

SFA Readout: Final SEC Conflicts of Interest in Securitizations Rule

The Securities and Exchange Commission incorporated many important changes suggested by industry participants to the final Conflicts of Interest Rule. The SFA and its members continue to analyze the rule and its implications for financial institutions and markets. Below we offer some *initial* thoughts about how the SEC addressed some of the key issues raised in our comment letters.

While our member firms support the original intent of Section 621, there were several reasons why the proposed rule was unworkable and would have had a materially negative effect on market functioning and risk management. Among the most important of these problems were:

1. **“Prong 3”** of the proposed rule’s list of “conflicted transactions” was enormously broad and pulled in many financial trades and transactions that are only tangentially related to a securitization and are routinely performed by a multitude of market participants.

Rule Outcome: Prong 3 now only includes any instrument or transaction that is substantially the economic equivalent of a transaction described in Prongs 1 (a short sale of the relevant ABS) or 2 (the purchase of a CDS or other credit derivative with respect to the relevant ABS), other than any transaction that only hedges general interest rate or currency exchange risk.

Initial Reaction: The SEC significantly amended Prong 3 to address concerns that the proposed rule was vague and unworkable. The final rule carves out general interest rate and currency exchange risk hedges and clarifies that other transactions unrelated to the idiosyncratic credit performance of the ABS are not conflicted transactions. Nonetheless, certain implementation questions around some of the language in Prong 3 remain, such as the meaning of “substantially the economic equivalent of”.

2. **Definition of securitization participant:** The proposed rule purported to capture a wide range of market participants, including broker-dealers, bond issuers, asset managers, servicers, insurance companies (including the long investors that are supposed to be the beneficiaries of the rule), and all their affiliates and subsidiaries.

Rule Outcome: The final rule reflects key changes from the proposed rule. These include: (i) limiting the application of the rule to affiliates only if they act in coordination with a securitization participant or have information about the ABS, (ii) not including within the definition of “sponsor” persons who direct the structure, design or assembly of an ABS, and (iii) excluding any persons who perform only administrative, legal or similar activities.

Initial Reaction: The SEC significantly amended the definition of “sponsor” and narrowed when an affiliate or subsidiary of a securitization participant is subject to the rule. These changes provide needed clarity as to what parties to a securitization are scoped into the rule.

3. Compliance Regime: The proposed rule included extensive compliance program requirements modeled primarily after the Volker Rule.

Rule Outcome: The SEC clarified the range of transactions and entities subject to the rule’s compliance program requirement.

Initial Reaction: Refining the definition of “conflicted transaction” and the scope of covered affiliates and subsidiaries will reduce the overall compliance program burden for market participants as many essential and routine market activities are now scoped out. The final rule also indicates that, for instances when the compliance program requirement will apply, the compliance regime can be tailored to a firm’s size and specific business model. Nevertheless, significant work remains to be done to determine how subjected firms should design their compliance programs in order comply with the final rule.

The SFA commends the SEC for providing the market with an 18-month compliance period, as requested, which gives the industry adequate time to design compliance programs. The SFA will be working with its members in 2024 to seek additional clarifications about various provisions in the final rule to ensure that market participants have the necessary guidance to comply with the final rule.

SFA Staff Contact List

<p>Leslie Sack Head of Government Relations Leslie.Sack@structuredfinance.org 202.524.6304</p>	<p>W. Scott Frame Chief Economist & Head of Policy Scott.Frame@structuredfinance.org</p>
<p>Jeff Gudiel Government Relations Associate Jeff.Gudiel@structuredfinance.org 202.524.6307</p>	<p>David Dwyer General Counsel, Policy and Regulatory Affairs David.Dwyer@structuredfinance.org 202.830.3458</p>