534]

We estimate that the baseline period annual issuance of ~~private-label~~[204]**private-label**[535] non-municipal ABS in the ~~U.S.~~**United States** was $~~814~~**603** billion in ~~1,441~~**1,122** individual ABS deals and the baseline period annual issuance of municipal ABS in the U.S. was $~~104~~**74** billion in ~~1,928~~**1,332** deals.[~~205~~536] Out of private-label non-municipal ABS, ~~29~~**10** deals totaling $~~11.5~~**2.8** billion were risk transfer ABS deals; some or all of these risk transfer ABS deals could be synthetic ABS or hybrid cash and synthetic ABS deals.[~~206~~537] During the baseline period, Ginnie Mae provided a government guarantee to $~~855~~**527** billion of newly issued MBS, and the Enterprises issued $~~2.65~~**1.20** trillion of Enterprise-guaranteed ~~MBS~~[207]**MBS**[538] **and 19** >CRT securities deals worth $<**21.6 billion.**[539] >Currently, the Enterprises are in<

[~~203~~534] The primary data source for our numeric estimates of issuance of private-label non-municipal ABS are the Green Street Asset-Backed Alert Database and the Green Street Commercial Mortgage Alert Database. The databases present the initial terms of all ABS, MBS, CMBS, and CLOs collateralized by asset ~~of some kind~~s, and synthetic CDOs, rated by at least one major credit rating agency, and placed anywhere in the world (however, only deals sold in the U.S. are included in our analysis). The databases identify the primary participants in each transaction. The primary data source of our numeric estimates of issuance of municipal ABS is Mergent Municipal Bond Securities Database**. The proposing release used calendar year 2021 as its baseline due to data availability at time of proposal**.

[~~204~~535] Private-label ABS are ABS that are not sponsored or guaranteed by U.S. Government agencies or the Enterprises.

[~~205~~536] Data drawn from the Green Street Asset-Backed Alert Database, the Green Street Commercial Mortgage Alert Database, and Mergent Municipal Bond Securities Database.

[~~206~~537] Data drawn from the Green Street Asset-Backed Alert Database and the Green Street Commercial Mortgage Alert Database.

[~~207~~538] *See* Laurie Goodman, *et al*., *Housing Finance~~:~~ At a Glance**:** Monthly Chartbook, ~~September 2022~~**July 2023***, Urban Institute (~~Sept. 29~~**July 28**, ~~2022~~**2023**), at ~~30~~**34**, *available at* https://www.urban.org/research/publication/~~housing-finance-glance-monthly-chartbook-september-2022~~**housing-finance-glance-monthly-chartbook-july-2023**.

and 16 <CRT securities deals worth $>16.9 billion.[208] <Currently, the Enterprises are in ><conservatorship with the U.S. Treasury and are regulated by the FHFA.>[209]

2. Affected Parties

<Parties potentially affected by the >re-proposed rule include:

- <Parties that have direct compliance obligations under the >re-proposed <rule with respect to the >proposed <prohibition, namely, underwriters, placement agents, initial purchasers, and sponsors, or any affiliates or subsidiaries of such entities >("securitization participants" as defined above).

- U.S. agencies and the Enterprises <with respect to certain types of ABS.>[210]
- <Other entities that provide services in the securitization process, including depositors, servicers >and other <service providers, as well as their domestic and foreign affiliates and subsidiaries>.
- <Counterparties that invest/deal in financial products, including derivatives, related to synthetic ABS (and hybrid cash and synthetic ABS). For example, dealers that trade CDS on the ABS to securitization participants.>

[208] [539] *See* The Green Street Asset-Backed Alert Database. Of the 1629 CRT transactions in 20212022, 1319 were issued by Freddie Mac ($13.8212.72 billion) and 39 were issued by Fannie Mae ($3.098.92 billion). Broadly, the Enterprise CRT programs transfer mortgage credit risk from the Enterprises to private investors. In doing so, CRT issuance lowers Enterprise capital requirements and increases their return on capital, while providing the Enterprises with market-based pricing information on Enterprise ABS credit risk. *See* Freddie Mac, CRTcast E4: CRT Then and Now, A Conversation with Don Layton (Nov. 17, 2021), *available at* https://crt.freddiemac.com/_assets/pdfs/insights/crtcast-episode-4-transcript.pdf; Jonathan B. Glowacki, *CRT 101: Everything you need to know about Freddie Mac and Fannie Mae Credit Risk Transfer*, Milliman (Oct. 11, 2021), *available at* https://www.milliman.com/en/insight/crt-101-everything-you-need-to-know-about-freddie-mac-and-fannie-mae-credit-risk-transfer.

>conservatorship with the U.S. Treasury and are regulated by the FHFA.<[540]

2. Affected Parties

>Parties potentially affected by the <**final rule include:**

>• Parties that have direct compliance obligations under the <**final** >rule with respect to the <>prohibition, namely, underwriters, placement agents, initial purchasers, and sponsors, or any affiliates or subsidiaries of such entities <**which act in coordination with such entities, or have access to or receive information about the relevant ABS or its underlying or referenced asset pool prior to the first closing of the sale of the ABS.**

• **U.S. agencies** >with respect to certain types of ABS.<[541]

>• Other entities that provide services in the securitization process, including depositors, servicers<**, special servicers, and other contractual** >service providers, as well as their domestic and foreign affiliates and subsidiaries <**with involvement in or knowledge concerning the securitization prior to its closing.**

>• Counterparties that invest/deal in financial products, including derivatives, related to synthetic ABS (and hybrid cash and synthetic ABS). For example, dealers that trade CDS on the ABS to securitization participants.<

• **Investment advisers and ABS investors. For example**>, pension funds, endowments, foundations, hedge funds, and mutual funds.<

~~209~~[540] *See* discussion in Section II.B~~2~~.3~~e~~.b~~ii~~.**i**v.

~~210~~[541] The ~~proposed exception~~**exclusion** from the definition of "sponsor**,**" **as discussed in Section II.B.3.b.iv.,** with respect to ~~those~~**these** entities ~~should~~ **is expected to** lessen the impact of the ~~re-proposed rule on these parties~~**final rule on the United States or an agency of the United States** with respect to ~~certain types of~~ ABS **that is fully insured or fully guaranteed**, but these ~~parties might~~**entities may** still be otherwise affected. **Notably, the Enterprises are more directly affected under the final rule while operating under conservatorship of the FHFA than contemplated by**

the proposed rule, but this is offset somewhat by other changes between the proposed and final rule. *See* Section IV.D.2.

- ~~ABS investors, *e.g.*<, pension funds, endowments, foundations, hedge funds, and mutual funds.>~~
- Ultimate borrowers that rely on ABS markets for capital (*e.g.*, corporations, households**, municipal entities**) and participants in the markets where the borrowed capital is applied.[542]
- Other market participants that ~~could~~**may** be affected by changes in securitization practices. For example, originators that retain **a** residual interest in the ~~reference~~**underlying or referenced** asset pool or their creditors.

~~While one part of the proposed~~**As explained in Section II.B.3., the final** definition of the term "sponsor" is ~~derived <from the Regulation AB definition of sponsor>, the definition in the re-proposed rule also includes any person that directs or causes~~**a functional definition that will apply regardless of a person's title, so long as its activities with respect to the ABS meet the definition. Accordingly, a person who organizes and initiates an ABS transaction, (a Regulation AB-based sponsor) or who has a contractual right to direct or cause** the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying **or referenced by** the ABS (a ~~"directing~~**Contractual Rights Sponsor) is a** sponsor~~") or that has the contractual right to do so (a "contractual rights sponsor")~~ **under the definition**. Whether a person is a ~~directing~~ sponsor ~~would~~**will** be based ~~upon~~**on** the specific facts and circumstances~~. This new definition of "sponsor" for purposes of the re-proposed rule has not been used before. Thus, the set of ABS sponsors would consist of three types of entities: those that organize and initiate an ABS transaction, those that are contractual rights sponsors, and those that are directing sponsors (for example, the latter two types might include~~ **and which part of the sponsor definition the person qualifies under. For example,** Registered Investment Advisers ("RIAs") that advise hedge funds~~, and that could also qualify as a sponsor under the re-proposed~~

~~rule).~~ **could be a Contractual Rights Sponsor under the final rule if they have a contractual right to direct or cause the direction of the structure, design, or assembly of an ABS or the composition of the pool assets underlying the ABS.**

We estimate that**,** in the baseline period, there were ~~455~~**385** unique sponsors ~~of the first type~~ of private-label non-municipal ABS and there were ~~52~~**106** unique underwriters for such ABS deals; of these, we estimate that there were ~~14~~**6** unique sponsors and ~~16~~**10** unique underwriters of risk transfer ABS.[~~211~~] ~~We also~~[**543**]

[542] **Households benefit from the ABS markets in a variety of ways, including for example the Enterprises' issuance of RMBS which adds liquidity and reduces credit risk to investors who finance home purchases. *See* The Fed. Nat'l Mortg. Ass'n, *Mortgage-Backed Securities*, *available at* https://capitalmarkets.fanniemae.com/mortgage-backed-securities.**

[~~211~~543] The Green Street Asset-Backed Alert Database.

We also estimate that, in the baseline period, there were ~~179~~**180** unique issuers of Ginnie Mae-guaranteed MBS,[~~212~~ ~~52~~544] **53** unique mortgage securities approved dealers of Freddie Mac-guaranteed MBS,[~~213~~545] and ~~9~~**15** unique underwriters of Enterprise CRT securitizations.[~~214~~546] We estimate that there were ~~478~~**352** unique municipal entities that sponsored municipal ABS, ~~104~~**145** unique underwriters of municipal ABS, and ~~112~~**97** unique municipal advisors.[~~215~~] [547] **We estimate that in the baseline period there were 177 securitized asset fund advisers associated with 2482 securitized asset funds.[548] Changes in numbers vis-à-vis the Proposing Release can be attributed to different stages in the business cycle: the significant increase in interest rates that occurred in 2022 may explain some of the decrease in the number of sponsors.**

There is an overlap between these categories of sponsors and underwriters since some sponsors and underwriters might perform multiple functions and might be active in multiple market segments and, thus, the total number of potentially affected sponsors and underwriters ~~is~~**may be** lower than the sum of the numbers above. As for ~~contractual rights sponsors and directing sponsors~~**Contractual Rights Sponsors**, we note that the ~~proposed~~ definition of sponsor ~~captures~~**does not capture** persons that direct or cause the direction of the structure**,** **design, or assembly** of ABS or the composition of the underlying ~~asset pool even if they do not have contractual rights in connection with the ABS. Under this proposed definition, we lack data related to the number of such sponsors, as the proposed definition expands the concept to certain securitization participants that currently are not counted as sponsors in any existing database to the best of our knowledge. We believe that the number of such sponsors is limited as explained below, but we do not have data to quantitatively determine the number of such sponsors.~~**or referenced asset**

[~~212~~544] To arrive at the figure of~~179~~ **180** unique issuers, we~~compared the list of Ginnie Mae approved issuers (*see* Ginnie~~

used the number of unique issuer IDs for~~Mac Approved Issuers Directory, available at~~

~~https://www.ginniemae.gov/issuers/issuer_tools/Pages/issuers.aspx) to the issuers that actually~~ **securitie**s issued~~securities~~ in the baseline perio**d, less one to account for the value "Multiple Issuers**" (*see* Ginnie Mae~~Single Family Loan Performance Data~~ **MBS SF Monthly New Issues dat**a, *available at* https://www.ginniemae.gov~~investors/disclosures_and_reports/Pages/bulletins.aspx).~~**/data_and_reports/disclosure_data/Pages/disclosurehistoryfiles.aspx?prefix=nimonS_FPS&grp=MBS%20(Single%20Family)). It is possible that some issuers of Ginnie Mae-guaranteed MBS were never a sole issuer, and thus were only included in the data as an unspecified member of "Multiple Issuers.**"

~~213~~545 *See* Freddie Mac Mortgage Securities Approved Dealer Group, *available at* **Internet Archive of** https://capitalmarkets.freddiemac.com/mbs/products/dealer-groups**, captured on Nov. 17 and Dec. 6, 2022**.

~~214~~546 The Green Street Asset-Backed Alert Database.

~~215~~547 Mergent Municipal Bond Securities Database. **The Commission received a comment stating that this analysis conflates ABS issued by municipalities and municipal securitizations issued by special purpose entities. *See* letter from SIFMA I. Both are subject to the rule and should be counted as part of the baseline.**

548 ***See* Division of Investment Management: Analytics Office, Private Funds Statistics Report: Fourth Calendar Quarter 2022 (July 18, 2023) ("Form PF Statistics Report"), at 4, *available at* https://www.sec.gov/files/investment/private-funds-statistics-2022-q4.pdf (showing number of funds and advisers by category as reported on Form PF).**

pool unless they have contractual rights to do so. As discussed in Section II.B.3.b.ii., certain investment advisers could be Contractual Rights Sponsors. We derived an estimate of the number of investment advisers that would be subject to the rule from Form PF and Form ADV data.

Table 1 shows the number of private fund advisors along with estimates of their assets which may be affected by the rule, including those smaller firms which may face difficulties establishing and demonstrating sufficient separation between staff involved in activities that lead to the firm being included as a securitization participant and those advising other funds, as of the fourth quarter of 2022.[549]

Table 1. Private Securitized Asset Fund Advisor Statistics as of 2022Q4

Stratification	Adviser Count	Fund Count	Gross Asset Value	Net Asset Value
All	177	2482	936.8	275.9
With at Least 1 Fund >10% Relevant Strategy Exposure	72		586.6	194.6
With at Least 1 Fund > 10% Relevant Strategy Exposure and <50 Non-clerical or <100 Investment	25		133.5	36.9

Note: These statistics related to the "Adviser Count," "Fund Count," "Gross Asset Value," "Net Asset Value," and "Relevant Strategy Exposure" rely on Form PF. The statistics related to "Non-clerical" and "Investment Adviser Employees" rely on Form ADV. Only SEC-registered advisers with at least $150 million in private fund assets under management must report to the Commission on Form PF; SEC-registered investment advisers with less than $150 million in private fund assets under management, SEC-exempt reporting advisers, and state-registered investment advisers are not required to file Form PF.

Data aggregated to Level 1.

">10% Relevant Strategy Exposure" refers to gross exposure attributable to specified strategies (Credit, Event Driven, Relative Value, Macro), as reported in Form PF, Q20. The same fund may allocate its assets to multiple strategies. We believe these private fund strategies are those most likely to engage in a conflicted transaction with an affiliate or subsidiary that issues an ABS, and that the 10% threshold will capture those funds which employ those strategies to a sufficient degree to be meaningfully conflicted. The cutoff for employees is based on estimates of the size of firm in terms of employees at which information barriers including physical separation will be feasible and is based on the number of

[549] Cross-referencing Form PF and Form ADV data.

2022 there were 283 broadly syndicated and middle market CLOs issued in the United States, totaling $130 billion. *See* Fitch Ratings, "Global CLO 4Q22 Activity Struggles Amid High Spreads, Low Corporate Issuance," *available at* https://www.fitchratings.com/research/structured-finance/global-clo-4q22-activity-struggles-amid-high-spreads-low-corporate-issuance-24-01-2023.

3. Current Relevant Statutory Provisions, Regulations, and Practices

~~Current market practices may <be generally consistent with the >re-proposed rule requirements as a result of market participants' current compliance with the existing rules and reputational incentives described below.~~

As an initial matter, the general anti-fraud and anti-manipulation provisions of the Federal securities laws, including Section 17(a) of the Securities Act~~,~~ **and** Section 10(b) and Rule 10b-5 under the Exchange Act, apply to ABS transactions.

~~There were several~~**Several** ABS deals ~~exhibiting conflicts of interest targeted by the re-proposed rule that were generally~~**that** originated in the pre-financial crisis years~~,~~ **between** 2005-2007~~. These deals harmed investors, exposed~~ **exhibited** conflicts of interest ~~of certain securitization participants, and~~**targeted by the final rule. These deals resulted in significant investor harm and** received increased attention from Congress, the market, and regulators in the 2010s.~~216~~[550] However, despite the increased scrutiny at that time, we do not have data on the extent of securitization participants' ~~participation~~**involvement** in ABS transactions that are tainted by material conflicts of interest following the financial crisis of 2007-2009. **We note that the types of transactions with material conflicts of interest exhibited during the 2007-2009 financial crisis and targeted by Section 621 of the Dodd-Frank Act may not be easily detected or as prevalent under current market practices as they were prior to the law's passage, possibly because of market participants' compliance with existing rules and reputational incentives, as described below.**

Following the financial crisis of 2007-2009, the Commission adopted several rules that reinforce the alignment of economic incentives of securitization participants and investors and reduce information asymmetries. Regulation RR, adopted by the Commission in 2014 for the~~<~~ ~~purpose of implementing Section 941 of the Dodd-Frank Act, generally requires certain ABS sponsors (as defined under Regulation RR) to retain not less than 5 percent of the credit risk of the assets collateralizing an ABS for a period from five to seven years, after the date of closing>~~

~~216~~55~~0~~ *See*, *e.g.*, Consent and Final Judgement as to Defendant J.P. Morgan Securities LLC in *SEC v. J.P Morgan Securities LLC* (*f/k/a/ J.P. Morgan Securities Inc.*), 11 CV 4206 (S.D.N.Y. 2011) Litigation Release No. 22008 (June 21, 2011), 2010 WL 6796637; Consent and Final Judgement as to Defendant Goldman, Sachs & Co. in *SEC v. Goldman, Sachs & Co. and Fabrice Tourre*, 10 CV 3229 (S.D.N.Y 2010) Litigation Release No. 21592 (July 15, 2010), 2010 WL 2799362 (July 15, 2010); Senate Financial Crisis Report, *supra* note~~11~~ 13.

≥purpose of implementing Section 941 of the Dodd-Frank Act, generally requires certain ABS sponsors (as defined under Regulation RR) to retain not less than 5 percent of the credit risk of the assets collateralizing an ABS for a period from five to seven years, after the date of closing ≤of the securitization transaction, as specified by the rule.[217][551] Credit risk retention ~~aligns~~**aims to align** the economic interest of ABS sponsors and long investors in an ABS by requiring ABS sponsors to retain financial exposure to the same credit risks as ABS investors and, in this regard, differs from the ~~re-proposed~~**final** rule, which does not require securitization participants to retain any exposure to securitization risks. Generally, a sponsor of an ABS deal that is required to retain exposure to the credit risk of the deal is not expected to engage in the transactions prohibited by the ~~re-proposed~~**final** rule because Regulation RR prohibits them from hedging**, subject to an exception for certain permitted hedging activities under that regulation,** the interest that they retain and, otherwise, such transactions would ~~generally~~ perform against the economic interest of the ~~party~~**sponsor** resulting from the **extent of the** retained exposure.

Compared to ~~the re-proposed rule~~**Rule 192**, Regulation RR is narrower in its scope: it ~~restricts the conduct of~~**applies to** only those ~~securitization participants~~**persons** that are "sponsors" for purposes of Regulation RR, the definition of which is roughly analogous to paragraph (i) of the ~~re-proposed rule's multipart~~**final rule's multi-part** definition of "sponsor."[218][552] However, ~~the re-proposed rule would not be~~**Rule 192 is not** limited to such "sponsors" and ~~would~~ thus ~~apply to various securitization participants~~**final Rule 192 applies to a broader set of persons** that are not sponsors under Regulation RR and that are not required to retain credit risk under Regulation RR. Additionally, Regulation RR **applies to certain types of securitizations and** does not apply to ~~several~~**other** types of securitizations (*e.g.*, arbitrage or

open-market CLO, synthetic ABS, or a security issued or guaranteed by any State, or by any political subdivision of

[551] > *See* RR Adopting Release, *supra* note < **54.**

[552] ***See* RR Adopting Release, Subpart A.2. at 77742, *supra* note 54.**

a State, or by any public instrumentality of a State that is exempt from the registration requirements of the Securities Act by reason of Section 3(a)(2) of that Act) while the ~~re-proposed~~**final** rule applies to ~~all types~~**a wider range** of ABS ~~securitizations~~**, such as synthetic ABS,** as discussed in Section II.A.**.**

~~217 <*See* RR Adopting Release, *supra* note >31.~~

~~218 *See* Regulation RR, Subpart A.2., p. 77742, *supra* note 31.~~

Further, SEC-registered ABS offerings must comply with the SEC's registration, disclosure, and reporting requirements. Commission disclosure requirements, including asset-level disclosures **which are required** for some asset classes,[219][553] reduce asymmetric information about securitization participants and underlying assets in ABS and allow investors easy access to data and tools to review ABS deals, including to assess underlying asset quality. While **such** disclosure ~~in the SEC-registered ABS offerings~~ creates incentives for securitization participants to avoid potential conflicts of interest ~~because~~**by making** such conflicts ~~would be~~ visible to a large set of potential investors, these disclosure rules only apply to SEC-registered ABS offerings. ~~The re-proposed~~**In contrast, the final** rule ~~would apply~~**applies** to both ~~registered~~ ABS **offered and sold in registered** and unregistered ~~ABS~~**transactions** (including synthetic ABS as well as hybrid cash and synthetic ABS) that are not subject to the Commission's disclosure requirements for registered offerings ~~by prohibiting~~**, and therefore the broader scope of the final rule prohibits** certain types of transactions involving registered ABS and unregistered ABS that involve or would result in a material conflict of interest. ~~Furthermore~~**Also**, the ~~re-proposed~~**final** rule ~~would apply~~**applies** to underwriters, placement agents, initial purchasers, and sponsors of an ABS, as well as to **certain of** their affiliates and subsidiaries, such that it ~~would prohibit~~**prohibits** misconduct by securitization participants that may or may not have disclosure liability under the Federal securities laws.

~~As noted above, current market practices may be generally consistent with the re-proposed rule requirements as a result of compliance with the existing rules described above. Additionally~~**Furthermore**, securitization participants might be incentivized to avoid conflicted transactions ~~in order~~ to maintain their industry reputation and avoid reputational harm. A securitization participant that is known to regularly engage in "conflicted

transactions," as defined in ~~proposed~~ Rule ~~192(a)(3) might lose its reputation among investors and its participation in ABS deals that a~~

~~219~~[55]3 Asset-level requirements are specified in Item 1125 of Regulation A~~,~~ B (17 CFR 229.112[5]).

192(a)(3), might harm its reputation among investors and be excluded from ABS deals that a participant facilitates. Failure to disclose a person's substantial role in selecting assets underlying an ABS and that person engaging in conflicted transactions **with respect to those ABS** would make a securitization participant potentially subject to enforcement actions under the ~~anti-fraud~~**antifraud** provisions of the securities laws~~.~~[220]**, as occurred in certain cases following the financial crisis.**[554] On the other hand, disclosing conflicted transactions to investors would create negative ~~reputation~~**reputational** effects for securitization participants. Thus, as a baseline matter, securitization participants may be incentivized to avoid conflicts of interest and make assurances to ABS investors about the absence of such conflicts of interest, which might serve as a signal to some investors that securitization participants have investors' interest in mind while facilitating ABS transactions and might increase investor participation in such deals; however, it may be difficult for investors to assess the credibility of those assurances.

~~C. We preliminarily believe that this is the current market equilibrium due to market participants' obligation to comply with the existing rules and to reputational incentives. However, we do not have data on actual incidence of conflicted transactions, and it is possible that such transactions continue to occur.~~

Broad Economic Considerations

Securitizations are an important part of the financial system, facilitating capital formation and capital flows from investors to borrowers. However, they can generate significant risks to the economy and ABS investors. Specifically, securitization markets are characterized by information asymmetries between securitization participants and investors in ~~the~~ ABS, who are **the**

~~220 Further, an adviser to a hedge fund, as part of the~~[554] ***See, e.g.*, Consent and Final Judgement as to Defendant J.P. Morgan Securities LLC in *SEC v. J.P Morgan Securities LLC (f/k/a/ J.P. Morgan Securities Inc.)*, 11**

CV 4206 (S.D.N.Y. 2011) Litigation Release No. 22008 (June 21, 2011), 2010 WL 6796637; Consent and Final Judgement as to Defendant Goldman, Sachs & Co. in *SEC v. Goldman, Sachs & Co. and Fabrice Tourre*, 10 CV 3229 (S.D.N.Y 2010) Litigation Release No. 21592 (July 15, 2010), 2010 WL 2799362 (July 15, 2010). Further, as part of an adviser's fiduciary duty to~~the~~ a hedge fund,~~has a~~ **th**e duty of loyalty~~that~~ requires it to "make full and fair disclosure to its clients of all material facts relating to the advisory relationship" and "eliminate, or at least expose, through full and fair disclosure all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested." *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)] at 33675.

~~the~~ ultimate providers of credit, and such information asymmetries may give rise to two groups of adverse effects.

First, asymmetric information can reduce the willingness of less informed market ~~participants[221]~~**participants[555]** to transact in a ~~given~~ market. This is a secondary effect of "adverse selection," the situation in which information asymmetry benefits some market participants (*i.e.*, securitization participants) to the detriment of others (*i.e.*, ABS investors).~~[222]~~**[556]** Adverse selection has been thoroughly documented in the economic literature, and its deleterious effects on market liquidity and efficiency are well known in sectors such as ~~banking[223]~~**banking[557]** and insurance.~~[224]~~**[558]** In securitization markets, adverse selection could possibly manifest itself through a reduction in the number of investors, because investors would be less informed about the quality of underlying assets than ~~loan originators or~~ securitization ~~sponsors~~**participants**, a consequence that reduces liquidity and increases transaction costs.~~[225]~~**[559]**

Second, asymmetric information may increase risk-taking by more informed counterparties if they do not bear the adverse consequences of such risks – an effect commonly **known as "moral hazard."[560]** >In the realm of securitizations, loan originators <**and securitization**

~~[221]~~[555] The term "market participants" used in this section encompasses all participants in the ABS markets, including ABS investors, and is a broader term than the proposed defined term "securitization participant."

~~[222]~~[556] *See* George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*, 84 The Quarterly J. of Econ. 488-500 (1970).

~~[223]~~[557] *See* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 The Am. Econ. Rev. 393-410 (1981).

~~[224]~~[558] *See* Amy Finkelstein & James Poterba, *Adverse Selection in Insurance Markets: Policyholder Evidence from the U.K. Annuity Market*, 112 J. of Pol. Econ. 183-208 (2004).

~~[225]~~[559] *See* Adam B. Ashcraft & Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit*, Fed. Reserve Bank of N.Y. Staff Report No. 318 (2008) (identifying ~~at least seven different~~ frictions in the residential mortgage securitization chain ~~that can cause agency and adverse selection problems in a securitization transaction~~ and explaining that ~~given that there are many different parties in a securitization, each~~

~~with differing economic interests and incentives,~~ the overarching friction that creates all other problems at every step in the securitization process is asymmetric information).

[560]> *See, e.g.*, Bengt Holmstrom, *Moral hazard and observability*, Bell Journal of Economics, pp. 74–91 (1979) and <**references therein.**

~~known as "moral hazard."[226]~~ ~~< In the realm of securitizations, loan originators>~~, ~~securitization sponsors, and underwriters~~**participants** potentially create or increase risks in the underwriting or securitization process for which they do not bear the consequence, and about which the investor lacks information.[~~227~~561]

Securitization participants have access to more information about the credit quality and other relevant borrower characteristics than the ultimate investors in the securitized assets. Securitization participants may also participate in the selection of assets for ABS. This information asymmetry can have adverse market effects to the extent that securitization participants seek to profit from their differential information. ~~As observed above, prior~~**Prior** to the financial crisis of 2007-2009, sponsors sold assets that they knew to be very risky, without **adequately** conveying that information to ABS investors, and sometimes even while taking financial positions to benefit from adverse performance of underlying assets **to the detriment of investors**.

The patterns for adverse selection and misreporting low-quality assets were even more severe in CDOs and synthetic CDOs in the period prior to the financial crisis of ~~2007-2009.[228]~~**2007-2009.**[562] One ~~paper[229]~~**paper** finds evidence consistent with the tailoring of CDO structures for short bets and negative performance~~,~~ and finds that the synthetic CDOs issued in 2005-2007 that were shorted in CDS contracts performed even worse in 2008-2010~~.~~ **than other CDOs.** [563] This is consistent with incentives of underwriters to structure these securities ~~so as~~ to profit from short positions on such securities **enabled by the information asymmetries in the market at the time**.

>There are several possible ways, which can be complementary, to mitigate the effects of such <**information asymmetries** >in the securitization process. One way to partially offset<

~~226<*See, e.g.*, Bengt Holmstrom, *Moral hazard and observability*, Bell Journal of Economics, pp. 74–91 (1979) and>~~

~~references therein.~~

~~227~~ 561 *See supra* note ~~225~~ 559.

~~228~~562 *See*, *e.g.*, Senate Financial Crisis Report.

~~229~~563 *See* Oliver Faltin-Traeger and Christopher Mayer, *Lemons and CDOs: Why Did So Many Lenders Issue Poorly Performing CDOs?*, Columbia Business School Working Paper (2012) (analyzing the characteristics and performance of underlying assets going into CDOs and synthetic CDOs issued in 2005-2007 and comparing the ABS observed in a CDO with other ABS not observed in a CDO).

~~<There are several possible ways, which can be complementary, to mitigate the effects of such~~ >information asymmetries ~~<in the securitization process. One way to partially offset~~ ~~>information asymmetries~~ is to require that sponsors retain some "skin in the game," through which loan performance can affect sponsors' profits as much as—or more than—those of the ABS investors: that is accomplished by the credit risk retention mandated **for some securitization participants** by Regulation RR.[~~230~~564] To the extent ~~the~~**that** Regulation RR reduces adverse selection costs and moral hazard, ~~many~~**affected** currently issued ABS are less likely to be instruments used in conflicted transactions. Another way to partially offset information asymmetries is to require securitization participants to have robust disclosures of information about ABS deals or individual assets. **The Commission has employed this strategy previously, including in amendments to Regulation AB in 2014, which enhanced disclosure requirements, including by requiring asset-level disclosures.[565] More broadly, securitization participants may be able to take steps to credibly signal that they are not engaging in actions to exploit information asymmetries with investors, or investors can require information disclosures and other means of reducing the threat of adverse selection and moral hazard as part of underlying ABS contracts or in the marketing and sales process.** An additional approach to partially offset the effects of information asymmetries is to directly prohibit securitization participants from engaging in certain transactions through which they could benefit from that information asymmetry, which is what the ~~re-proposed~~**final** rule, as mandated under the Dodd-Frank Act, is designed to achieve.

The adverse selection problem may be especially severe when it is costly for investors to demand from securitization participants sufficient transparency about the assets or securitization structure to overcome informational differences between these securitization

participants and investors or when it is costly for investors to process such information. In these cases, the

[56]>4 *See* discussion of current market practices with respect to credit risk retention in Section< **IV.B.3.**

[565] ***See Asset-Backed Securities Disclosure and Registration*, Release No. 33-9638 (Sept. 4, 2014) [79 FR 57184 (Sept. 24, 2014)] ("2014 Regulation AB 2 Adopting Release").**

securitization process can misalign incentives so that the welfare of some market participants is maximized at the expense of other market participants. ~~Many~~**Some** of these risks ~~are~~**may** not **be** adequately disclosed to investors in securitizations, an issue that ~~is~~**may be** compounded as sponsors introduce increasingly complex structures like CDOs or synthetic ABS.

~~230 < *See* discussion of current market practices with respect to credit risk retention in Section > III.B.3.~~

~~Thus, the re-proposal~~**The final rule** is designed to enhance investor protection and the integrity of the ABS markets by helping to constrain the ability of securitization participants to benefit from the information asymmetry and limiting their incentives to exploit the information asymmetry at the expense of ABS investors. In particular, **under the final rule,** securitization participants ~~would further~~**will** be precluded from ~~benefitting from the actual, anticipated, or potential <adverse performance of an ABS >or assets underlying such ABS. And, the re-proposed~~**obtaining a short position in an ABS, purchasing a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the ABS or purchasing or selling any financial instrument (other than the relevant ABS) or entering into a transaction that is substantially the economic equivalent of the aforementioned transactions, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk or that otherwise satisfies the conditions of one of the exceptions. The final** rule ~~would~~**will** help prevent the sale of ABS that are tainted by the material conflicts of interest that Section 27B is designed to address, to the extent such sales currently occur, and ~~would~~**will** curb activity that is viewed as ~~contributing~~**having contributed** to the financial crisis of 2007-2009 **and may continue today**. In this way, the ~~re-proposal would help prevent conflicted transactions leading to~~**final rule will help discourage** the creation and sale of ABS that facilitate amplification of risk transfer from informed to uninformed parties and the spread of risks from low quality or riskier loans throughout the financial system.

Accordingly, the ~~re-proposal might~~**final rule may** have economic effects on broader credit markets. ABS investors may be willing to pay more or accept a lower rate of return for bearing the credit risk,

which in turn could reduce borrowing costs for underlying borrowers. **Additional compliance costs, frictions in matching borrowers and lenders, or increased difficulty managing risk can have the opposite effect.** The direction and magnitude of this possible impact on borrowing rates ~~would~~**will** depend on the tradeoff between the costs of complying with the ~~re-proposed~~**final** rule and how market participants ~~may~~ reprice ABS due to **the** enhanced investor protection ~~benefits in~~**that** the ~~re-proposed~~**final** rule **will provide**.

The economic considerations above are significantly less applicable to ABS backed by the full faith and credit of the United States government. Even though investment in such fully insured or fully guaranteed ABS is not ~~risk free~~**risk-free**, investors in such ABS are not exposed to the credit risk of individual underlying assets and, thus, are not subject to the adverse selection and

moral hazard issues described above.[231][566] As a result, such ABS are less susceptible to the conflicts of interest that ~~the re-proposed rule intends to limit. Similarly~~<, ~~while the Enterprises are in conservatorship,~~ >~~due to the unique nature of the authority and oversight of FHFA over their operations as a result of such status, they are less likely to act in a manner that would result in prohibited transactions for the benefit of private parties, and, thus, the adverse selection issues described above would be less likely to apply to them. In addition to Enterprise-guaranteed ABS, Enterprises issue CRT securities. For these Enterprise-issued CRT transactions, the Enterprises would be "sponsors" for purposes of the re-proposed rule and therefore would be prohibited from engaging in conflicted transactions with respect to investors in CRT securities (*e.g.*<, a short sale of the relevant >CRT security).~~>Section 27B is designed to prevent <**and are excluded from the final rule.**

Some commenters have stated that municipal issuers of ABS do not have an incentive to enter into conflicted transactions relative to for-profit issuers and sponsors and suggested that such municipal ABS and their issuers should be excluded from Rule 192.[567] However, application of the final rule is not conditioned on a securitization participant having a profit motive.[568] Additionally, as discussed earlier, the exclusion from the definition of sponsor >for the United States or an agency of the United States <**with respect to ABS that are** >fully insured or fully guaranteed by the United States <**is primarily based on the insulation of investors from credit risk in such ABS.[569] Municipal securities are considered safe investments with default rates at**

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[566]> *See* discussion in Section II.B<.**3.b.iv.**

[567] ***See* letters from NABL et al.; NAHEFFA.**

[568] ***See* Section II.B.3.b.i.**

[569] ***See* Section II.B.3.b.iv.**

significantly lower levels compared to corporate and foreign government bonds.[570] However, unlike the United States Government, issuers of municipal ABS are in most cases not responsible for repaying obligations they issue on behalf of conduit borrowers, including borrowers in single-asset conduit bonds.[571] As noted previously by the Commission, non-governmental conduit borrowers account for the majority of municipal bond defaults.[572] In particular, certain conduit issuers which are managed by private firms have elevated default risks on their bonds.[573] Because investors in municipal ABS are exposed to credit risk in a way that investors in ABS that are fully guaranteed by the United States government are not, carving out municipal ABS or their issuers from the final rule would reduce the investor protection benefits of the rule more significantly as compared to the carve-out for U.S. Government guaranteed ABS.[574]

Similarly, the Enterprises' ABS guarantees as to principal and interest payments are not fully guaranteed by the United States government.[575] Given that the Enterprises may eventually emerge from FHFA conservatorship and to avoid granting unnecessary competitive benefits to the Enterprises as market participants, as discussed in Section II.B.3.b.iv., we are not excluding

[570] *See* SEC, Report on Municipal Securities Market, July 31, 2012, at p. 22 and references therein for a discussion on municipal bond default rates, *available at* https://www.sec.gov/files/munireport073112.pdf.

[571] *See* footnote 56 for a discussion of municipal conduit assets.

[572] Yang, LK, *General Purpose Local Government Defaults: Type, Trend, and Impact*. 2020 Public Budgeting & Finance, 40(4): 62-85 (showing that defaulted bonds are more likely to be conduit debt and unrated).

[573] Heather Gillers, *How Did Things Go So Wrong at This Arizona Park Built With Muni Bonds?*, WALL ST. J. (Aug. 28, 2023), *available at* https://www.wsj.com/finance/investing/how-did-things-go-so-wrong-at-this-arizona-park-built-with-muni-bonds-a30a54f0 (retrieved from Factiva database) (discussing the shortcomings of the conduit structure and how conduit-related defaults are piling up); Martin Z Braun, Bloomberg, Aug. 10, 2020, *Muni Bonds Sold by Phantom Agency Draw Texas Town's Scrutiny*, *available at* https://www.bloomberg.com/news/articles/2020-08-19/muni-bonds-sold-by-phantom-agency-draw-texas-town-s-scrutiny (The Public Finance Authority had a much higher rate of borrower payment defaults than any other issuer over a three year period).

[574] See Sections II.A.3.a. and II.B.3.b. for discussion of the rule's applicability to municipal ABS and issuers.

[575] *See, e.g.*, *Mortgage Backed Securities*, Fannie Mae, *available at*

https://capitalmarkets.fanniemae.com/mortgage-backed-securities (stating that "[t]he certificates and payments of principal and interest on the certificates are not guaranteed by the U.S. Government and do not constitute a debt or obligation of the United States or any of its agencies or instrumentalities other than Fannie Mae.").

the Enterprises from the definition of sponsor.[576] Changes between the proposed and final rule, most notably in the risk-mitigating hedging activities exception, will enable the Enterprises to maintain their CRT issuance without such general exclusion from the securitization participant definition where guaranteed ABS are concerned.[577]

D. Costs and Benefits

~~Both~~**The** overall costs and ~~overall~~ benefits of the ~~re-proposed~~**final** rule ~~would~~ depend on the extent to which ~~the~~ existing market practices ~~are largely consistent with the re-proposed rule and the existing investor protection mechanisms via~~**and other regulations, including the** anti-fraud and anti-manipulation provisions of the **Federal** securities laws~~. Costs~~**, already reduce the risk of conflicts in ABS transactions. We discuss costs** and benefits ~~are~~ separately ~~discussed~~ in the next sections in more detail.[232]

1. Benefits

Investors benefit when an ABS performs in a manner that is commensurate with the level of risk that investors are willing to take and, generally, they do not benefit from the >adverse performance of an ABS<**. The final rule will benefit investors by prohibiting securitization participants from engaging in a short sale of the relevant ABS, purchasing a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS. These benefits are supported by the rule's further prohibition against securitization participants purchasing or selling any** >financial instrument (other than the relevant ABS) or <**entering into a transaction that is substantially the economic equivalent of the aforementioned transactions, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk. The final rule may thus help alleviate investor concerns that the**

576 ***See* letters**> from Fannie Mae and Freddie Ma<**c; HPC; M. Calabria; SFA I.**

577 **Part of the reason for excluding the Enterprises in the proposed rule had been to enable them to continue to issue CRTs. *See* Proposing Release** >Section II.B.2.c.ii.<

~~Investors in ABS economically benefit from the performance of ABS that is commensurate with the level of risk that investors are willing to take and, generally, they do not benefit from the adverse performance of ABS. The re-proposed rule would benefit investors by~~

~~231 <*See* discussion in Section II.B.>2.c.i.~~

~~232 As discussed above, some commenters on the 2011 proposed rule discussed the proposal's economic analysis. In light of the changes in the re-proposal, the economic analysis in this release addresses <the costs and benefits of the >re-proposal.~~

~~prohibiting securitization participants from engaging in certain transactions through which they would benefit from the actual, anticipated, or potential adverse performance of an ABS, or assets underlying such ABS, to the detriment of ABS investors. Additionally, the re-proposed rule would provide broad investor protection by prohibiting conflicted transactions and this protection could help alleviate investor concerns that the~~ securities they purchase might be tainted by certain material conflicts of interest. It ~~could~~**can** also help reduce moral hazard and adverse selection costs in the ABS market, leading to better investor protection and **a** lower cost of capital.[~~233~~**578**]

The ~~re-proposed~~**final** rule ~~could~~**will** enhance market stability through reduced incentives to engage in conflicted transactions and other speculative activity in the ABS market. This effect could be especially pronounced for asset pools that are involved in re-securitizations or synthetic ABS because of their complexity and the relative difficulty of assessing information about underlying assets of such ABS. Enhanced market stability ~~would~~**may** reduce the variance of ABS prices in the primary market and volatility of ABS prices in the secondary market.

Lower adverse selection costs, higher expected liquidity, and lower expected volatility in ABS markets ~~can~~**are expected to** lower the expected return required by ABS investors to invest in ABS ~~and~~**. These effects**, in turn, ~~that~~ may lower credit costs in loan markets for households and corporations whose debts enter the ~~reference~~ asset pools underlying the asset-backed securitizations. ~~For the reasons explained above, therefore, this re-proposal could lead to lower credit costs to the extent it would lower adverse selection costs, increase expected liquidity, and lower expected volatility.~~

~~233 Adverse selection in securitizations arises because securitization participants have information about the underlying asset selection process and the underlying asset quality that ABS investors do not have. Thus, the ABS offering price might exceed ABS private value known to securitization participants. ABS investors, therefore, might require a higher rate of return on ABS tranches to compensate them for the risk of buying lower valued assets, which is a cost of adverse selection. If the asymmetric information is reduced, the adverse selection costs might reduce as well. *See supra* note 225.~~

~~We believe our proposed~~**The** definitions of the terms "underwriter," "placement agent," "initial purchaser," "sponsor," "material conflict of interest," and "conflicted transaction" in the ~~re-proposed rule would capture with precision the types~~**final rule encompass an array** of securitization participants and ~~types of conflicts of interest at which Section 27B is aimed, would reduce asymmetric~~**conduct. This coverage will reduce asymmetries of** information between securitization participants and investors~~, and, in turn, may reduce evasion and better protect investors. In particular, the proposed definition of "sponsor" captures both the contractual rights associated with sponsoring ABS and a person's function in connection with a securitization. The function prong in the proposed definition of sponsor relies on a determination of directing the structure of the ABS or the composition of its underlying asset pool rather than solely on contractual rights to exercise discretion over ABS. The proposed definition would reduce rule evasion executed through non-contractual control over the composition of the asset pool for ABS. All these effects would further reduce adverse selection costs in the ABS market and encourage investment in asset-backed securities to the extent that investors consider material conflicts of interest important in their investment decisions. Clearly defined terms also facilitate compliance with the rule and reduce compliance costs.~~ **at various stages of the transaction structuring and marketing process, which, in turn, is expected to enhance investor protection and reduce evasion.** [579]

[578] ***See supra* note 559.**

[579] **One commenter on the rule proposal supported a broader definition of sponsor to "capture** ≥any person that directs or causes the direction of the structure, design, or assembly of an ABS or the composition of the pool of assets underlying the ABS or has the <**right to do so." *See* letter from Better Markets. As discussed below, we have revised the definition of sponsor in the final rule to remove the Directing Sponsor prong in light of commenter concerns regarding the scope of the proposed definition. To the extent a party is able to direct the structuring of the ABS without contractual provisions granting them the right to do so, opportunities to bet**

The ~~re-proposed rule would commence application of the~~**final** rule's prohibition **commences** when a person has reached~~, or has taken substantial steps to reach,~~ an agreement to become a securitization participant. ~~This approach in the re-proposed rule would help prevent evasive conduct that might happen before closing of~~**As discussed in Section II.C., this approach helps ensure that the prohibition will apply during the transaction structuring and marketing process when** a securitization **participant may be incentivized to engage in conflicted transactions,** and, thus, further ~~enhance~~**enhances** investor protection benefits of the ~~re-proposed~~**final** rule. Similarly, covering **certain** affiliates or subsidiaries of securitization participants under the ~~proposed~~ definition of "securitization participant" ~~would help~~**helps** ensure that the benefits of the ~~re-proposed~~**final** rule are ~~not nullified through evasive conduct executed via such affiliates or subsidiaries.~~**robust with respect to**

securitization participants that are part of large, complex entities, while leaving each affiliate or subsidiary primarily liable for its own conduct rather than that of other persons within the larger organization.

In addition, the ~~re-proposed~~**final** rule ~~would specify~~**specifies** the scope of conflicts of interest ~~through the proposed definitions of~~**subject to the prohibition by defining** the terms "material conflict of interest" and "conflicted transaction~~." "Material conflict of interest" would be defined as~~**," as well as including an anti-evasion provision. Under Rule 192(a)(2), "engaging in** any transaction ~~that~~ would involve or result in a material conflict of interest between a securitization participant of an ABS and an investor in such ABS if such a transaction is a conflicted transaction.**"** The ~~proposed~~ definition of "conflicted transaction" ~~would include explicit descriptions of~~**identifies** specific types of conflicting transactions and ~~would~~ also ~~include any financial instrument through which the securitization <participant would benefit from the actual, anticipated, or potential adverse performance of an ABS or its underlying >asset pool.~~[234]**includes any transaction that is substantially the economic equivalent of the specified transactions, provided that in either case "there is a substantial likelihood that reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the asset-backed security."**[580] These aspects of the ~~re-proposal would~~**final rule** tailor the ~~prohibition of the re-proposed rule to certain conflicts of interest. At~~

against the ABS may remain, which would limit the extent of the benefits described above. For the reasons discussed in Section II.B**.3.b., the final definition of sponsor appropriately balances commenter concerns about the Directing Sponsor prong being a potential impediment to a long investor's negotiating power with the need to protect investors against potential conflicts of interests in securitization transactions.**

[580] ***See*** **Section II.D for a more detailed discussion of the definition of a "conflicted transaction" under the final rule.**

prohibition to specified conflicts of interest that are likely to present the most acute investor protection concerns.

Under the ~~same time, however, the proposed anti-circumvention provision states that a transaction that circumvents the prohibition is a conflicted transaction even if the definitions do not address the form, label, or documentation of the transaction in question~~**anti-evasion provision, if a securitization participant engages in a transaction or series of related transactions that, although in technical compliance with the Rule's exceptions, is a part of a plan or scheme to evade the prohibition in Rule 192(a)(1), then the transaction will be deemed to violate the final rule's prohibition. To the extent market participants are more familiar with complying with anti-evasion restrictions than anti-circumvention provisions, as stated by a commenter, the final rule's anti-evasion restriction may reduce the compliance burden imposed by the rule in comparison to that of the proposed rule.[581] To the extent that the anti-evasion provision reduces uncertainty by focusing on the actions of securitization participants rather than the effect of transactions, the final rule may reduce compliance costs imposed relative to the proposed rule**. In addition, the ~~proposed~~**final** definition of the term "~~material conflict~~**conflicted transaction" is consistent with Section 27B's prohibition of conflicts** of interest~~"~~ **that are "material" and** looks to whether ~~securitization participants who engage in an ABS would benefit from a "conflicted transaction" (as defined above) and whether~~**there is a substantial likelihood that** a reasonable investor would consider the conflicted transaction important to the investor's investment decisions. **By using a definition of materiality grounded in the Federal securities laws, the final rule sets forth a standard that is familiar to both investors and registrants, facilitating compliance and enhancing investor confidence in the rule's effectiveness.** These elements of the ~~re-proposal may~~**final rule will work together to** capture certain types of material conflicts of interest that give rise to adverse selection and moral hazard costs. ~~The magnitude of economic~~

~~benefits from a reduction of these costs may be dampened to the degree that market participants already avoid such material conflicts of interest.~~

The Commission received comment that the extent of benefits from the rule's prohibition of conflicts of interest may be reduced relative to when the Dodd-Frank Act was passed due to

[581] ***See*** **letter from ABA.**

other new regulatory requirements and evolving market practices and incentives.[582] We acknowledge this consideration and have considered these developments in our assessment of the economic effects of the final rule, but note that these developments do not remove the possibility of conflicts occurring in securitization transactions, and thus the final rule will provide additional investor protection benefits as compared to the baseline. In addition, implementing Section 27B remains a Congressional mandate.

The adopted definition of conflicted transactions differs from the proposed definition by including any transactions that constitute substantially the economic equivalent of the specified transactions. This definition replaces the proposed broader category of any financial transactions through which the >participant would benefit from the actual, anticipated, or potential adverse performance of an ABS or its underlying <**assets. This narrowed definition addresses the concerns of various commenters who stated that adverse performance of an ABS can be associated with many factors not unique to the security, such as general interest rates or foreign exchange rates,[583] and it is similar to commenter suggestions.[584] As discussed in Section II.D, the revised definition is intended to cover bets placed against an ABS to effectuate Section 27B's investor protection mandate while not unnecessarily restricting transactions wholly unrelated to credit performance of the ABS, such as reinsurance agreements, hedging of general market risk (such as interest rate and foreign exchange risks), or routine securitization activities (such as the provision of warehouse financing or the transfer of assets into a securitization vehicle).**

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[582] ***See, e.g.,*** **letter from AIMA/ACC.**

[583] ***See, e.g.,*** **letters from AFME; Representatives Wagner and Huizenga; U.S. Representative Brad Sherman dated June 21, 2023 ("Representative Sherman"); Senator Kennedy.**

584 **See letter from AIC.**

The ~~re-proposed~~**final** rule provides exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities, which are consistent with Section 27B. As discussed below, all ~~of~~ these exceptions taken together ~~could~~**can** improve market efficiency and

~~234 *See* Section II.D for a more detailed discussion of possible conflicting transactions.~~

facilitate investor protection without diluting the investor protection benefits of the ~~re-proposed~~**final** rule. The ~~re-proposal's~~**final rule's** conditions for the availability of these exceptions ~~would~~**will** permit valuable risk-mitigating hedging, liquidity provision, and bona fide market-making, while ~~reducing the severity~~**minimizing the likelihood** of conflicts of interest between securitization participants and investors in ABS, thus enhancing investor protections. Defining the scope of these exceptions may also ease compliance with the rule, although benefits from specificity ~~could be dampened by the proposed anti-circumvention~~**can be limited by the anti-evasion** provision which states that a transaction ~~circumventing the proposed~~**which is part of a scheme to evade the** prohibition will be deemed a conflicted transaction**, because the anti-evasion provision is necessarily less certain. However, the potential ambiguity under the anti-evasion restriction may be minimal, to the extent that it covers transactions that are part of a scheme to evade the rule's prohibitions rather than considering the effects of a transaction and to the extent the prohibitions are clearly and tightly defined**. To the extent the ~~proposed anti-circumvention~~**anti-evasion** provision prevents misuse of the exceptions, ~~however,~~ that provision ~~would~~**will** strengthen investor protections.

Risk-mitigating hedging activities permit a securitization participant to fine-tune the amount of credit **or other** risk taken or to limit some of the consequences of taking a risk. ~~We believe that the proposed~~**Consistent with Section 27B, we are adopting a** risk-mitigating hedging activities **exception that permits securitization participants to continue to hedge their risk exposures. Subject to specified conditions, the final rule provides an exception for risk-mitigating hedging activities of a securitization participant in connection with, and related to, individual or aggregated positions, contracts, or other holdings of the securitization participant, including those arising out of its**

~~exception would~~**securitization activities, such as the origination or acquisition of assets that it securitizes. The final risk-mitigating hedging activities exception are expected to** promote the ~~re-proposed~~**final** rule's benefits of investor protection without prohibiting securitization participants' risk mitigation activities, unduly increasing securitization participants' costs of engaging in such activities~~,~~ or increasing barriers to entry in ABS markets. Thus, the ~~proposed~~ exception may improve efficiency of ABS markets and help protect ABS investors. ~~The re-proposed rule's conditions that risk-mitigating hedging activities do <not facilitate or create an opportunity to benefit from a conflicted transaction>, and that a securitization participant establishes an internal compliance program, enhance~~

The final rule includes the following conditions to the risk-mitigating hedging activities exception: (i) at the inception of the hedging activity and at the time of any adjustments to the hedging activity, the risk-mitigating hedging activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; (ii) the risk-mitigating hedging activity is subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that the hedging activity satisfies the requirements of the exception and does not facilitate or create an opportunity to materially benefit from a conflicted transaction other than through risk-reduction, and (iii) the securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of the exception, including reasonably designed written policies and procedures regarding the risk-mitigating hedging

activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored.

The scope of these conditions enhances the benefits of the rule by assuring investors that risk-mitigating hedging activities of securitization participants ~~would~~**will** be less likely to create (intentionally or inadvertently) economic conflicts of interest with investors. Moreover, the policies and procedures in the ~~proposed~~ risk-mitigating hedging activities exception that provide for the

identification, monitoring, and documentation of the risk and related hedging ~~could~~**can** be used by the Commission in its examination programs for regulated entities. Thus, the ~~proposed~~**final** risk-mitigating hedging activities exception ~~would~~**will** help ensure the investor protection benefits of the rule, while allowing risk-reducing actions of securitization participants.

The ~~proposed~~ exceptions for liquidity commitments and bona fide market-making activities may help prevent a loss of secondary liquidity and efficiency in the ABS market and, thus, benefit ABS investors. The ~~re-proposed~~**final** rule conditions for the availability of and limits on the liquidity commitments and bona fide market-making activities exceptions, ~~as well as~~**including** the requirement that a securitization participant establish an internal compliance program **when relying on the bona fide market-making activities exception**, may enhance the benefits of the ~~re-proposal~~**final rule** by assuring investors that such activities of securitization participants ~~would~~**will** be less likely to create (intentionally or inadvertently) economic conflicts of interest with investors.

~~The re-proposed rule also includes an exception from the proposed definition of "sponsor" for the United States, agencies of the United States, and, subject to certain conditions, the Enterprises, in each case with respect to an ABS that is fully insured or fully guaranteed by the relevant entity. While the Enterprises are in conservatorship with the U.S. Treasury and the Enterprises retain all credit risk associated with guaranteed ABS, market participants perceive Enterprise-guaranteed ABS as having almost no credit risk.[235] Also, as discussed above in <Section II.B.2.c.ii.>, while the Enterprises are in conservatorship, due to the unique nature of the authority and oversight of FHFA over their operations as a result of such status, as well as the capital support provided by Treasury under the PSPAs, the Enterprises are not expected to~~

act in a manner that would result in conflicted transactions that would benefit private parties, and, thus,

[235] *See, e.g.*, Zhiguo He & Zhaogang Song, *Agency MBS as Safe Assets*, NBER Working Paper no. 29899 (2022).

~~are not expected to engage in the adverse selection of assets for their ABS. Thus, this exception from the proposed definition of "sponsor" would not adversely affect investors, would help ensure that U.S. mortgage borrowers do not face any additional mortgage borrowing costs, and, in the case of the Enterprises, would continue to allow the Enterprises to transfer credit risk to private investors to lower the Enterprises' capital requirements and increases the Enterprises' return on capital.~~

2. Costs

The ~~re-proposed~~**final** rule ~~would~~**will** create direct compliance costs for securitization participants, some of which are discussed in detail in Section ~~IV.C~~**V**. The compliance costs ~~could come~~**will result** from the need to ~~establish~~**implement and monitor** policies, procedures, and ~~informational~~**information** barriers to ~~implement the re-proposed~~**ensure compliance with the final** rule, as well as associated legal review.[236] ~~The re-proposed rule could also create higher monitoring costs in order to avoid entering into covered transactions. To the extent that market participants have compliance systems that could be modified to help ensure compliance with the re-proposed rule, these compliance costs would be lower.~~[585] **Some commenters also expressed concerns**

[585] **Various commenters suggested that meeting the requirements of the rule would create additional legal and compliance costs. These costs will make it more costly to participate in securitization transactions. *See, e.g.*, letters from AIMA/ACC; NAMA.**

that compliance with the rule will be more costly for securitization participants >that are not subject to the Volcker <**Rule.[586] We agree that the final rule may impose additional compliance and legal costs on certain securitization participants. These costs are likely to be higher if a securitization participant has no established compliance framework that facilitates the Volcker Rule requirements since the conditions of the final rule share similarities with the Volcker Rule. However, we expect that after incurring initial start-up costs to establish the necessary compliance systems, or modify the existing compliance frameworks, some of these costs will decrease over time as securitization participants gain experience in fulfilling the requirements and implementing the rule.**

Section ~~IV~~**V** below estimates**, for the purposes of the Paperwork Reduction Act,** the initial and ongoing compliance costs to implement, maintain, **test,** and enforce written policies and procedures for securitization participants that ~~would be relying~~**rely** on the risk-mitigating hedging activities or bona fide market-making activities exceptions of the ~~re-proposed~~**final** rule.[237] ~~As estimated~~[587] **As reported** in Section ~~IV~~**V**, ~~we expect~~ the ~~industry-wide~~ total annual paperwork burden of the ~~re-proposed~~**final** rule for securitization participants to prepare, review, and update the policies and procedures under the ~~re-proposed~~**final** rule **is estimated** to be ~~45,540~~**31,606** burden **hours and cost $6,321,150.**

~~[236] One commenter suggested that the rule would significantly increase costs, including legal costs. *See* ABA Letter at 15.~~

The Commission received comment that considering all short sales of ABS to be conflicted transactions would have a disproportionate impact and be unworkable and that only short positions that result in a profit for the securitization participant should be considered potentially conflicted.[588] A short sale of an ABS by a securitization participant is a bet against

[586] *See, e.g.*, letters from AIC; LSTA II.

~~237~~587 *See* Section ~~IV~~V (discussing costs and burdens relating to the ~~re-proposed~~final rule for purposes of the Paperwork Reduction Act).

588 ***See*** **letter from AIMA/ACC.**

~~hours. Using the same $600 hourly cost of either retaining outside professionals or estimates of internal hourly salaries of senior compliance officers, we estimate that <the total annual direct compliance cost >would be $27,324,000.~~

~~As required by Section 27B(a), the scope of securitization participants in the re-proposed rule includes <affiliates and subsidiaries of underwriters, placement agents, initial purchasers, and sponsors>. In some instances, the activities of an affiliate or subsidiary may not be known to the underwriter, placement agent, initial purchaser, or sponsor, and could, inadvertently, involve or result in a material conflict of interest with the investors in the ABS. Monitoring the activities of the affiliate or subsidiary for conflicts could be operationally difficult, especially when there are existing information barriers between the entities, including for reasons unrelated to the ABS (*e.g.*, between investment banking and trading). This additional monitoring could also impose additional compliance costs for large groups of affiliated financial entities.~~

the relevant ABS regardless of whether the bet is successful, and this is the exact type of transaction that the rule is intended to prohibit in order to remove the incentive for securitization participants to place their own interests ahead of those of investors. However, we do not believe that this provision will have a disproportionate effect on the market because Rule 192(a)(3)(i) will not prohibit all ABS short selling. Rather, the prohibition only applies to parties that are securitization participants with respect to the relevant ABS. Third parties that are not securitization participants, as defined in the final rule, with respect to the relevant ABS are not prohibited from entering into short sales of such ABS. Furthermore, a short sale of the relevant ABS may, subject to satisfaction of the applicable conditions, be permitted by the final rule pursuant to one of its exceptions.

In response to commenters' concerns about the broad scope of >the terms "material conflict of interest" and "conflicted transaction" <**under the proposed rule, the final rule defines these terms more precisely by including** >descriptions of specific types of conflicting

transactions<**: the short sale of an ABS, the purchase of a CDS or** >other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant <**asset-backed security, or any transaction that is substantially the economic equivalent of the previous two transactions. These definitions should enable securitization participants to better evaluate a potentially conflicted transaction, including those covered by the anti-evasion provision, mitigating the costs of uncertainty. In addition, the exclusion of certain general interest rate or currency exchange risk hedges from** >the definition of "conflicted transaction" <**is designed to address the concerns of several commenters, who stated that hedges for interest rate or foreign exchange risk, for example, could in some cases benefit**

from adverse ABS performance while having no meaningful connection to the credit quality of the assets included in a securitization pool.[589]

Also, the final rule, in response to several commenters' concerns regarding the commencement point of the prohibition,[590] **begins** >application of the rule's prohibition when a person has reached <>an agreement to become a securitization participant. This <**timing will provide a more definite point of reference that securitization participants can use to structure their transactions and monitor their market activities and thereby ensure compliance with the rule. The revised commencement point will thus help limit the costs imposed by the rule generally.**

The scope of securitization participants in the final rule includes certain affiliates and subsidiaries of >underwriters, placement agents, initial purchasers, <**and sponsors rather than any affiliate or subsidiary of such persons, as was proposed. The Commission received several comments on the proposed definition to the effect that monitoring costs would be substantial and that** >an exception for affiliates and subsidiaries <**separated from securitization participants by information barriers would be a mechanism to mitigate conflicts of interest.**[591] **The final rule does not include an exception or requirement for information barriers. However, as adopted, the prohibition of the final rule will apply only to affiliates and subsidiaries of securitization participants that act in coordination with an underwriter, placement agent, initial purchaser, or sponsor or have access to or receive information about the relevant ABS or the asset pool underlying or referenced by the relevant asset-backed security prior to the first closing of the sale** >of the relevant asset-backed security.<

[589] ***See, e.g.*, letters from AFME; LSTA III; SFA I; SIFMA I.**

[590] ***See, e.g.*, letters from ABA; AIMA/ACC (stating that "uncertainty surrounding what constitutes compliance will increase costs and potentially reduce securitization activity").**

[591] ***See, e.g.*, letters from ABA; AFME; AIC; ICI; SIFMA I.**

The Commission received comments requesting that the final rule permit the use of information barriers or other indicia of separateness to mitigate potential conflicts of interest, with some commenters supporting a specific exception if certain conditions were satisfied, and others instead requesting that the final rule consider the presence or absence of information barriers (and the robustness and effectiveness thereof) as part of a multi-factor analysis as a preferred alternative to affirmatively requiring the use of prescriptive information barriers. As discussed in greater detail in Section II.B.3.c., the revised definition of "securitization participant" will capture the range of affiliates and subsidiaries with the opportunity and incentive to engage in conflicted transactions while still obviating the need for a prescriptive information barrier exception. Information barriers, including barriers which exist for purposes other than compliance with the final rule, may be used to support a claim that an affiliate or subsidiary should be excluded from the rule's prohibitions on the basis of an absence of coordination with a securitization participant or access to information, along with other potential indicia such as maintaining separate accounts and a lack of common officers or employees.[592] This revision may help mitigate cost concerns of those commenters who maintain information barriers separating securitization participants from affiliates and subsidiaries, as they do not need to incur the costs of recalibrating the existing information barriers. They can use the information barriers to support a claim that the affiliates and subsidiaries are not involved in conflicted transactions, reducing the compliance costs. Furthermore, the final rule enables flexibility in ensuring affiliates and subsidiaries are not securitization participants rather than prescribing a set

[592] ***See* Section II.B.3.c. (discussing the availability of information barriers or other indicia of separateness under the final rule).**

of policies and procedures, so that entities may have less costly options to do so than formal information barriers.

The Commission received comments that without accommodations to facilitate compliance, additional costs to comply with the rule may limit participation in securitizations by smaller firms or those unfamiliar with compliance programs similar >to the Volcker Rule, or <**smaller or emerging advisors and managers, potentially limiting investor choice** >through a decline in the available set of investment opportunities.<[593] **The revised scope of conflicted transactions, affiliates and subsidiaries covered by the rule, and exceptions to the rule's prohibitions all serve to reduce the costs associated with compliance to the rule. Smaller entities may tend to have less complex operations requiring less substantial compliance considerations, which would result in lower costs of compliance relative to larger and more complex entities.**

The compliance date for the final rule is 18 months following adoption. One commenter stated that the Commission should consider that "the sheer number and complexity of the Commission's Proposals, when considered in their totality, if adopted, would impose staggering aggregate costs, as well as unprecedented operational and other practical challenges."[594] But, consistent with its long-standing practice, the Commission's economic analysis in each adopting release considers the incremental benefits and costs for the specific rule—that is the benefits and costs stemming from that rule compared to the baseline. In doing so, the Commission acknowledges that, in some cases, resource limitations can lead to higher compliance costs when the compliance period of the rule being considered overlaps with the compliance period of other

[593] ***See*** **letters from AIMA/ACC; SFA I; MFA III.**

[594] ***See*** **letter from MFA III.**

rules. In determining compliance periods, the Commission considers the benefits of the rules as well as the costs of delayed compliance periods and potentially overlapping compliance periods.

We considered here whether recently adopted rules identified by one commenter that affect market participants subject to the final rule have overlapping implementation timeframes with the final rule.[595] The Commission acknowledges that there are compliance dates for certain requirements of these rules that overlap in time with the final rule, which may impose costs on resource-constrained entities affected by multiple rules.[596] However, we do not think these increased costs from overlapping compliance periods will be significant for several reasons. First, the number of ABS market participants who are also private fund advisers, and who will be subject to one or more of these recently adopted rules could be limited; as discussed above, we estimate that in the baseline period there were 177 securitized asset fund advisors associated with 2,481 securitized asset funds, and of those securitized asset fund advisors, depending on their activities, only a portion, if potentially a substantial one, may also be required to comply with one or more of the recently adopted rules raised by one commenter (and even fewer may need to comply with more than one of those other rules).[597] In addition, the commenter's concerns about the costs of overlapping compliance periods were raised in response to the proposal and as

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[595] Specifically, we considered the Beneficial Ownership Reporting Release, the May 2023 SEC Form PF Amending Release, the Private Fund Advisers Adopting Release, and the Short Position Reporting Release. *See supra* notes 527-30. As noted above, one commenter also specifically suggested the Commission consider potential overlapping compliance costs between the final rule and certain proposing releases. *See supra* note 531. These proposals have not been adopted and thus have not been> considered as part of the baseline< here. To the extent those proposals are adopted in the future, the baseline in those subsequent rulemakings will reflect the regulatory landscape that is current at that time.

[596] *See supra* notes 527-30 (summarizing compliance dates).

[597] **For example, an ABS market participant who reports on Form PF may need to comply with both the final rule and the May 2023 SEC Form PF Amending Release but may not have to comply with all of the other recently adopted rules.**

discussed above, we have taken steps to reduce costs of the final rule.[598] Finally, although the compliance periods for these rules overlap in part, the compliance dates adopted by the Commission are generally spread out over a two-year period from 2023 to 2025.[599]

The Commission also received a comment stating that existing guidance places the "burden of proof" in conducting a rulemaking with the Commission and the Commission must establish "substantial evidence" of a market failure as well as the sufficiency of the purported benefits of the rule in light of any costs.[600] In response, we note that this rule is being issued pursuant to a Congressional mandate in the Dodd-Frank Act that the Commission implement a rule prohibiting certain transactions by specified parties. Furthermore, the analysis set forth in this release, as well as the corresponding discussion in the Proposing Release, describes in detail the investor protection concerns that the final >rule is designed to address<.[601]

The Commission received comments stating that investors intending to purchase a long position in a securitization can have a role in determining the composition of the asset pool but have little incentive to engage in conflicted transactions, and can operate as a check against asymmetric information by negotiating over what risks may be included in the asset pool.[602] The commenters expressed concern that such negotiation may become less desirable if it carries

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598 The final rule mitigates costs relative to the proposal. As discussed above, the revised definition of affiliates and subsidiaries includes only those that act in coordination with an underwriter, placement agent, initial purchaser, or sponsor or receive, or have access to, information about relevant ABS or underlying or referenced asset pools prior to the first closing sale of the ABS. We believe that this revision may help mitigate cost concerns of those commenters who maintain information barriers separating securitization participants from affiliates and subsidiaries.

599 For example, the compliance period for the May 2023 SEC Form PF Amending Release concludes by mid-2024 while reporting under the final rule will be required by the end of 2024 at the earliest. For the Private Fund Advisers Adopting Release, the compliance date is Mar. 14, 2025, for the rule's quarterly statement and audit requirements for registered investment advisers with private fund clients. *See supra* notes 527-30.

600 *See* letter from MFA III.

601 *See* Sections I.C. and IV.C and Sections I.B. and III.C. of the Proposing Release.

[602] ***See, e.g.*, letters from ABA; AFME; CREFC I; IACPM; MBA; LSTA III; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SIFMA I.**

additional regulatory costs, as these costs can prove significant and thus operate in opposition >to the purpose of the <**rule, which is to protect the purchasers of ABS. In a change from the proposal, the final** >rule does not include the <**Directing Sponsor prong of the definition of sponsor and the final rule's Contractual Rights Sponsor prong of the definition excludes a person that is solely a purchaser of a long position in the ABS.**

Some commenters also requested an exemption for the B-piece buyers of CMBS on a similar basis.[603] B-piece buyers are generally affected by the rule's prohibitions in roughly the same way as any other securitization participant. They may face greater exposure to the performance of an ABS than investors due to their role as a holder of a lower-seniority economic interest. They may thus be more affected by the rule than other parties, but they also may utilize the same exceptions for risk-mitigating hedging and transactions intrinsic to the operation of an ABS. Because the role of B-piece buyers is more involved, including potentially acting as a special servicer or making decisions such as whether to release a borrower from a lien, we believe the benefits of providing such an exception to be less than those for long-only investors, and the potential for conflicted transactions to be greater.

Subject to certain conditions, the final rule provides an exception for risk-mitigating hedging activities of a securitization participant in connection with, and related to, individual or aggregated positions, contracts, or other holdings of the securitization participant, including those arising out of its securitization activities, such as the origination or acquisition of assets that it securitizes. Despite the inclusion of the risk-mitigating hedging activities exception, restrictions under the ~~re-proposed~~**final** rule ~~could~~**may** limit **some options for** risk mitigation and revenue-enhancing investment ~~options~~

available to affected securitization participants. For example, ~~by restricting the type and extent of hedging allowed to those activities excepted from the re-proposed rule,~~

[603] ***See*** **letters from ABA; CREFC I; Fannie and Freddie; MBA.**

securitization participants ~~may not be able to actively hedge their portfolio exposure.~~**wanting to engage in risk mitigation may face additional costs to comply with the conditions to the risk-mitigating hedging activities exception.**[604] This outcome could require securitization participants to increase their fees to compensate for ~~the loss of ability to hedge some risks~~**such costs**. Alternatively, such costs could be borne by securitization participants or passed to investors in the form of lower expected returns or to borrowers in the form of higher cost of capital.

To help mitigate such unintended effects, the final rule uses narrower definitions of both conflicted transactions and affiliates and subsidiaries subject to the rule (via changes to the definition of "securitization participant") than the proposed rule and permits the initial issuance of an ABS to qualify for the risk-mitigating hedging activities exception. These changes relative to the proposed rule are expected to substantially reduce the restrictions and additional costs associated with risk-mitigating hedging by securitization participants. For example, these changes enable risk-mitigating hedging by affiliates or subsidiaries that act in coordination with the parts of a firm actively engaged in securitization activities as well as the issuance of new ABS as a means of transacting a risk-mitigating hedge.

We recognize that the ~~re-proposed rule could~~**definition of conflicted transaction can** affect the scope of some current activities undertaken by underwriters, sponsors, and other securitization participants~~,~~ if they perceive such

activities as conflicting with the ~~re-proposed~~ rule. For example, ~~one commenter to the 2011 proposed rule suggested that financial firms might not be able to determine with a sufficient level of certainty that a conflict of interest exists or does not exist with respect to a transaction, and that this lack of clarity will provide significant disincentive for activity in ABS.[238] This commenter also stated that potential participants in ABS transactions could be conflicted out and, as a result, securitization markets in some situations could function less effectively, which could ultimately be detrimental to consumers of credit, the economy, and investors.[239] Further, we~~ **several commenters suggested paragraph (iii) of the conflicted transaction definition in the proposed rule could include a wide range of activities deemed essential for the functioning and issuance of ABS and the risk- and balance sheet-management of many securitization participants**>. These commenters suggested that the <**rule could therefore result in participants leaving or reducing involvement in**

[604] *See* letter from IACPM.

the market and potentially require a complete restructuring of the market to issue ABS with only parties who would be free of conflicted transactions.[605]

As discussed above, the revised definition in the final rule is intended to cover bets placed against an ABS to effectuate Section 27B's investor protection mandate, while not unnecessarily restricting transactions wholly unrelated to credit performance of the ABS, such as reinsurance agreements, hedging of general market risk (such as interest rate and foreign exchange risks), or routine securitization activities (such as the provision of warehouse financing or the transfer of assets into a securitization vehicle).[606] The reduction in scope and increased precision of clause (iii) is expected to result in lower costs associated with compliance with the final rule. Securitization participants are prohibited from a narrow range of transactions under the final rule, resulting in minimal limitation to the exposures they may take on or lay off, which is further reduced by the rule's exceptions. The monitoring of transactions unrelated to positions in the ABS is expected to impose modest costs, relative to the baseline and will be far simpler than would have been expected under the proposed rule. Indeed, many transactions that might plausibly have caused a participant to benefit from adverse performance of an ABS will not need to be considered under the final rule because only transactions directly linked to an ABS, or series of transactions constructed to be directly linked to an ABS, which may include those linked to a substantially overlapping and/or similar asset pool, will qualify as conflicted.

The Commission received comments that not providing a definition of synthetic ABS creates ambiguity about what constitutes synthetic transactions. [607] Some commenters suggested that clarifying which specific synthetic securitizations are subject to the rule will help market

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[605] *See, e.g.*, letters from AIC; AFME; IACPM.

[606] *See* Section II.D. and included citations.

[607] ***See, e.g.*, letter from ABA.**

participants comply with new requirements. [608] While we believe that most securitization participants understand and are able to identify synthetic ABS transactions, we acknowledge that not having an explicit definition of synthetic securitizations may impose compliance costs on certain securitization participants who may seek legal advice and incur other costs to ascertain whether the transactions they seek to participate in are subject to the final rule. We also expect that some securitization participants may refrain from entering transactions if they are uncertain about whether the final rule applies.

Not defining synthetic securitizations may lessen benefits to investors who may not be certain if they can rely on the rule's protections for a transaction. However, we believe that these costs may be partially offset by a higher degree of substantive compliance with the rule. The compliance costs of the rule should also decrease with time, as market participants gain experience in applying the new rule. In addition, not including an explicit definition of synthetic securitizations will help the rule remain effective over time by increasing its responsiveness to financial innovation.

Additionally, as >discussed above, we do not believe that there is a significant amount of activity in the synthetic or hybrid cash and synthetic securitization markets outside of the Enterprises' CRT market <**and a CRT market for U.S. banks. Because CRTs are eligible for the risk-mitigating hedging activities exception under the final rule, due to the removal of the carve-out of initial distributions of an ABS from the risk-mitigating hedging activities exception, we do not expect economic effects in the synthetic securitization markets to be substantial.**

We recognize that **the** curtailment or cessation of ~~some~~**certain** activities **by securitization participants**, in turn, ~~could~~**can** lead to potential costs for such participants and the broader

[608] ***See, e.g.*, letter from AIMA/ACC.**

securitization market. ~~As described below, material~~**Material** conflicts of interest ~~might only~~**may** arise between an investor and a particular securitization participant~~, which might~~ **that may** lead ~~the~~**that** investor to seek a relationship with another securitization participant. However, ~~other material conflicts of interest could arise as a result of the~~**depending upon the** nature or structure of the transaction ~~as a whole (without regard to the identity of the securitization participants involved), such <that these types of transactions >might be effectively prohibited. In such cases, there might be costs to the marketplace as a whole as~~**considered, there may be a lack of counterparties willing or able to accept the regulatory costs and risks required to engage in the transaction under the final rule. In such cases,** investors and securitization participants **may** seek alternative ~~and~~**,** potentially less efficient transaction structures to effect a similar investment strategy ~~in a way that would not <result in a material conflict of interest, >or if investors and securitization participants were unable to effect their investment strategies at all.~~

, if even feasible. This may ≥have an adverse impact on ≤~~Thus, the re-proposed rule could result in the loss of clientele for some securitization participants, especially diversified firms that service different risk mitigation and investment needs of clients, customers, or counterparties. This could <have an adverse impact on>~~

~~238 *See* SIFMA Letter at 2, 22.~~

~~239 SIFMA Letter at 5-6, 22, 33. Similarly, another commenter also suggested that the rule could affect the availability of credit. CRE Letter at 3.~~

securitization participant revenues as well as costs, due to the nature of the business (for example, underwriting), where finding and retaining clientele could be an expensive activity.

At the same time, clients, customers, or counterparties of ~~covered parties~~**securitization participants** in the ABS market could ~~also~~ face higher search costs ~~as~~**should** they ~~might need to find new, non-conflicted counterparties. The clients, customers, or counterparties also could bear undesirable costs by losing~~**lose** the ability to utilize firms with ~~particular expertise or specialization~~**experience** in certain areas due to real or perceived material conflicts of interest~~. Clients, customers, or counterparties might also incur costs in searching for a different firm to consummate a transaction, where they have a preexisting relationship that they too have invested resources into developing. In addition, to retain their ability to utilize specific firms for non-asset-backed security related transactions, some~~ **and, therefore, need to find non-conflicted counterparties. Some** potential clients, customers, or counterparties might choose to forgo the ABS investment~~. We recognize that if the re-proposed rule were to cause an investor to forgo an ABS investment entirely,~~**, in which instance** the investor could incur costs in seeking out alternative investments as well as the opportunity cost of the loss of return ~~from~~**on** the ABS investment.

This could ~~Taken together, conflicting out certain relationships can~~ reduce market liquidity and investor choice~~< through a decline in the available set of investment opportunities. >This decline could~~**, and this effect may** be more acute in the short-term when securitization participants and clients, customers, or counterparties realign their business practices to comply with the rule~~, but it could persist even in the long run.~~**. Having said that, there remain significant incentives for securitization participants to find efficient means of complying with the rule, which could serve to limit the magnitude of these costs to securitization participants, investors, and the broader market.**

~~The re-proposed rule could impose certain costs upon departments within a firm not directly involved with the securitization process, by influencing their ability to conduct transactions that could result <in a material conflict of interest with investors >in an asset-backed security for which the firm is a securitization participant. The scope of the re-proposed rule~~

The Commission also received a comment suggesting the additional costs of the rule could limit the appetite of smaller firms to participate in securitizations and potentially limit

~~could require monitoring for potential material conflicts of interest within all or many departments of the firm. If any department's proposed transaction were determined to raise a potential material conflict of interest, that department would have to abandon the proposed transaction or wait until the re-proposed rule's prohibition period ended.~~

~~The re-proposed rule may have significant costs with respect to how firms and clients, customers, or counterparties establish, maintain, and benefit from relationships. For instance, because larger financial entities tend to be organized in an effort to achieve synergies and economies of scope in combining and offering multiple services, restrictions on such activities could lead to changes to their business activities that could reduce firm earnings. These potential changes could have some disruptive effect on the firms, their clients, customers, or counterparties, and the broader marketplace, reducing current efficiencies that may exist. Restricting <the ability of securitization participants to >maintain relationships that service multiple objectives could ultimately negatively affect both financial firms and their clients', customers', or counterparties' ability to conduct economically efficient activities.~~

~~As <discussed above, we do not believe that there is a significant amount of activity in the synthetic or hybrid cash and synthetic securitization markets outside of the Enterprises' CRT market>, and therefore, we do not believe that any economic effects stemming from the synthetic securitization markets would be substantial. We do, however, recognize that—to the extent that the re-proposed rule could curtail some prospective activity in the market—the transactions prohibited by the re-proposed rule may <involve or result in a material conflict of interest >that is prohibited by Section 27B, and as a result, there may be some investor protection benefits for synthetic securitizations associated with the re-proposed rule, as discussed above.~~

investor choice.[609] The extent to which this occurs may be limited as smaller firms may have less extensive and complex securitization activities and a smaller range of other

operations, thus potentially reducing their compliance costs relative to large, diversified securitization participants. We believe that some of these disruptions will be temporary, since securitization participants will have incentives to adapt the methods they use to avoid conflicted transactions over time to minimize costs. The potential costs to investors will be mitigated to the extent that a securitization participant who leaves the market was profiting at investors' expense through undisclosed conflicted transactions.

The Commission received comments that municipal ABS issuers are unlikely to engage in conflicted transactions yet may face "unnecessary" or "unjustifiable" costs, burdens, or liability and should be excluded from Rule 192.[610] Since the final rule does not exclude municipal issuers from the definition of sponsor, these issuers may seek legal guidance and incur costs to ascertain that the activities they seek to engage in are not violating the final rule. We expect that the overall impact of the final rule on the municipalities will be modest as it will be limited to those municipalities that issue ABS covered by the rule, an approximated 352 in the baseline year out of over 50,000 issuers of municipal securities in the United States as of 2018.[611] Thus, even among municipalities issuing securities, under 1% of municipalities are expected to be covered by the final rule. The final rule does not >exclude the Enterprises from the definition of <sponsor with respect to any ABS for which they provided a guarantee of principal and interest payments. The final rule could thus result in some additional costs, such as

[609] *See* letter from AIMA/ACC.

[610] *See* letters from NABL et al.; NAHEFFA; SIFMA I.

[611] Municipal Securities Rulemaking Board, 2018, as reported in "Self-Regulation and the Municipal Securities Market," *available at* https://www.msrb.org/sites/default/files/MSRB-Self-Regulation-and-the-Municipal-Securities-Market.pdf.

compliance costs, for the Enterprises. These costs will be mitigated, however, by the rule's risk-mitigating hedging activities exception, which the final rule extends to the initial distribution of an ABS. This change is intended in large part to permit CRT transactions, including by the Enterprises, given that the Enterprises are now included as ABS sponsors under the final rule.[612]

~~Paragraph (ii)(B) of the re-proposed~~**The Commission received various comments that the inclusion of the Directing Sponsor prong in the proposed rule's** definition of ~~the term~~ "sponsor"~~ proposing to define~~ **was too broad and thus costly.**[613] **The Directing Sponsor prong defined** a "sponsor" functionally as any person that directs or causes the direction of the structure, design, or assembly or the composition of the pool of assets of an ABS~~ might increase~~ **other than a person that is solely a purchaser of a long position in the ABS. Removing this prong from the final rule will help limit the costs for** securitization participants~~' costs because entities would have to determine, under the specific facts and circumstances, whether they fall under~~ **by limiting the scope of persons encompassed by the sponsor definition.**

~~this~~**Notwithstanding this change, the adopted** definition~~. Such costs might~~ **of sponsor will impose certain compliance costs for securitization participants. For example, compliance costs may** arise even for entities ~~that perform~~**performing** solely administrative, legal, due diligence, custodial, or ministerial functions**,** because such entities would ~~also need~~**have needed** to determine whether they fall within the ~~ministerial exception of~~**Service Provider Exclusion from** the term "sponsor." **Likewise, such costs may arise for entities that are solely service providers or the holder of long positions in an ABS, when such entities need to determine whether they have affiliates or subsidiaries that are participants in the ABS. In some cases, an organization containing various affiliates and subsidiaries may engage in activities that cause it to be a securitization participant as well as activities that**

will fall within the Service Provider Exclusion or other exclusion. If such an organization is unable to arrange

[612] ***See*** **letter from M. Calabria at 4.**

[613] ***See, e.g.*****, letters from ABA; AIMA/ACC; AFME; CREFC I, CREFC II; NAMA; Representatives Wagner and Huizenga; Senator Kennedy; SFA I; SFA II; SIFMA I.**

~~The re-proposed rule would also commence <application of the rule's prohibition when a person has reached>, or has taken substantial steps to reach, <an agreement to become a securitization participant. This >commencement point would increase costs on securitization participants and those who seek to become securitization participants, because of the need to determine whether and at what point they are covered by prohibitions under the re-proposed rule. Additionally, some entities might avoid participation in some other market activities <even if they are not >participating in any securitizations, due to potential uncertainty and perceived difficulties in making the determination of whether they are securitization participants for purposes of the re-proposed rule, thus reducing the efficiency of those markets.~~

~~The re-proposed rule would also define <the terms "material conflict of interest" and "conflicted transaction" >by including explicit <descriptions of specific types of conflicting transactions >and also including any transaction through which the securitization participant would benefit from the actual, anticipated, or potential adverse performance of an ABS or its underlying asset pool. Although complying with the statutory prohibition could result in the re-proposed rule imposing the costs discussed earlier in this section, these costs might be mitigated~~

~~by the certainty and clarity provided by the proposed definitions of these key terms. In particular, the proposed detailed definitions of "material conflict of interest" and "conflicted transaction" might make it easier for securitization participants to evaluate a potentially conflicting transaction, including those covered by the proposed anti-circumvention provision.~~ **these activities in such a way that they take place in separate affiliates or subsidiaries wherein the servicer affiliate does not coordinate with or receive information regarding the ABS from the sponsor affiliate, then the organization will need to ensure that such servicing activities either do not entail conflicted transactions or otherwise fall within other exceptions to the rule. Organizations unable to do so may need to abandon one set of activities or the other, leading to costs for that organization and their counterparties.**

~~Exceptions under the re-proposed rule might give rise to additional costs. As discussed above, the re-proposed~~**Finally, the** rule provides exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities, which are consistent with Section 27B. As discussed in Section ~~III~~**II**.~~D~~**E**.~~1~~**3**., we believe that such exceptions ~~would~~**will** preserve the ability of securitization participants to reduce and mitigate specific risks that arise out of underwriting, placement, initial purchase, or sponsorship of an asset-backed security, and may preserve secondary market liquidity and efficiency, while enhancing investor protections. ~~However, we~~**We** recognize that **certain** securitization participants ~~would bear additional costs in dedicating resources to determine whether their activities fall within these exceptions. Moreover, securitization participants would~~**will** incur costs ~~of~~**related to** complying with **the** conditions for the availability of these exceptions, such as costs related to the **requirement to establish, and to implement, maintain, and enforce an internal compliance program, including certain reasonably designed written** policies and procedures ~~requirement for~~**, when relying on the** risk-mitigating hedging activities ~~and~~**exception or the**

bona fide market-making activities ~~exceptions, as discussed in greater detail in Section III.D.2~~**exception**.

~~Finally, the re-proposed rule would provide an exception for the Enterprises while the Enterprises are in conservatorship and when they act as sponsors of securitizations. If the Enterprises exit conservatorship, the Enterprises would likely face increased costs similar to those outlined above for private-label ABS issuers and might have to re-structure or abandon their CRT offerings to comply with the re-proposed rule. As a result, an Enterprise exit from~~

The rule includes a safe harbor for foreign ABS transactions if the ABS is not issued by a U.S. person and the offer and sale of the ABS are in compliance with Regulation S. This safe harbor will provide regulatory certainty for securitization participants in connection with securitizations occurring outside the United States and thus may help to reduce certain compliance costs. It is not expected to have a significant effect on the costs of U.S.

securitization participants.

~~conservatorship might result in increased costs for U.S. mortgage borrowers and higher Enterprise capital requirements.~~

E. Anticipated Effects on Efficiency, Competition, and Capital Formation

The scope of activities under the ~~re-proposed~~**final** rule that could constitute material conflicts of interest ~~could~~**and therefore would be prohibited can** potentially impact market efficiency, competition among asset-backed securitization market participants, and capital formation via the ABS markets. **As with the general costs and benefits discussed above, we are sensitive to these factors and consider the rule's effects through those lenses below.**

1. Efficiency

~~As discussed above in Section III.D.1., the re-proposed rule would <generally lead to lower adverse selection costs, higher expected liquidity, and lower expected volatility in the ABS markets. >Taken together, these benefits would <improve the efficiency of the ABS markets.>~~

Competition

~~Other factors could also affect efficiency. As an initial matter, larger~~**Larger** entities with multiple business lines could have~~, <as a result of their >structure,~~ unavoidable material conflicts of interest ~~and such~~**because of their structure. Such** entities ~~might~~**may** abandon their participation in **certain** securitizations to avoid violating the ~~re-proposed~~**final** rule. ~~An~~**In addition, an** investor that utilizes such entities for multiple services ~~could~~**may** have to switch to competitors or, depending on the structure of asset-backed security, forgo the transaction. Thus, ~~the re-proposed rule could increase competition amongst covered parties and~~ relatively smaller entities ~~might~~**may** gain market share at the expense of relatively larger entities~~. The re-proposed rule could create competitive benefits for less diversified firms and firms that already have in place policies and procedures similar to the ones required by the re-proposed rule. One commenter to the 2011 proposed rule similarly stated <that the rule could lead to >increased competition among underwriters in the ABS market, which could in turn increase efficiency and~~

~~help reduce moral hazard related to having fewer underwriters in the ABS market who may, therefore, be more inclined to take larger risks.[240] In addition, some of the parties and~~**, or firms with less diverse operations may gain market share at the expense of those with more diverse operations. This effect may be limited by the final rule's exclusion of affiliates and subsidiaries that do not act in coordination with a sponsor or other securitization participant within an entity or receive, or have access to, information about the ABS or asset pool prior to the first closing of the ABS sale. We also expect that the costs on smaller securitization participants may adversely impact competition, notably the ability of smaller investment advisers to compete, due to their limited ability to effectively implement information barriers.**

~~[240] *See* Tewary 1 Letter at 17.~~

~~capital could move out of ABS market and into alternative markets that cater to customers' investment needs.~~

On the other hand, certain requirements of the ~~re-proposed~~**final** rule that ~~would be applicable~~**apply** to the risk-mitigating hedging ~~activity~~**activities** exception and bona fide market-making activities exception are similar to those under the Volcker Rule (see discussion in Sections II.E. and II.G.). Such similarity ~~would~~**will** be

more beneficial to securitization participants that are already familiar with the Volcker Rule compliance ~~issues~~**requirements** and already have relevant programs in place, because these securitization participants ~~would~~**will** incur lower ~~initial~~**marginal** costs of compliance**, especially in the short run**. Securitization participants of this type tend to be larger entities (*e.g.*, bank holding companies). Accordingly, those that are not subject to the requirements of the Volcker Rule ~~could~~**may** incur larger initial compliance costs~~.~~ **to the extent they wish to utilize the risk-mitigating hedging activities exception or the bona fide market-making activities exception. This may be offset by smaller entities having smaller and less complex securitization activities, as well as fewer and less complex non-securitization activities which could result in conflicted transactions, leading to less intensive compliance requirements than entities that are larger, more complex, and more diversified. Furthermore, both smaller and larger entities can also benefit from the flexibility provided by the final rule since it does not prescribe a specific set of policies and procedures with which market participants need to comply to demonstrate the separation of their affiliates and subsidiaries.**

To the extent >that the rule could lead to <**reduced moral hazard and curb excessive risk-taking, it can both draw more capital into the ABS market and lead to better allocation of capital between market participants, increasing competition among underwriters. Alternatively, if some of the activity in the ABS market is pursued only because sponsors or underwriters are subsidized by exploiting moral hazard, the market may shrink while still achieving a better allocation of resources and more competitive landscape.**

In addition, as stated above, one commenter requested the Commission consider interactions between the economic effects of the proposed rule and other recent Commission

<ABS investors could incur additional search costs and >enjoy <less efficient business processes due to the loss of relationships with securitization participants described above. >Securitization participants could also lose profits or fees that would have resulted from conflicting transactions,[241] and, potentially, future profits and fees if investors take future business to other securitization participants. In addition, investors and financial firms could both lose the financial benefits from established relationships with securitization participants. As firm-investor relationships <are costly to develop, but valuable to maintain>,[242] securitization participants and ABS investors might find application of the re-proposed rule to be disruptive in some circumstances of maintaining firm-investor relationships. Thus, the re-proposed rule may

241 This may result in reduced fees or a move of transaction activity to other securitization participants that offer similar services at lower fees, which may benefit ABS investors. *See also* Tewary 1 Letter at 16.

242 < *See, e.g.*, Murat M. Binay, Vladimir A. Gatchev, and Christo A. Pirinsky. *The Role of Underwriter-Investor Relationships in the IPO Process*, Journal of Financial and Quantitative Analysis 42, no. 3, 785–809 (2007), and the literature reviewed therein.>

rules, as well as practical realities such as implementation timelines.[614] As discussed above, the Commission acknowledges that overlapping compliance periods may in some cases increase costs.[615] This may be particularly true for smaller entities with more limited compliance resources.[616] This effect can negatively impact some competitors because these entities may be less able to absorb or pass on these additional costs, making it more difficult for them to remain in business or compete. However, the final rule mitigates overall costs relative to the proposal,[617] and we do not believe these increased compliance costs will be significant for most ABS market participants.[618] We therefore do not expect the risk of negative competitive effects from increased compliance costs due to simultaneous compliance periods to be significant. Efficiency

~~<result in a contraction in ><securitization markets' size, liquidity, or efficiency, and these adverse effects may flow through to asset markets underlying ABS >and investors in such asset markets.~~

~~Since the ABS offering process can involve multiple lead underwriters or underwriting syndicates with several members,[243] the re-proposed rule could have a multiplicative effect by conflicting out several unaffiliated financial institutions. Securitization participants may react to the re-proposed rule <by reducing the number of >parties involved in a securitization, which may negatively affect the manner in which ABS are structured and underwritten and may reduce the efficiency of the securitization process. As previously stated, the scope of the statutory prohibition could amplify the inability of departments within a securitization participant to conduct business as they have in the past, which could increase financial costs, as well as heighten market inefficiency. These inefficiencies could ultimately negatively impact investors in ABS, as well as the consumers whose loans back the ABS.~~

~~The re-proposed rule may reduce informational efficiency of ABS prices. Informed short positions of securitization participants can aid in price discovery and the re-proposal would~~

~~reduce information about intrinsic values that would otherwise have been embedded in ABS prices due to informed trades of securitization participants. However, the re-proposed rule would also~~ **As discussed above in Section IV.D.1., the final rule will** generally lead to lower adverse selection costs, higher expected liquidity, and lower expected volatility in the ABS markets. **In particular, the rule will** reduce the effects of information asymmetries between securitization participants and ABS investors, which may reduce adverse selection costs and~~may~~ increase the willingness of ABS investors to engage in ABS transactions, thus, possibly improving informational efficiency of ABS prices**. These effects will** improve the efficiency of the ABS markets.

2. ~~[243] We observe that out of 1,441 non-municipal ABS deals in the baseline period, 660 deals had more than one underwriter and out of 1,928 municipal ABS deals, 841 had more than one underwriter.~~

ABS investors could incur additional search costs and less efficient business processes due to the loss of relationships with securitization participants described above. **These costs**

[614] *See* Section IV.B.

[615] *See id.*

[616] *But see infra* Section VI. (noting that the final rule will not affect smaller entities other than those that will be a "sponsor" for purposes of the final rule).

[617] *See supra* note 598.

[618] *See* Section IV.D.2.

~~The re-proposed rule could adversely impact short-term and medium-term operational efficiency of the ABS market because covered parties and their customers may seek less efficient transaction structures to effect investment strategies similar to the current baseline. However, as securitization participants adapt their transaction activity to avoid conflicted transactions, the ABS market is likely to become more accessible, more liquid, and less volatile. This may improve the longer-term operational efficiency of the ABS market and the underlying debt markets.~~

~~3. Enhanced investor protection and more stable ABS markets could result in greater investor participation, resulting in higher capital formation~~<. ~~To the extent that the~~ >~~re-proposed rule reduces the adverse selection costs and improves pricing efficiency that follow from the asymmetric information problem discussed in Section III.C. above, it would result in more efficient allocation of capital and thereby enhance capital formation.~~

would be mitigated to the extent that securitization participants that leave the market were profiting at investors' expense through conflicted transactions. Securitization participants and ABS investors might also find the application of the final rule disruptive to existing firm-investor relationships, which >are costly to develop, but valuable to maintain<.[619] **Thus, the final rule may** >result in a contraction in <**the** >securitization markets' size, liquidity, or efficiency, and these adverse effects may flow through to asset markets underlying ABS<. **This could result in higher costs for borrowers and lower risk- and liquidity-adjusted returns for investors.**

Capital Formation

We believe that the final rule will improve pricing efficiency and reduce adverse selection costs. These effects will benefit investors, who are less informed about the quality of underlying assets than securitization participants. The final rule is also likely to increase

investor confidence because it restricts activities that possibly deter investors from participating in the ABS market. Furthermore, the final rule will reduce the screening costs of those investors who prefer to ensure that securitization participants have no prior reputation of engaging in conflicted transactions. Thus, the final rule will lead to greater investor participation, and more efficient allocation of capital, thereby enhancing capital formation.

However, the potential benefits of the ~~re-proposal~~**final rule** for capital formation ~~could~~**may** be offset by potential losses in investment opportunities due to disruptions in relationships with securitization participants, at least in the short-term. The ~~re-proposed~~ rule ~~could~~**may** negatively ~~impact economic efficiency both from the point of view of~~**affect those** securitization participants~~,~~ and ~~sometimes also from the point of view of~~ investors who seek to invest in asset pools that back ABS, if certain ABS transactions ~~did~~**do** not occur because of the scope of the ~~re-proposed~~**final** rule. **Additionally, new compliance**

~~The re-proposed rule also provides an exception from the proposed definition of "sponsor" for the United States or an agency of the United States or for the Enterprises, while the Enterprises are in conservatorship, when they act as sponsors of securitizations that are fully guaranteed. If the Enterprises do exit conservatorship, additional frictions created by the need for the Enterprises to comply with the re-proposed rule requirements would likely weaken the~~

~~61~~>[9] *See, e.g.*, Murat M. Binay, Vladimir A. Gatchev, and Christo A. Pirinsky. *The Role of Underwriter-Investor Relationships in the IPO Process*, Journal of Financial and Quantitative Analysis 42, no. 3, 785–809 (2007), and the literature reviewed therein<.

requirements under the rule may also increase costs of securitizations that are not currently associated with >a material conflict of interest.<

~~competitive position of the Enterprises compared to private-label ABS issuers, in particular, increasing costs and possibly hampering~~**The net effect of the final rule on** capital formation ~~in the mortgage market via the Enterprise channel. However, some of that capital formation could move to private-label ABS markets that might gain some competitive advantage if Enterprises have to incur additional costs. If the Enterprises were to become private entities and to maintain an exemption post conservatorship, that would disadvantage other private entities that would not enjoy such an exemption.~~

is likely to be small given the offsetting factors discussed above. The potential costs of the final rule will be further limited due to the narrowed scope of transactions restricted by the final rule relative to the proposed rule.

F. Reasonable Alternatives

We considered~~a number of~~ **several** alternative approaches,~~with some of the~~ **including** alternatives suggested by commenters to the~~2011~~ proposed rule. This section considers **the** potential economic effects of **these** reasonable alternatives.

1. **Changes to** Scope **of Definitions**

We ~~could change~~**considered changing** the scope of the definition for securitization participants. One alternative to our ~~proposed~~ definition would be to broaden the definition of the terms "placement agent" and "underwriter" to include language used in the Volcker Rule that would include "a person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder." While this approach could offer additional investor protections, we ~~preliminarily~~ believe that the benefits associated with applying the rule's prohibitions to persons with an ancillary role in the distribution of an ABS, such as selling group members who have no direct relationship with an issuer or selling security holder, would not offer substantial benefit, and could substantially increase compliance costs.

~~Alternatively, we could also narrow the scope of securitization participants. We could, for example, exclude persons who have only~~**We also considered commencing the prohibition at an earlier point in time, *i.e.*, when a person has** taken substantial steps to reach an agreement~~ but have not reached such~~

~~agreements —~~ to become an underwriter, placement agent, initial purchaser, or sponsor~~,~~ of an ABS. This ~~could reduce~~**approach was revised from the proposal in response to comments regarding ambiguity and undue** compliance costs associated with determining when the potential

securitization participant has taken substantial steps to reach an agreement to participate. ~~We believe, however, that this could increase the circumstances in which a person attempts to evade the rule by engaging in prohibited conduct prior to when the person signed an agreement to be securitization participant. We could also~~[620] **Alternatively, we could** narrow the scope of securitization participants**. We could, for example, narrow the scope of securitization participants**, as suggested by some commenters, to ~~exclude persons such as underwriters, initial purchasers, or placement agents who did not structure an ABS transaction or select <the assets underlying the ABS.>~~[244] ~~We preliminarily believe, however, that this approach~~ **capture only those with direct involvement in structuring the ABS or choosing the underlying assets.**[621] **This approach,** >by reducing the number of <**covered participants, would limit costs associated with complying with the rule. However, it** would not offer the investor protection benefits associated with including these persons, given that this could also create opportunities to evade the intended prohibition of Section 27B and the ~~re-proposed~~**final** rule.

~~<As discussed above in Section II.>A., the re-proposal would specify~~**We also considered changing** the scope of material conflicts of interest for purposes of the ~~re-proposed rule as~~ **final rule.** >As discussed above in Section II.D., the <**final rule defines such** conflicts of interest **as those** that arise between a securitization participant ~~for an~~**and** ABS ~~and~~ investors ~~in such ABS~~, as a result of engaging in ~~any transaction through~~**a short sale of the relevant ABS, purchasing a credit default swap or other credit derivative pursuant to** which the securitization participant would ~~benefit from the actual, anticipated, or potential adverse performance of an ABS or its underlying asset pool~~**be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant ABS or purchasing or selling any financial instrument (other than the relevant ABS) or entering into a transaction that is substantially the economic equivalent of the aforementioned transactions, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk**.

This aspect of the ~~re-proposal would limit~~**rule limits** the scope of the prohibition to certain conflicts of interest, rather than extending the ~~re-proposed~~**proposed** rule's prohibition to broader conflicts of interest that are wholly independent of and unrelated to a specific ABS. Defining the scope of the ~~re-proposed~~**final** rule to broadly cover any conflict of interest between securitization participants and investors would

[620] *See, e.g.*, letters from ABA; AIMA/ACC.

[621] *See* letters from AFR; Better Markets; SFA I; SIFMA I; SIFMA II.

potentially offer some incremental investor protection but would significantly increase the costs of the rule and decrease efficiency of the securitization markets.

The tailored approach to [244] ~~*See* SIFMA Letter at 10.~~

~~Therefore, the tailoring of~~ this prohibition in the ~~re-proposed~~**final** rule ~~may reduce~~**should limit** the economic costs of the ~~re-proposal~~**rule** as discussed above **while still providing substantial investor protection benefits**.

2. Information Barriers

~~The re-proposal could have included an exception for affiliates or subsidiaries of securitization participants that rely on information barriers, under certain conditions. Such conditions could include a requirement that the affiliate or subsidiary is engaged in a business wholly unrelated to securitization; that the securitization participant establishes, maintains, and enforces information barriers, such as physical separation of personnel and functions, and limits permissible activities as memorialized in reasonably designed written policies and procedures; that existing rules and regulations already provide for managing conflicts of interest or restricting information flow at the affiliate or subsidiary; and that offering documents for the ABS disclose the types of transaction that the affiliate or subsidiary could engage in as part of their normal, ordinary course of business.~~

The final rule's definition of affiliates or subsidiaries of named securitization participants includes only those affiliates or subsidiaries that act in coordination with an >underwriter, initial purchaser, placement agent, or sponsor <**of an ABS or receive, or have access to, information about an ABS or its underlying or referenced asset pool prior to the first closing of sale of the ABS. We considered not including this limitation or not permitting securitization participants to rely on information barriers to be excluded from the "securitization participant" definition.** As discussed above in ~~Sections II.B.3. and III.D.2., the re-proposed rule may be~~**Section IV.D.2., Rule 192, as proposed, might have been** significantly more costly for large and diversified securitization participants ~~that have~~**with** an extensive network of affiliates and subsidiaries, such as investment companies and investment advisers, engaged in unrelated businesses. Relative to the ~~re-proposed rule, an information~~

~~barriers exception could reduce the above~~**final rule, defining certain uninvolved and uninformed affiliates and subsidiaries as securitization participants could increase the compliance** costs of the ~~prohibition~~**final rule** for securitization participants with large affiliate and subsidiary networks~~, especially <if the affiliate or subsidiary >is already~~**. Such increased costs could be greatest for affiliates or subsidiaries not** subject to existing rules and regulations that provide for conflict management or restricting information flow.[~~245~~] **Similarly, those operating subject to existing information barriers that could complicate implementation of steps to avoid conflicted transactions would face greater costs.**[622] To the degree that such an alternative could ~~reduce~~**increase** the scope of ABS transactions that would become conflicted, it could~~ allow a greater number of securitization~~

~~245~~622 *See*, *e.g.*, **letters from** AB~~ Letter at 11-12; ASF Letter at 10-11; Roundtable Letter at 10; SIFMA Letter at 14-15~~**A; AIMA/ACC; IC**I.

allow a smaller number of securitization participants to retain relationships with ABS investors and continue transacting in ABS. Thus, the alternative ~~may reduce~~**might increase** disruptions to counterparty relationships, with potential ~~beneficial~~**detrimental** effects on efficiency and capital formation in ABS and underlying asset markets.

~~However, an alternative that reduces the scope of conflicted transactions, but adds information barriers, may be insufficient to manage conflicts of interest intended to be addressed by the re-proposed rule and may be difficult to monitor and enforce.[246] Thus, such an alternative may reduce the scope of adverse selection and investor protection benefits relative to the re-proposal. However, conditions on the availability of the information barriers alternative, such as those listed above, could reduce those adverse effects of the alternative.~~

~~In addition, an information barriers alternative would give rise to its own costs related to the conditions for the applicability of the alternative exception, such as costs of physically separating personnel and functions, costs of designing related policies and procedures, and costs of monitoring and enforcing information barriers. Notably, under the alternative, securitization participants would choose to rely on such an exception only if costs of complying with the information barriers exception would be lower than costs of complying with the re-proposed rule's prohibitions.~~

In the Proposing Release, the Commission also requested comment with respect to certain conditions that securitization participants could satisfy to qualify for a potential information barrier exception to the final rule, including, for example, the establishment of written policies and procedures to prevent the flow of information between securitization participants and their affiliates and subsidiaries, internal controls, etc. While commenters suggested that affiliates and subsidiaries should only be subject to the rule if they have direct involvement in, or access to information about, the relevant ABS or are otherwise acting in coordination with the named securitization participant, they expressed concerns,

as discussed in Section II.B.3.c., that the inclusion of a prescriptive information barrier exception could be too burdensome or expensive and suggested instead that the final rule consider the presence, robustness, and effectiveness of information barriers as part of a multi-factor analysis. Relative to the prescriptive information barrier conditions discussed in the Proposing Release, the adopted approach of including as securitization participants only those affiliates and subsidiaries which acted in coordination with a securitization participant or received or had access to information regarding an ABS or its underlying or referenced asset pool prior to the first closing of the sale of the ABS should result in lower implementation and compliance costs. We expect these costs to be lower because securitization participants are not required to establish a customized information barrier compliance program for Rule 192, but can instead rely on existing information barriers or other mechanisms that would effectively prevent coordination or flow of

information between named securitization participants and their affiliates and subsidiaries. Similar potential limitations and exceptions to the rule were suggested by commenters. Two commenters proposed that, rather than including as securitization participants all affiliates and subsidiaries of a named securitization participant, >the rule should specify that <**any transaction described in paragraph (a)(3) of the final rule, entered into at the direction of a related person, would be presumed to be a conflicted transaction unless that person demonstrates that it had no substantive role in structuring, selecting the assets for, marketing, or selling the ABS.[623] This alternative would substantially reduce compliance costs for affiliates and subsidiaries which do not engage in conflicted transactions, but does not sufficiently address the potential for conflicts of interest because it would still permit information transfer which could enable bets against an ABS. Similarly, a commenter's suggestion[624] that the Regulation M "Separate Accounts Exception" framework could be used to determine whether the prohibition applied to affiliates and subsidiaries could likewise reduce compliance costs but may not sufficiently address the concerns motivating Section 27B(a).**

3. ~~"Sponsor" Exceptions~~Changes to Exclusions

~~Potential alternatives to excluding~~**The Commission proposed an exclusion** from the definition of "sponsor" ~~the United States or an agency of the United States or~~**for** the Enterprises~~,~~ while ~~the Enterprises are in~~**operating under** conservatorship~~, and when they act as sponsors of securitizations~~ **of the FHFA with respect to ABS** that are fully **insured or fully** guaranteed~~, would likely result in lower benefits or higher costs. Providing no exclusion from the definition for such entities as~~ **by the Enterprises.[625] This exception would have reduced the**

246 *See* Barnard Letter at 2; Better Markets Letter at note 23; Public Citizen Letter at 1, 4-5; Tewary 1 Letter at 13-14.

[623] ***See* letters from SFA II; SIFMA II.**

[624] ***See* letter from SIFMA I.**

[625] ***See* Proposed Rule text, "**>(B) The Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617) with capital support from the United States; or any limited-life regulated entity succeeding to the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that the entity is operating with capital support from the United States; will not be a<

~~sponsors of government-guaranteed securitizations or for the Enterprises' securitizations may increase frictions in the government-guaranteed or the Enterprise ABS or CRT processes, perhaps increasing costs for U.S. mortgage borrowers or limiting the transfer of credit risk to investors, without attendant benefits of reducing the adverse selection problem in securitizations, which is alleviated by the government guarantee or the conservatorship. Making the Enterprise exclusion permanent (*e.g.*, keeping it regardless of whether the Enterprises are in conservatorship) may reduce investor benefits in the long run because post-conservatorship structure of the Enterprises might affect their incentives when they participate in securitizations. If the Enterprises were to become private entities and to maintain an exemption post conservatorship, that would also disadvantage other private entities that would not enjoy such an exemption. Indeed, uncertainty persists regarding the nature or timing of the Enterprises' exit from conservatorship, private or government participation in the Enterprises after conservatorship, or how any changes in Enterprise structure surrounding conservatorship may affect conflicts of interest. Finally, an alternative that would provide an exception for government-guaranteed securities and Enterprise-guaranteed securities accordingly would provide an exception to all participants in such securitizations (and not just the sponsors), which would reduce the scope of adverse selection and investor protection benefits relative to the re-proposal.~~

costs of compliance with the rule for the Enterprises while they remained in conservatorship. The final rule's removal of this exclusion will encourage market efficiency and competition by applying the same treatment to a larger proportion of market participants and reducing any competitive advantages accruing to the Enterprises because of the final rule's implementation. At the same time, the expansion of the risk mitigating hedging activities exception to provide for initial distributions of ABS should help to mitigate the additional costs to Enterprises. Applying the rule to all of the

Enterprises' ABS (together with changing the risk-mitigating hedging activities exception to permit the Enterprises' CRT transactions) addresses commenter concerns regarding the treatment of Enterprise securities if and when they emerge from conservatorship, including whether CRT transactions would continue to be issued post-conservatorship under a rule that would not have considered such ABS eligible for the risk-mitigating hedging activities exception.[626]

Another alternative exception concerns ~~synthetic CLOs. As <described in Section II.A.>, we received comments to the 2011 proposed rule that suggested an exception for certain~~**entirely excepting** synthetic balance sheet ~~CLOs~~**transactions from the rule without imposing any conditions on such transactions (such as those specified in the adopted risk-mitigating hedging activities exception)**. Providing such **an unconditional** exception would reduce compliance costs to certain banks and ~~CLO managers who could use such CLOs as a risk management tool~~**sponsors who could engage in such synthetic balance sheet transactions without needing to satisfy the conditions** >applicable to the risk-mitigating hedging activities exception<. However, such an alternative ~~may reduce~~**might limit** the scope of **reduced** adverse selection and investor protection **benefits relative to the final rule** >because a conflicted transaction could be structured using such instruments<**, thus**

>sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity<."

626 ***See*** **Section II.B.3.b.iv. and footnotes 261, 265, 267, and 274 for further discussion of the proposed exception for the Enterprises and related comments.**

~~benefits relative to the re-proposal <because a conflicted transaction could be structured using such instruments>.~~

running counter to the investor-protection mandate of Section 27B. To ensure that these types of transactions cannot be utilized as a bet by a securitization participant against the performance of the reference assets, the final rule requires compliance with each of the conditions to the risk-mitigating hedging activities exception.

4. **Conditions of the Exceptions**

We considered alternative conditions ~~of~~**to** the ~~proposed~~ exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities as described in detail in Sections II.E., II.F., and II.G., respectively, including alternatives suggested by ~~the comments to the 2011 proposed rule~~**commenters**. Generally, making the conditions for the exceptions less stringent would reduce investor protection benefits of the ~~re-proposed~~**final** rule while also reducing compliance costs. Conversely, making the exceptions more stringent (*e.g.*, making the exception for bona fide market-making activities more stringent than the equivalent concept in the Volcker Rule) would increase compliance costs and could restrict the relevant activities, although it may provide additional investor protection benefits. We believe that the ~~re-proposed~~**final** conditions, in particular their similarity to the existing rules (*e.g.*, in the case of the bona fide market-making activities exception, with the concept of market-making in both the Volcker Rule ~~as well as~~**and** 15 U.S.C. 78c(a)(38)), ~~would~~ strike the appropriate balance between investor protection benefits and compliance costs of the ~~re-proposed rule. The re-proposed~~**final rule. For those entities already subject to the Volcker Rule, the similarities could make it less costly to comply with the final rule. The** conditions ~~would~~ allow securitization participants sufficient flexibility to design their ~~securitization related~~**securitization-related** risk-mitigating

hedging activities, liquidity commitments, and bona fide market-making activities in a way that is not unduly complicated or cost prohibitive. **To the extent smaller entities engage in less complex securitization activities or have fewer or less complex other operations that might require costs to comply with the rule, these costs may be**

proportionally less than larger entities with more complex and diverse securitization activities and other operations. Notably, the final rule's risk-mitigating hedging activities exception includes the initial distribution of an ABS which is used to mitigate the risks associated with another ABS, allowing for a greater range of risk management tools available to market participants than proposed.

We also considered ~~proposing~~**adopting** a certification requirement for using the risk-mitigating hedging activities~~, liquidity commitments,~~ and bona fide market-making activities exceptions. Under this alternative, an officer within the securitization participant would certify that the conditions supporting the exception had been met. This additional step might provide additional

investor protection~~,~~ but ~~might~~**would** also create additional paperwork and procedural burdens associated with documenting the exception. To avoid these burdens, or ~~perceived~~**potential** enforcement or liability risk, securitization participants might choose not to engage in the excepted activities even in ~~legitimate~~ circumstances **where they do not represent a bet against the relevant ABS**.

~~**Request for Comments**~~

~~We request comment on all aspects of our economic analysis, including the potential costs and benefits of the re-proposed rule and alternatives thereto, and whether the rule, if we were to adopt it, would promote <efficiency, competition, and capital formation>. In addition, we request comments on our selection of data sources, empirical methodology, and the assumptions we have made throughout the analysis. Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on costs and benefits estimates. We especially appreciate comments that distinguish between costs and benefits that are attributed to Section 27B itself and costs and benefits that are a result of policy choices made by the Commission in implementing the statutory requirements. In particular, we request comments on the following questions on the Economic Analysis:~~

~~98. What additional qualitative or quantitative information should be <considered as part of the baseline >for the economic analysis of the re-proposed rule?~~

~~99. Are the costs and benefits of the re-proposed rule accurately characterized? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should be taken into account? If possible, please offer ways of estimating these costs and benefits. What additional considerations can be used to estimate the costs and benefits of the proposed amendments?~~

100. What would be the impact of the re-proposed rule on the ultimate borrowers (*e.g.*, households, businesses)? What aspects of the re-proposed rule would have the biggest impact, and how would the impact change if that aspect of the rule were revised? What would be the direction and magnitude of possible impact of the re-proposed rule on the borrowing rates and credit availability? What, if any, data could be used to estimate the impact?

101. Would the types, or extent, of any benefits or costs of the re-proposed rule differ between different types of securitizations? For example, do potential benefits or costs differ in their application to ABS backed by different types of assets? Do the types, or extent, of any benefits or costs from the re-proposed rule differ between ABS and synthetic ABS? If so, how do the benefits or costs differ?

102. Would the potential benefits and costs differ for securitizations of different size?

103. Are the costs and benefits of the re-proposed rule different between municipal ABS and non-municipal ABS? How does the re-proposed rule affect ultimate borrowers of loans that back municipal ABS?

104. Would potential benefits and costs differ for securitization participants of different size?

105. What potential costs might arise in relation to monitoring for transactions that would <result in a material conflict of interest between a securitization participant >and investors in the ABS? Do securitization participants have existing procedures that might help mitigate potential costs? What is the proportion of securitization participants that currently enter into contractual assurances that would be compliant with the re-proposed rule?

106. With respect to potential costs related to the re-proposed rule prohibiting transactions by affiliates, subsidiaries, or another department within the firm that would result in a

material conflict of interest with investors in the ABS, is it possible to quantify the cost of not being permitted to undertake such transactions?

107. Are the effects on competition, efficiency, and capital formation arising from the proposed amendments accurately characterized? If not, why not?

108. Are the economic effects of the above alternatives accurately characterized? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should be taken into account?

109. Are there other reasonable alternatives to the proposed amendments that should be considered? What are the costs, benefits, and effects on competition, efficiency, and capital formation of any other alternatives?

110. Are there data sources or data sets that can help refine the estimates of the costs and benefits associated with the proposed amendments? If so, please identify them.

111. What are the benefits and costs of reasonable alternatives to the proposed conditions for the exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities? Are there alternative conditions we should include, and if so, why?

112. What benefits and costs might result from requiring an officer to certify that the conditions supporting the exceptions for risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities had been met? In what ways (if any) would such a requirement alter the behavior of securitization participants?

~~IV~~V. ~~Paperwork Reduction Act~~ PAPERWORK REDUCTION ACT

Summary of the ~~Collection~~Collections of Information

Certain provisions of the ~~re-proposed~~**final** rule ~~would impose a new~~**contain** "collection of information" ~~requirement~~**requirements** within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[247][627] The Commission ~~is submitting the re-proposed rule~~**published a notice requesting comment on these collections of information in the Proposing Release and submitted these requirements** to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[248] ~~The title for this proposed new information collection is "<Prohibition Against Conflicts of Interest in Certain Securitizations>." OMB has not yet an assigned control number to the collection of information.~~ An agency may not conduct or sponsor, and a person is not required to ~~respond to~~**comply with**, a collection of information unless it displays a **currently** valid ~~control number.~~**OMB**

[627] ≥ 44 U.S.C. 3501 *et seq*<.

A.

control number. The title for the affected collection of information is "Securities Act Rule 192" (OMB Control No.: 3235-0807).

The ~~re-proposed~~**final** rule ~~would implement~~**implements** Section 621 of the Dodd-Frank Act, which added Section 27B to the Securities Act, by prohibiting securitization participants from directly or indirectly engaging in any transaction that would involve or result in any material conflict of interest between a securitization participant for such ABS and an investor in such ABS. **The final rule includes certain** >exceptions for risk-mitigating hedging activities and bona fide market-making activities<**, both of which are conditioned on the securitization participant implementing, maintaining, and enforcing certain written policies and procedures.** A more detailed description of the ~~re-proposed~~**final** rule, including the need for the information ~~and its proposed~~**collection associated with these exceptions and its** use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the economic effects of the ~~re-proposed~~**final** rule can be found in Section ~~III~~**IV** above.

The collection of information ~~would be~~**is** mandatory for securitization participants that rely on two exceptions to the ~~re-proposed~~**final** rule described below. ~~Additionally, the~~**The** collection of

~~247 <44 U.S.C. 3501 *et seq.*>~~

~~248 *See* 44 U.S.C. 3507(d); 5 CFR 1320.11.~~

information is not required to be filed with the Commission or otherwise made publicly available but ~~would~~**will** not be confidential. **Summary of Comment Letters**

~~**Respondents Subject to Rule**~~

In the Proposing Release, the Commission requested comment on the PRA burden hour and cost estimates and the analysis used to derive the estimates.[628] While a number of parties commented on the potential costs of the proposed rule, only two commenters specifically addressed the PRA analysis.[629] One of these commenters stated that the PRA analysis in the

[628] Proposing Release at 9723.

[629] *See* letters from ABA; AIC.

B.

Proposing Release underestimated the number of securitization participants that could rely on the risk-mitigating hedging activities exception given the scope of securitization participants that would be subject to the rule, as proposed, and >the scope of the proposed definition of "conflicted transaction<**."[630] The other commenter expressed similar concerns regarding the scope of the proposed rule and stated that the PRA underestimated the annual hourly burden for each securitization participant** >relying on the risk-mitigating hedging activities or bona fide market-making activities exceptions <**and** >the total annual direct compliance cost <**of the proposed rule.[631]**

While we acknowledge the commenter's concerns about costs of the proposal, for the reasons discussed in >Sections II.E. and II.G. <**and elsewhere throughout this release, we believe that the information required by the final rule with respect to the compliance program conditions to the risk-mitigating hedging activities and** >the bona fide market-making activities <**exceptions is necessary and appropriate in the public interest and for the protection of investors. Further, a discussion of the economic effects of the final rule, including consideration of comments that expressed concern about the expected costs associated with the proposed rule, can be found in Section IV above. With regard to the calculation of paperwork burdens, we note that both the Proposing Release's PRA analysis and our PRA analysis of the final rule here estimate** >the burden of the collection of information <**requirements of the applicable exceptions and fully comport with the requirements of the PRA. In response to the comments that the PRA analysis in the Proposing Release underestimated the number of affected securitization participants and their average annual hourly burden given the scope of the proposed rule, the**

modifications to the proposed rule that we are adopting in response to commenter concerns, including the changes

[630] ***See*** **letter from ABA.**

[631] ***See*** **letter from AIC.**

discussed above in Section II.B.3.c. regarding the scope of affiliates and subsidiaries that will be subject to the final rule[632] and the changes discussed above in Section II.D.3. regarding the scope of the defined term "conflicted transaction"[633] should reduce both the number of respondents and the burden hours associated with the collection of information. We are adjusting our PRA estimates to reflect these modifications.

C. **Effects of the Final Rule on the Collections of Information**

The final rule requires >a securitization participant to implement, maintain, <**and** >enforce written policies and procedures <**when it relies on the risk-mitigating hedging activities exception in 17 CFR 230.192(b)(1) ("Rule 192(b)(1)") or the bona fide market-making activities exception in Rule 192(b)(3). Specifically, when a securitization participant relies on the risk-mitigating hedging activities exception it is required, under Rule 192(b)(1)(ii)(C), to have established, and to implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the other requirements of the exception, including reasonably designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored. Similarly, when a securitization participant relies on the bona fide market-making activities exception it is required, under Rule 192(b)(3)(ii)(E), to have established, and to implement, maintain, and enforce, an internal**

632 ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).**

633 ***See*** **Section II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) and provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction).**

~~The re-proposed rule would not require < a securitization participant to implement, maintain, > or < enforce written policies and procedures>, unless it is < relying on the risk-mitigating hedging activities or bona fide market-making activities exceptions > of the re-proposed rule. The proposed~~ **compliance program that is reasonably designed to ensure the securitization participant's compliance with the other requirements of the exception, including reasonably designed written policies and procedures that demonstrate a process for prompt** >mitigation of the risks of <**its market-making positions and holdings. Accordingly, securitization participants will** >be required to either prepare new policies and procedures or update existing ones in order to rely on <**these exceptions.**[634] **As adopted, these written** policies and procedures requirements ~~are intended to~~**will** help prevent evasion of the ~~re-proposed rule and the abusive conduct at which <Section 27B to the Securities Act >is aimed by requiring the implementation, maintenance, and enforcement of frameworks to facilitate compliance with the other conditions of each exception~~**final rule and discourage practices that resulted in the misconduct that Section 27B was enacted to prohibit**. If a securitization participant ~~were~~**is** a regulated entity, the collection of such information (*i.e.*, policies and procedures) ~~would be used by the Commission~~**required by Rule 192 will provide important information to** staff in ~~its~~**the Commission's** examination and oversight program, and if such securitization participant ~~were~~**is** also subject to oversight by a self-regulatory organization, ~~the~~**this** collection of ~~such~~ information ~~might also be used by~~**should provide important compliance information to** the relevant self-regulatory organization in connection with its oversight of the securitization participant.[249][635]

As discussed in Section II, we have made some changes to the proposed rule as a result of comments received. [636]

~~<As stated below in PRA Table 1, we estimate that there are a total of >1,265 <securitization participants, all of whom could rely on the risk-mitigating hedging activities exception >and 150 of these securitization participants could rely on <the bona fide market-making activities exception. For the purposes of this analysis, as described below, we have made assumptions regarding actions respondents >might take to manage and memorialize compliance with the re-proposed rule.~~

634 >We estimate that only a subset of<> securitization participants (*e.g.*, broker-dealers)< **will**> rely on the bona fide market-making activities exception and that, while amending their written policies and procedures to address the more broadly applicable risk-mitigating hedging activities exception, such securitization participants< **will**> also amend their written policies and procedures to address the bona fide market-making activities exception<.

~~249~~635 We recognize that not all securitization participants that ~~would~~**will** rely on the risk-mitigating hedging activities exception or the bona fide market-making activities exception (*e.g.*, municipal entities that are sponsors of municipal ABS) would be subject to the Commission's examination and oversight programs (or, if applicable, those of the relevant self-regulatory organization).

636 ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security) and Section II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) and**

~~The availability of the proposed exceptions would be conditioned on securitization participants implementing, maintaining, and enforcing written <policies and procedures reasonably designed to >ensure compliance with the requirements of the exceptions, including the identification, documentation, and monitoring of such activities. Accordingly, securitization participants would <be required to either prepare new policies and procedures or update existing ones in order to rely on >the exception.[250]~~

>As stated below in PRA Table 1, we estimate that there are a total of <**1,277** >securitization participants, all of whom could rely on the risk-mitigating hedging activities exception<**, and 156 securitization participants who could rely on** >the bona fide market-making activities exception. For the purposes of this analysis, as described below, we have made assumptions regarding actions respondents <**are expected to take to implement, manage, and ensure compliance with the final rule.**

PRA Table 1: Estimated Number of Securitization Participants[1]

Private-label ABS sponsors	~~455~~**420**
Municipal ABS ~~sponsors~~**sponsors[2]**	~~590~~**516**
Sponsors related to government-backed securities	185
Unique underwriters, placement agents, and initial purchasers **that are not included in the categories above**	~~150~~**156**
Total	~~**1,380**~~ **1,277**

[1] **The securitization participant estimates are derived from data in the Green Street Asset-Backed Alert Database, the Green Street Commercial Mortgage Alert Database, the Mergent Municipal Bond Securities Database, and information on www.ginniemae.gov and https://capitalmarkets.freddiemac.com/mbs/products/dealer-groups. To account for recent market variability, these estimates represent a two-year average of the data available from such sources for calendar year 2021 and calendar year 2022.**

[2] **This estimate includes municipal advisors, municipal issuers, and issuers of securitizations of municipal securities that may be sponsors for purposes of the final rule but are not municipal issuers.**

~~[1] The securitization participant estimates are derived from data in the Green Street Asset-Backed Alert Database, the Green Street Commercial Mortgage Alert Database, the Mergent Municipal Bond Securities Database, and information on www.ginniemae.gov and https://capitalmarkets.freddiemac.com/mbs/products/dealer-groups.~~

We estimate that for each securitization participant relying on ~~the proposed~~**these** exceptions, it would take approximately 80 hours to initially prepare new written policies and ~~procedures~~[251] **procedures**[637] **and**

~~[250] <We estimate that only a subset of > covered <securitization participants (e.g., broker-dealers) > would <rely on the bona fide market-making activities exception and that, while amending their written policies and procedures to address the more broadly applicable risk-mitigating hedging activities exception, such securitization participants > would <also amend their written policies and procedures to address the bona fide market-making activities exception.>~~

provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction).

~~[251]~~[637] While some securitization participants may have policies and procedures in place related to hedging or market-making, we are estimating the same burden hour estimates for all securitization participants. Burden hour estimates for the preparation of new policies and procedures (80 hours) are derived from similar estimates for~~< the documentation of policies and procedures by RIAs as required by Rule 206(4)-7 of the > Investment Advisers Act of 1940 <. *See Compliance Programs of Investment Companies and Investment Advisers*, Release No. IA-2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (taking into account industry participant comments specific to the 80-hour estimate). Because the > proposed <exceptions would require the drafting or updating of reasonably designed written policies and procedures regarding each requirement applicable to such exception, we believe 80 hours is an appropriate burden estimate.>~~

and approximately 10 hours annually to review and update those policies and procedures[252].[638] As a result, we estimate that the annual burden for each securitization participant would be 33 hours[253].[639] Because these estimates are an average, the burden could be more or less for any particular securitization participant, and might vary depending on a variety of factors, such as the degree to which the participant uses the services of outside professionals or internal staff.

The following table summarizes the estimated paperwork burdens associated with the re-proposed**final** rule.

<PRA Table 2: Estimated Paperwork Burden of >Proposed Rule 192

Proposed Rule 192	**Estimated Burden Increase**	**Brief Explanation of Estimated Burden Increase**
Require policies and procedures implementing, maintaining, and enforcing written policies and procedures reasonably designed to ensure compliance with the requirements of the applicable exceptions, including the identification, documentation, and monitoring of such activities.	An increase of 33 burden hours.	This is the estimated effect to initially prepare and subsequently review and update the policies and procedures.

>the documentation of policies and procedures by RIAs as required by Rule 206(4)-7 of the <**Advisers Act**>. *See Compliance Programs of Investment Companies and Investment Advisers*, Release No. IA-2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (taking into account industry participant comments specific to the 80-hour estimate). Because the <**final** >exceptions would require the drafting or updating of reasonably designed written

policies and procedures regarding each requirement applicable to such exception, we believe 80 hours is an appropriate burden estimate.<

~~252~~638 Burden hour estimates for the annual review of policies and procedures (10 hours) are derived from the same estimates for recently proposed Exchange Act Rule 17Ad-25(h). Rule 17Ad-25(h) requires updating current policies and procedures or establishing new policies and procedures to ensure ongoing compliance, which would impose an ongoing annual burden similar to the one imposed by the proposed risk-mitigating hedging activities exception here. *See Clearing Agency Governance and Conflicts of Interest*, Release No. 34-95431 (Aug. 8, 2022) [87 FR 51812 (Aug. 23, 2022)].

~~253~~639 These estimates ~~represent the average burden for all issuers, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual issuers based on a number of factors, including the size and complexity of their organizations. The OMB PRA filing inventories~~ represent a three-year average. In deriving our estimate, the burden hour estimates for the preparation of new policies and procedures (80 hours) were added to the ongoing estimates for the annual review of policies and procedures (10 hours) for the following two years resulting in a 100 hour burden over three years, or approximately 33 hours per year. Some ~~issuers~~**securitization participants** may experience costs in excess of this average in the first year of compliance with the amendments and some ~~issuers~~**securitization participants** may experience less than the average costs. Averages also may not align with the actual number of ~~filings~~**estimated burden hours** in any given year.

>PRA Table 2: Estimated Paperwork Burden of< Final Rule 192

Final Rule 192	Estimated Burden Increase	Brief Explanation of Estimated Burden Increase
Require policies and procedures implementing, written policies and procedures reasonably designed to ensure compliance with the requirements of the applicable exceptions, including the identification, documentation, and	An increase of 33 burden	This is the estimated burden to initially prepare and procedures.

D. Aggregate Burden and Cost Estimates for the Final Rule

Below we estimate the paperwork burden in hours and costs as a result of the new collection of information established by the ~~re-proposed~~final rule. These estimates represent the average burden for all securitization participants who could rely on the risk-mitigating hedging activities exception or the bona fide market-making activities exception, both large and small. In deriving our estimates, we recognize that the burdens would likely vary among individual securitization participants. We estimate the total annual burden of the ~~re-proposed~~final rule to be ~~45,540~~42,141 burden hours. We calculated the burden estimate by multiplying the estimated number of securitization participants by the estimated average amount of time it would take a securitization participant to prepare and review and update the policies and procedures under the ~~re-proposed~~final rule. For purposes of the PRA, the burden is to be allocated between internal burden hours and outside professional ~~cost~~costs. PRA Table 3 sets forth the percentage estimate for the burden allocation for the new

collection of information. We also estimate that the average cost of retaining outside professionals is $600 per hour.[254][640]

PRA Table 3. Estimated Burden Allocation for the Collection of Information

Collection of Information	Internal	Outside Professionals
Prohibition Against Conflicts of Interest in Certain Securitizations	75%	25%

The following PRA Table 4 summarizes the requested paperwork burden, including the estimated total reporting burdens and costs, under the final rule.

[254] ~~< We recognize that the costs of retaining outside professionals (*e.g.*, compliance professionals and outside counsel) might vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $600 per hour, consistent with other recent rulemakings.>~~

PRA Table 4. Requested Paperwork Burden for the New Collection of Information

	Requested Paperwork Burden		
Collection of Information	**Securitization Participants (A)**	**Burden Hours (A) x 33 x (0.75)**	**Cost Burden (A) x 33 x (0.25) x $600**
Prohibition Against Conflicts of Interest in Certain Securitizations	~~1,380~~**1,277**	~~34,155~~**31,606**	$~~6,831,000~~**6,321,150**

~~**Request for Comment**~~

~~We are using the above estimates for the purposes of calculating reporting burdens associated with the re-proposed rule. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comments in order to:~~

- ~~Evaluate whether the proposed collection of information would be necessary for the performance of the functions of the Commission, including whether the information would have practical utility;~~
- ~~Evaluate the accuracy of our estimates of the burdens of the proposed collection of information;~~
- ~~Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;~~
- ~~Evaluate whether there are ways to minimize <the burden of the collection of information >on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and~~
- ~~Evaluate whether the proposed amendments would have any effects on any other collection of information not previously identified in this section.~~

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, <Office of Information and Regulatory Affairs>, Washington, DC 20503; and send a copy to Vanessa Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090, with reference to File No. S7-01-23. Requests for materials submitted to OMB by the Commission with regard to the collection of information requirements should be in writing, refer to File No. S7-01-23 and be submitted to the U.S. Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[255] the Commission must advise OMB as to whether the proposed amendments constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in:

- An annual effect of the U.S. economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or

[255] 5 U.S.C. 801 *et seq.*

- ~~Significant adverse effects on competition, investment, or innovation.[256]~~

~~We request comment on whether the re-proposed rule would be a "major" rule for purposes of SBREFA. In particular, we request comment and empirical data on:~~

- ~~The potential effect on the U.S. economy on an annual basis;~~
- ~~Any potential increase in costs or prices for consumers or individual industries; and~~
- ~~Any potential effect on competition, investment, or innovation.~~

VI. ~~Initial Regulatory Flexibility Analysis~~FINAL REGULATORY FLEXIBILITY ANALYSIS

The Regulatory Flexibility Act ("RFA")[257] ~~requires an agency, when issuing a rulemaking proposal, to prepare and make available for public comment an Initial~~ **requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[641] to consider the impact of those rules on small entities. We have prepared this Final** Regulatory Flexibility Analysis ("~~IRFA") that describes the impact of the re-proposed rule on small entities.[258] We have prepared the following IRFA in accordance with Section 3(a) of the RFA.[259] It relates to proposed Rule 192 under the Securities Act.~~**FRFA") in**

~~**Reason for and Objectives of the Proposed Action**~~

[64]~~>~~0 We recognize that the costs of retaining outside professionals (*e.g.*, compliance professionals and outside counsel) might vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $600 per hour, consistent with other recent rulemakings~~<~~.

[641] **5 U.S.C. 553.**

accordance with Section 604 of the RFA.[642] An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release.[643]

A. Need for, and Objectives of, the Final Rule

We are ~~proposing~~**adopting** Rule 192 to implement Section 27B of the Securities Act. The ~~re-proposed~~**final** rule ~~seeks~~**is designed** to prevent the sale of ABS that are tainted by material conflicts of interest by prohibiting securitization participants from engaging in certain transactions that could incentivize a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors. ~~The re-proposed rule also provides a standard for determining~~**As discussed in more detail in Section II.D.3. above, the final rule specifies** which types of transactions ~~would~~**will** be prohibited so that activities that are routinely undertaken in connection with the securitization process or >that are unrelated to the <**securitization process will not be unnecessarily restricted. Also, as discussed in more detail in Sections II.E.3., II.F.3. and II.G.3., the final rule also provides specific exceptions to its prohibition** with respect to the types

~~256 5 U.S.C. 804(2).~~
~~257 5 U.S.C. 601 *et seq*.~~
~~258 5 U.S.C. 603(a).~~
~~259 5 U.S.C. 603(a).~~

of ~~financial assets underlying securitizations covered by the re-proposed~~ ~~rule~~**risk-mitigating hedging, liquidity commitment, and bona fide market-making activities of securitization participants** that do not give rise to the risks that Section 27B ~~was intended to address would not be unnecessarily restricted. The requirements of the re-proposed~~**addresses. The need for, and objectives of, the final** rule are discussed in more detail in Section II above. We discuss the economic impact and potential alternatives to the ~~re-proposed~~**final** rule in Section ~~III~~**IV** above, and the estimated compliance costs and burdens of the ~~re-proposed~~**final** rule under the PRA in Section ~~IV~~**V** above.

~~**Legal Basis**~~

~~The re-proposed rule is being proposed under authority set forth in in Sections 10, 17(a), 19(a), 27B, and 28 of the Securities Act.~~

Significant Issues Raised by Public Comments

In the Proposing Release, the Commission requested comment >on any aspect of the <**IRFA, and particularly on the** >number of small entities that <**would be affected by the proposed**

[642] **5 U.S.C. 604.**

[643] ***See*** **Proposing Release at 9724-9726.**

B.

rule, the >existence or nature of the potential impact of the <**proposed** >rule on small entities discussed in the analysis<**, how the proposed** >rule could further lower the burden on small entities<**, and how to quantify the impact of the proposed amendments.**

The Commission did not receive any comments specifically addressing the IRFA. The Commission did receive, however, one comment expressing concern that the proposed rule would apply to small entities without a longer implementation period or other accommodations to facilitate their compliance. [644] **This commenter stated the additional costs that would be imposed under the rule, as proposed, would limit the ability of smaller firms to participate in securitizations, potentially limiting investor choice.**[645] **The Commission also received comments expressing concerns regarding the compliance burdens that would be imposed under the rule, as proposed, on municipal advisors that are small entities.**[646] **We have considered these comments in developing the FRFA.**

C. Small Entities Subject to~~Proposed~~ the Rul~~192~~e

The ~~re-proposed~~**final** rule ~~would~~**will** affect some small entities—such as municipal entities, small broker-dealers, and RIAs that advise hedge funds—that ~~would~~**will** be "sponsors" for purposes of the ~~re-proposed~~**final** rule.[260][647] The RFA defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[261][648]

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644 ***See*** **letter from AIMA/ACC.**

645 ***See*** **letter from AIMA/ACC.**

646 ***See*** **letters from AIMA/ACC; NAMA (stating that many municipal advisors are small entities and that including them within in** >the scope of the rule would <**require them to "spend a great deal of time, effort and expense" and suggesting an exclusion from the rule for municipal advisors); Wulff Hansen (supporting NAMA's statements).**

647 **We believe that the final rule will** >not affect small entities other than those that <**will** >be a "sponsor" for purposes of the <**final rule.**

648 **5 U.S.C. 601(6).**

For purposes of the RFA, under 17 CFR 230.157 and 17 CFR 240.0-10(a), an issuer, other than an investment company, is a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities not exceeding $5 million. We estimate that no sponsors of private-label ABS ~~would~~**will** meet the definition of "small entity" applicable to issuers.

[260] ~~We preliminarily believe that the re-proposed rule would <not affect small entities other than those that >would <be a "sponsor" for purposes of the >re-proposed rule.~~

[261] ~~5 U.S.C. 601(6).~~

A municipal entity is a small entity for purposes of the RFA (*i.e.*, a "small government jurisdiction") if it is a city, county, town, township, village, school district, or special district, with a population of less than fifty thousand.[262][649] We estimate that, of the 478**415** municipal entities who act as sponsors of ABS, between 75**69** and ~~104 would~~**90 will** meet the definition of small entity applicable to municipal entities.[263][650]

A broker-dealer is a small entity if it has total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a-5(d), or, if not required to file such statements, had total capital of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been a business, if shorter); and it is not affiliated with any person (other than a natural person) that is not a small business or small organization.[264][651] We ~~estimate that one sponsor that is a broker-dealer would~~

[649] **5 U.S.C. 601(5).**

[650] **We analyzed and averaged calendar year 2021 data and calendar year 2022 data** >from the Mergent Municipal Bond Securities Database to determine the scope and characteristics of <**municipal entities that are sponsors of municipal ABS, including ABS issued by municipal issuers and securitizations of municipal securities issued by special purpose entities. Although certain securitizations of municipal securities issued by special purpose entities might not have a sponsor that is a municipal entity, we are taking the conservative approach to include such securitizations in these estimates to avoid any potential undercounting for purposes of the FRFA.**

[651] ***See* 17 CFR 240.0-10.**

estimate that two sponsors that are broker-dealers will meet the applicable definition of small entity.~~265~~[652]

RIAs other than broker-dealers that advise hedge funds and municipal advisors that advise with respect to municipal securitizations, could also qualify as a "sponsor" under the ~~re-proposed~~**final** rule. A RIA is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common

~~262 5 U.S.C. 601(5).~~

~~263 We analyzed calendar year 2021 data <from the Mergent Municipal Bond Securities Database to determine the scope and characteristics of >the issuers of municipal ABS.~~

~~264 *See* 17 CFR 240.0-10.~~

~~265 We evaluated all ABS sponsors for the period of Jan. 2021 through Dec. 2021 <to determine whether their characteristics and affiliations (as described in FOCUS data and other disclosures) would result in their being "small entities" for purposes of Section 605 of the RFA.>~~

control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[266][653] We estimate that, of the RIAs that advise hedge funds, up to ~~17 would~~**16 will** be a small entity as defined for investment advisers.[267][654]

~~We estimate that there are 112 municipal advisors who would be sponsors of ABS for purposes of the re-proposed rule.[268] There is no Commission definition regarding when a municipal advisor is a small entity. In adopting rules relating to municipal advisors, the Commission has used the Small <Business Administration's definition of small business for municipal advisors.>[269] <The Small Business Administration defines small business for purposes of entities that provide financial investment and related activities as a business that had annual receipts of less than $>7 <million during the preceding fiscal year and is not affiliated with any person that is not a small business or small organization.>[270] <Based on this definition, a majority of municipal advisors >would be small businesses. In the MA Adopting Release, the Commission estimated that approximately 62<% of municipal advisors would be small entities; >therefore, we estimate that 69 would be small entities.~~

We estimate that there are 105 municipal advisors who will be sponsors >of ABS for purposes of the <**final rule.[655] There is no Commission definition regarding small municipal advisors. In adopting rules relating to municipal advisors, the Commission has used the Small**

652 **We analyzed and averaged calendar year 2021 and calendar year 2022 data**> to determine whether their characteristics and affiliations (as described in FOCUS data and other disclosures) would result in their being "small entities" for purposes of Section 605 of the RFA<.

266653 *See* 17 CFR 275.0-7(a).

267654 **We analyzed and averaged calendar year 2021 data and calendar year 2022 data from Form ADV.** Based on Form ADV data, we estimate that **(i) for calendar year 2021,** only 17 RIAs that advise hedge funds, representing 0.7% of all RIAs advising hedge funds, would be a small entity as defined by Rule 0-7(a) of the ~~Investment~~ Advisers Act ~~of 1940~~**and (ii) for calendar year 2022, only 15 RIAs that advise hedge funds, representing 0.6% of all RIAs advising hedge funds, would be a small entity as defined in Rule 0-7(a) of the Advisers Act**. *See Definitions of "Small Business" or "Small Organization" Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933*, Release Nos. 33-7548, 34-40122, IC-23272, and IA-1727 (June 24, 1998) [63 FR 35508 (June 30, 1998)]. Furthermore, we believe that not all ~~17~~ of those RIAs act as sponsors of ABS transactions.

268655 **We analyzed and averaged calendar year 2021 data and calendar year 2022 data from** Mergent Municipal Bond Securities Database. We note that some municipal advisors are broker-dealers and/or RIAs.

269 ~~<*See Registration of Municipal Advisors*, Release No. 34-70462 (>Sep<. 20, 2013) [78 FR 67468 (Nov. 12, 2013)] ("MA Adopting Release").>~~

270 ~~*See* 13 CFR 121.201.~~

>Business Administration's definition of small business for municipal advisors.<[656] >The Small Business Administration defines small business for purposes of entities that provide financial investment and related activities as a business that had annual receipts of less than $<**47** >million during the preceding fiscal year and is not affiliated with any person that is not a small business or small organization.<[657] >Based on this definition, a majority of municipal advisors <**will be small businesses. The Commission recently estimated that approximately 75**>% of municipal advisors would be small entities;<[658] **therefore, we estimate that 79 will be small entities.**

This results in a Commission estimate of ~~162~~**166** to ~~191~~**187** small entities that could be impacted by the ~~re-proposed~~**final** rule.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

~~If adopted, the re-proposed~~**The final** rule ~~would~~**will** apply to small entities to the same extent as other entities, irrespective of size. Therefore, we expect that **the nature of** most of the benefits and costs associated with the ~~re-proposed~~**final** rule ~~would~~**to** be similar for large and small entities. ~~Accordingly, we refer to the discussion of the re-proposed rule's~~**We discuss the** economic effects**, including the estimated costs and burdens, of the final rule** on all affected ~~parties,~~**entities,** including small entities, in Section ~~III~~**IV** above. Consistent with that discussion, we anticipate that the economic benefits and costs could vary widely among small entities based on a number of factors, such as the nature and conduct of their businesses, which makes it difficult to project the economic impact on small entities with precision. We note, however, that ~~the similarity of~~**reliance on** certain ~~proposed~~ exceptions to the ~~re-proposed rule to the Volcker Rule might be more beneficial to~~**final rule may be more burdensome for small entities than** larger entity securitization participants~~(~~

[656] >*See Registration of Municipal Advisors*, Release No. 34-70462 <(**Sep**>t. 20, 2013) [78 FR 67468 (Nov. 12, 2013)] ("MA Adopting Release")<.

[657] ***See* 13 CFR 121.201.**

[658] **The Commission estimated for purposes of the PRA, as of Dec. 31, 2022, approximately 446 municipal advisors were registered with the Commission and an estimated 333 of these municipal advisors, or approximately, 75%, were small entities. *See* PRA Supporting Statement for Registration of Municipal Advisors (Aug. 1, 2023), *available at* https://www.reginfo.gov/public/do/PRAViewDocument?ref nbr=202307-3235-012.**

(*e.g.*, banking entities and affiliated broker-dealer entities) due to ~~their familiarity with~~**the similarity of these exceptions to** the Volcker Rule**, with which such larger entities will be familiar, thereby reducing their costs**. Conversely, as discussed above in ~~Sections II.B.3. and III.D.2.,~~**Section IV, small entities may face fewer** compliance ~~with the re-proposed rule might be more costly for~~**costs than** large and diversified securitization participants that have an extensive network of affiliates and subsidiaries. **This may allow such small entities to gain market share at the expense of such large and diversified securitization participants.**

As a general matter, we also recognize that costs of the ~~re-proposed~~**final** rule potentially ~~could~~**may** have a proportionally greater effect on small entities, as such costs may be a relatively greater percentage of the total cost of operations for smaller entities than larger entities, and thus small entities ~~might~~**may** be less able to bear such costs relative to larger entities. **However, the potentially less complex securitization activities of small entities and their correspondingly less complex compliance considerations may counterbalance such costs as compared to larger and more diversified securitization participants.** Compliance with the ~~re-proposed~~**final** rule might require the use of professional skill, including legal skills. ~~We request comment on how the re-proposed rule would affect small entities.~~

E.

Agency Action to Minimize Effect on Small Entities

~~**Duplicative, Overlapping, or Conflicting Federal Rules**~~

~~We have not identified any Federal rules that currently duplicate, overlap, or conflict with the re-proposed rule. We request comment on whether commenters perceive any such duplication, overlap, or conflict if the re-proposed rule is adopted and, if so, how we should address any such duplication, overlap, or conflict.~~

~~**Significant Alternatives**~~

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. ~~In connection with the proposed amendments~~**Accordingly**, we considered the following alternatives:

- Establishing different compliance requirements **or timetables** that take into account the resources available to small entities;
    - ~~Delaying the implementation of compliance requirements for small entities to take into account the resources available to them;~~
- Exempting small entities from all or part of the requirements;
- Using performance rather than design standards; and

- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities.

The ~~re-proposed~~**final** rule ~~seeks~~**is designed** to prevent the sale of ABS that are tainted by material conflicts of interest by prohibiting securitization participants from engaging in certain transactions that could incentivize a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors. ~~We believe that all ABS investors should <be protected from securitization participants >entering into conflicted transactions, and exempting~~**Exempting** small entities from the ~~re-proposed~~**final** rule's prohibition~~,~~

~~establishing different compliance requirements for small entities, or delaying the implementation of the compliance requirements for small entities could frustrate that goal by protecting only ABS investors in~~ **could frustrate Section 27B's investor protection purpose by narrowing the scope of the rule to** transactions with respect to which the relevant securitization participants are larger entities. We ~~do not believe that imposing~~ **see no reason why investors should not** >be protected from securitization participants <**that are small entities** >betting against the relevant ABS <**in the same way that they will be for larger entities. Similarly, applying** different standards ~~or~~**and legal** requirements based on the size of ~~the securitization participant would be appropriate, and doing so might~~**an entity would dimmish investor protection, create unnecessary complexity, and likely** result in additional costs associated with ascertaining whether a particular securitization participant ~~may~~**is eligible to claim an exception from the rule or** avail itself of such different standards **and legal requirements**. For these reasons, we are not ~~proposing differing~~**adopting different** compliance or reporting requirements~~ or timetables~~, or an exception, for small entities~~. For the same reasons we do not believe it would be appropriate to impose different standards or requirements based on the size of the securitization participant, we do not believe that the implementation of compliance requirements for small entities should be delayed. We request comment below whether the implementation of compliance requirements for small entities should be delayed. Section II.B. above includes specific requests for comment on whether certain categories of securitization participants should be exempted from the re-proposed rule.~~ **as suggested by certain commenters.[659] The final rule, however, does include a delayed implementation period for all entities as discussed in detail in Section II.I. One commenter generally expressed a concern that the proposed rule did not include an implementation period**

[659] ***See*** **letters from AIMA/ACC (expressing a concern about the lack of accommodations for small entities to facilitate their compliance); NAMA (stating that many municipal advisors are small entities and that including them within in the scope of the rule would require them to "spend a great deal of time, effort and expense" and suggesting an exclusion from the rule for municipal advisors); Wulff Hansen (supporting NAMA's statements).** ***See also*** **Section II.B.3.b. above for a discussion of why we are not adopting an exclusion from the rule for municipal advisors.**

for small entities.[660] Another commenter recommended a compliance period of 18-24 months based on concerns regarding the scope of the proposed definition of conflicted transaction and the proposed application of the rule to affiliates.[661] We recognize that certain persons subject to the rule will need to update their operations and systems in order to comply with the final rule, and we are adopting the compliance date of 18 months after adoption. We believe that this delayed compliance date will provide affected securitization participants that intend to utilize >the risk-mitigating hedging activities exception and the bona fide market-making activities exception<**, including small entities, with adequate time to develop the internal compliance programs that are required to comply with such exceptions. We are not persuaded that any additional time is needed for smaller entities because we believe that the changes made from the proposed rule to narrow the scope of the definition of conflicted transaction[662] and the scope of the affiliates and subsidiaries of a securitization participant that are subject to the rule[663] should generally ease compliance burdens and mitigate the need for a compliance period longer than 18 months after adoption.**

As discussed in Section II, we have made certain changes from the proposal to clarify and simplify the scope of the final rule for all entities by further specifying the type of conduct that will be prohibited as well as the applicability of the final rule to an entity's affiliates and

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660 ***See*** **letter from AIMA/ACC.**

661 ***See*** **letter from SFA II.**

662 ***See*** **Section II.D.3. (discussing how Rule 192(a)(3)(iii) as adopted only applies to the purchase or sale of any financial instrument that is substantially the economic equivalent of a transaction described in Rule 192(a)(3)(i) or Rule 192(a)(3)(ii) and provides that, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk is not a conflicted transaction).**

663 ***See*** **Section II.B.3.c. (discussing how paragraph (ii) of the definition of a "securitization participant" as adopted will only capture any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of the definition if the affiliate or subsidiary: (A) acts in coordination with a person described in paragraph (i) of the definition; or (B) has access to or receives information about the relevant asset-backed security or the asset pool supporting or referenced**

by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security).

~~<We do not believe that >clarifying, consolidating, or simplifying the compliance requirements under the re-proposed rule would permit us to achieve our stated objective. We have sought to create a clear, consolidated, and simple regulatory framework as we believe appropriate under the circumstances~~**subsidiaries**. With respect to using performance rather than design standards, the prohibition of the ~~re-proposed~~**final** rule is a performance standard that ~~would~~**will** prohibit a securitization participant from entering into a conflicted transaction during the covered time-period. Although the ~~proposed~~ bona fide market-making activities and risk-mitigating hedging activities exceptions do include design standards **such as those specified in Rule 192(b)(1)(ii)(A) and Rule 192(b)(3)(ii)(B)**, we believe that those design standards ~~would~~**will** promote the ~~objective of the re-proposed~~**investor protection objectives of the final** rule while still providing flexibility to securitization

participants to design compliance programs that are tailored to their specific business models.< Sections II.E. and II.G. >above include specific requests for comment on whether smaller securitization participants <should be exempted from the >proposed compliance program requirements applicable to <the bona fide market-making activities >and risk-mitigating hedging activities exceptions, and if so, how "smaller securitization participant" should be defined for purposes of any such exemption.

Request for Comment

We encourage the submission of comments with respect to any aspect of the IRFA. In particular, we request comment regarding:

- The <number of small entities that >may be affected by the re-proposed rule;
- The <existence or nature of the potential impact of the >re-proposed <rule on small entities discussed in the analysis>;

- How the re-proposed <rule could further lower the burden on small entities >by, for example, exempting small entities from compliance requirements applicable to such entities or delaying the implementation of compliance requirements for such entities; and

- How to quantify the impact of the re-proposed rule.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the re-proposed rule is adopted, and will be placed in the same public file as comments on the re-proposed rule itself.

Statutory AuthoritySTATUTORY AUTHORITY

The Commission is proposing**adopting** new 17 CFR 230.192 under the authority set forth in Sections 10, 17(a), 19(a), 27B, and 28 of the Securities Act.

List of Subjects in 17 CFR Part 230

Reporting and recordkeeping requirements, Securities.

~~**Text of Proposed Amendments**~~

TEXT OF AMENDMENTS

For the reasons set forth in the preamble, the Commission ~~is proposing to amend~~**amends** title 17, chapter II of the Code of Federal Regulations as follows:

PART 230–GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The general authority citation for part 230 continues to read**,** in part**,** as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78*l*, 78m, 78n, 78*o*, 78*o*-7 note, 78t, 78w, 78*ll*(d), 78mm, 80a-8, 80a-24, 80a-28, ~~80a-29~~**80a29**, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

2. Add § 230.192 to read as follows:

§ 230.192 Conflicts of interest relating to certain securitizations.

(a) *Unlawful activity*. (1) *Prohibition*. A securitization participant shall not, for a period commencing on the date on which ~~a~~**such** person has reached~~, or has taken substantial steps to reach,~~ an agreement that such person will become a securitization participant with respect to an asset-backed security and ending on the date that is one year after the date of the first closing of the sale of such asset-backed security, directly or indirectly engage in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such asset-backed security.

(2) *Material conflict of interest*. For purposes of this section, engaging in any transaction would involve or result in a material conflict of interest between a securitization participant for

an asset-backed security and an investor in such asset-backed security if such a transaction is a conflicted transaction.

(3) *Conflicted transaction*. For purposes of this section, a conflicted transaction means any of the following transactions with respect to which there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the asset-backed security:

(i) A short sale of the relevant asset-backed security;

(ii) The purchase of a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant asset-backed security; or

(iii) The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction ~~through which the securitization participant would benefit from the actual, anticipated or potential:~~**that is substantially the economic equivalent of a transaction**

described in paragraph (a)(3)(i) or (a)(3)(ii) of this section, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk.

~~(A) Adverse <performance of the asset pool supporting or referenced by the relevant >asset-backed security;~~

~~(B) Loss of principal, monetary default, or early amortization event on the relevant asset-backed security; or~~

~~(C) Decline in the market value <of the relevant asset-backed security.>~~

(b) *Excepted activity*. The following activities are not prohibited by paragraph (a) of this section:

(1) *Risk-mitigating hedging activities*. (i) *Permitted risk-mitigating hedging activities*. Risk-mitigating hedging activities of a securitization participant conducted in accordance with this paragraph (b)(1) in connection with and related to individual or aggregated positions,

contracts, or other holdings of the securitization participant**, including those** arising out of its securitization activities, ~~including~~**such as** the origination or acquisition of assets that it securitizes~~, except that the initial distribution of an asset-backed security is not risk-mitigating hedging activity for purposes of paragraph (b)(1) of this section~~.

(ii) *Conditions*. Risk-mitigating hedging activities are permitted under paragraph (b)(1) of this section only if:

(A) At the inception of the hedging activity and at the time of any adjustments to the hedging activity, the risk-mitigating hedging activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(B) The risk-mitigating hedging activity is subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1) of this section and does not facilitate or create an opportunity to **materially** benefit from a conflicted transaction other than through risk-reduction; and

(C) The securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements set out in paragraph (b)(1) of this section, including reasonably designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored.

(2) *Liquidity commitments*. Purchases or sales of the asset-backed security made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for the asset-backed security.

(3) *Bona fide market-making activities*. (i) *Permitted bona fide market-making activities*. Bona fide market-making activities, including market-making related hedging, of the securitization participant conducted in accordance with this paragraph (b)(3) in connection with and related to asset-backed securities with respect to which the prohibition in paragraph (a)(1) of this section applies, the assets underlying such asset-backed securities, or financial instruments that reference such asset-backed securities or underlying assets **or with respect to which the prohibition in paragraph (a)(1) of this section otherwise applies**, except that the initial distribution of an asset-backed security is not bona fide market-making activity for purposes of paragraph (b)(3) of this section.

(ii) *Conditions*. Bona fide market-making activities are permitted under paragraph (b)(3) of this section only if:

(A) The securitization participant routinely stands ready to purchase and sell one or more types of the financial instruments described in paragraph (b)(3)(i) of this section as a part of its market-making related activities in such financial instruments, and is willing and available to

quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(B) The securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers,

or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments described in paragraph (b)(3)(i) of this section;

(C) The compensation arrangements of persons performing the foregoing activity are designed not to reward or incentivize conflicted transactions;

(D) The securitization participant is licensed or registered**, if required,** to engage in the activity described in paragraph (b)(3) of this section in accordance with applicable law and self-regulatory organization rules; and

(E) The securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of paragraph (b)(3) of this section, including reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its market-making positions and holdings.

(c) *Definitions*. For purposes of this section:

Asset-backed security has the same meaning as in section 3(a)(79) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(79)), and also includes **a** synthetic asset-backed ~~securities~~**security** and **a** hybrid cash and synthetic asset-backed ~~securities~~**security**.

Distribution means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

Initial purchaser means a person who has agreed with an issuer to purchase a security from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon 17 CFR 230.144A or that are otherwise not required to be registered because they do not involve any public offering.

Placement agent and *underwriter* each mean a person who has agreed with an issuer or selling security holder to:

(i) Purchase securities from the issuer or selling security holder for distribution;
(ii) Engage in a distribution for or on behalf of such issuer or selling security holder; or

(iii) Manage or supervise a distribution for or on behalf of such issuer or selling security holder.

Securitization participant means:
(i) An underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security; or

(ii) Any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of this definition~~.~~ **if the affiliate or subsidiary: (A) Acts in coordination with a person described in paragraph (i) of this definition; or**

(B) Has access to or receives information about the relevant asset-backed security or the asset pool underlying or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security.

Sponsor means:

(i) Any person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the entity that issues the asset-backed security; or

(ii) Any person~~:~~

~~(A)~~ with a contractual right to direct or cause the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying **or referenced by** the asset-backed security~~; or~~**, other than a person who acts solely pursuant to such person's contractual rights as a holder of a long position in the asset-backed security.**

~~(B) <that directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security.>~~

(~~C~~**iii**) Notwithstanding ~~paragraphs~~**paragraph** (ii)~~(A) and (ii)(B)~~ of this definition, a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, ~~or~~ assembly**, or ongoing administration** of an asset-backed security or the composition of the pool of assets underlying **or referenced by** the asset-backed security will not be a sponsor for purposes of this rule.

~~(iii<) Notwithstanding paragraphs (i) and (ii) of this definition>:~~
(~~A) The~~ **iv**>) Notwithstanding paragraphs (i) and (ii) of this definition<**, the** United States or an agency of the United States will not be a sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States.

~~<(B) The Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617) with capital support from the United States; or any limited-life regulated entity succeeding to the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that the entity is operating with capital support from the United States; will not be a >~~<sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity.>~~

(d) ***Anti-evasion***>. If a securitization participant engages in a transaction <**or a series of related transactions that, although in technical compliance with paragraph (b) of this section, is**

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

(e) *Safe harbor for certain foreign transactions*. The prohibition in paragraph (a)(1) of this section shall not apply to any asset-backed security for which all of the following conditions are met:

(1) The asset-backed security (as defined in this section) is not issued by a U.S. person (as defined in 17 CFR 230.902(k)); and

(2) The offer and sale of the asset-backed security (as defined by this section) is in compliance with 17 CFR 230.901 through 905 (Regulation S).

By the Commission.

~~By the Commission.~~

Dated: ~~January 25~~**November 27**, 2023.

Vanessa A. Countryman,

Secretary.

Summary report: Litera Compare for Word 11.4.0.111 Document comparison done on 11/27/2023 4:22:53 PM	
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Embedded Excel	0
Format changes	0
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