December 10, 2010

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: Request for Public Comments Regarding Implementation of Section 621 (Conflicts of Interest) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to communicate its views with respect to the forthcoming rules that will implement Section 621 (Conflicts of Interest) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). This letter is our response to a request from members of the Staff of the Securities and Exchange Commission (the "Commission") for input regarding potential conflicts of interest occurring in securitizations that should not be prohibited under Section 621 of the Dodd-Frank Act ("Section 621"). We also wish to extend our thanks to the Commission for requesting industry input in connection with its rulemaking process. SIFMA appreciates the intent of Section 621 and agrees that certain reforms may be necessary to ensure that securitization transaction parties are not creating and selling asset-backed securities ("ABS") that are intentionally designed to fail or default and profiting from the failure or default of such ABS. In drafting rules to carry out the intent of Section 621, however, the Commission should consider the primary motivation behind securitization and recognize that securitizations by their nature require various transaction participants to assume roles and perform different functions as part of a securitization transaction. These roles and functions may, in certain instances, give the

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

appearance of a conflict of interest with respect to investors in the securitization. The goal of this letter is to provide the Commission with some representative examples of potential conflicts of interest that may arise as part of an ABS transaction but that should not be expressly prohibited under Section 621. SIFMA's comments reflect its goals of restoring capital flow to the securitization markets and increasing the availability of credit to American consumers and small businesses while giving effect to the legislative intent behind Section 621.

I. Background

In April 2010, the Senate Permanent Subcommittee on Investigations chaired by Senator Carl Levin held a series of hearings relating to the financial crisis. On May 10, 2010, Senator Levin and Senator Jeffrey Merkley proposed Section 619, Section 620 and Section 621 (the "Merkley-Levin Provisions") as an amendment to the Dodd-Frank Act to address issues of concern arising from these hearings. Section 621 of the Dodd-Frank Act[2] originated as a result of "one of the most dramatic findings" of the subcommittee hearings, which was that firms are "betting against financial instruments they are assembling and selling."[3] The intent of Section 621, as expressed in testimony from Senators Merkley and Levin, is to prohibit securitization participants from intentionally designing ABS to fail or default while such participants profit from the securities' failures.[4] According to Senator Levin, "[r]egulators must act diligently to ensure that an underwriter is not making bets against the very financial products that it assembled and sold."[5]

Section 621 adds a new Section 27B to the Securities Act of 1933 entitled "Conflicts of Interest Relating to Certain Securitizations." Section 27B(a) states that "[a]n underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, of an asset-backed security . . . which for purposes of this section shall include a synthetic asset-backed security, 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." For purposes of this letter, we refer to each of an underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, of an asset-backed security as a "Designated Party." Under Section 27B(b), the Commission is directed to issue rules implementing Section 27B(a) not later than 270 days after the date of enactment of the Dodd-Frank Act (*i.e.*, by April 17, 2011). We understand that the Commission intends to propose rules to implement Section 27B(a) later this month.

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[2] The scope of this letter is limited to Section 621.
[3] 156 *Cong. Rec.* S 3470 (May 10, 2010) (statement of Sen. Levin).
[4] *See id.*; *see also* 156 *Cong. Rec.* S 4057 (May 20, 2010) and 156 *Cong. Rec.* S 5901 (July 15, 2010) (statements of Sen. Levin and Sen. Merkley).
[5] 156 *Cong. Rec.* S 5901 (July 15, 2010) (statement of Sen. Levin). Senator Levin testified that designing a security to fail, selling it to investors and then betting against it is analogous to removing the brakes from a car before selling it and then taking out a life insurance policy on the purchaser. 156 *Cong. Rec.* S 3469 (May 10, 2010) (statement of Sen. Levin); 156 *Cong. Rec.* S 5899 (July 15, 2010) (statement of Sen. Levin).

In a letter addressed to the Chairman of the Commission and the heads of various other government agencies, Senators Merkley and Levin state that the main objective of Section 621 is to "[e]nd the conflicts of interest that arise when a financial firm designs an asset-backed security, sells it to customers, and then bets on its failure."[6] Senators Merkley and Levin further add that the directive set forth in Section 621 "provided the [Commission] with sufficient authority to define the contours of the rule in such a way as to remove conflicts of interest from these transactions, while also protecting the healthy functioning of our capital markets."[7] It is clear from the legislative history and letters submitted by the sponsors of Section 621 that it is intended for one year after the issuance of ABS to prohibit a Designated Party who participated in the creation of an ABS transaction from intentionally betting against and profiting from the failure of that transaction. As part of its proposal and adoption of rules to implement Section 621, SIFMA strongly urges the Commission to consider and give deference to the legislative history and intent of the Merkley-Levin Provisions. The Commission should craft final rules implementing Section 621 that do not create unnecessary or prohibitive restrictions on the ABS markets, such as restricting industry practices that are fundamental to the issuance of ABS as described in greater detail in Part III of this letter, and that will not be detrimental to the healthy functioning of the securitization markets, which are an integral part of the United States capital markets.[8]

SIFMA recommends that the Commission adopt rules that recognize that many potential and actual conflicts of interest are inherent in the ordinary course of securitization transactions. Certain types of transactions and activities should not be prohibited under Section 621 regardless of whether such transactions and activities result in potential or actual conflicts if, as demonstrated by the examples set forth in Part III of this letter, (i) such transaction or activity represents an overall alignment of risk to the ABS or underlying assets similar to that borne by investors in the ABS, (ii) such transaction or activity is unrelated to the Designated Party's role in the specific ABS transaction, (iii) disclosure of the transaction or activity of the Designated Party adequately mitigates the risk posed by the potential or actual conflict with respect to any investors in the ABS or (iv) another regulatory regime applies with respect to the potential or actual conflict of interest. An overly broad interpretation of Section 621 could effectively eliminate securitization as a part of the capital markets because potential conflicts are inherent in all capital markets transactions. If not focused on the transactions referenced by Senators Merkley and Levin, rules promulgated under Section 621 could restrict many standard industry practices which are vital to the functioning of the ABS markets and beneficial to investors. This result would be contrary to the intentions of Congress. Fundamentally, capital markets transactions involve principal trades where one transaction party benefits at the expense of another transaction party. This dynamic arises

[6] Letter from Senator Merkley and Senator Levin dated August 3, 2010, page 2, addressed to, *inter alios*, the Honorable Mary Shapiro, Chairman of the Commission, regarding the implementation of the Merkley-Levin Provisions.
[7] *Id.* at page 5.
[8] Senator Levin himself recognized this point in stating that the Commission "has sufficient authority to define the contours of the rule in such a way as to remove the vast majority of conflicts of interests from [ABS] transactions, while also protecting the healthy functioning of our capital markets." 156 *Cong. Rec.* S 5899 (July 15, 2010) (statement of Sen. Levin).

from each party's willingness to take on certain levels of risk that are the basis of the transaction and does not always imply that a conflict of interest exists.

The following discussion describes the securitization industry generally, including the motivations of securitizers, and enumerates certain natural and expected conflicts which may arise in ABS transactions but do not constitute the type of "material conflicts" intended to be regulated by Section 621.

II. Securitization as a Means of Transferring Risk

Securitization has been used by market participants for several decades as a mechanism for transferring and dispersing risk. In structuring and packaging ABS, asset originators and ABS sponsors seek to reduce exposure by transferring risk associated with the underlying assets to investors who purchase such ABS for an associated return on their investment. Investors purchase ABS because they are taking on risk in exchange for return, while asset originators and ABS sponsors receive funding and at the same time decrease their exposure to the risk associated with the ownership of the assets.[9] This transfer of risk, which occurs in every ABS transaction, whether done on a cash basis or synthetically, inherently involves potential conflicts. This reality is highlighted by Section 941 of the Dodd-Frank Act, which was adopted to require the retention of some portion of this risk by sponsors and originators. Substantial transfer of risk occurs in an ABS transaction regardless of whether an ABS sponsor or asset originator is required to retain a portion of the related securities. To the extent the risk transfer dynamic between ABS sponsors and asset originators and investors constitutes a conflict of interest, this potential conflict is best addressed through disclosure and should not be considered to be of the type prohibited by Section 621.

In addition to the basic risk transfer that occurs in structuring a securitization, potential conflicts may result from the tranching of debt into senior and subordinate debt, a structural feature which is fundamental to ABS transactions. ABS are typically issued in multi-class structures in which subordinate tranches act as credit enhancement for the more senior tranches. To the extent the assets underlying the ABS incur losses, those losses will be borne first by holders of subordinate securities. This type of conflict exists regardless of the identity of such holders. We will describe additional conflicts in greater detail in Part III of this letter.

[9] One of the most explicit examples of risk transference within the broad spectrum of securitization transactions is the issuance of insurance risk linked securities, commonly referred to as catastrophe bonds ("Cat Bonds"), where the investors expressly agree to assume a specific type or types of insurance risk "linked" to the occurrence of an adverse event or series of events such as natural catastrophes (*e.g.*, hurricane or earthquake) or the adverse development of other categories of insurance risk (*e.g.*, life insurance, accident and health insurance, etc.). An insurer would typically sponsor a Cat Bond issuance to secure risk protection from the capital markets relating to its insurance exposures (that it has assumed in the ordinary course of its business) in lieu of obtaining traditional reinsurance protection for certain risks. In such transactions, investors receive an agreed upon return for assuming a risk that, if realized, may result in a complete loss of the principal amount of their investment. The securities are rated based upon the probability of that loss.

III. Potential Conflicts Inherent in, or Vital to, Securitization

In proposing and implementing rules regarding conflicts of interest under Section 621, the Commission must distinguish between potential conflicts that are necessary or beneficial for the functioning of the securitization markets and those material conflicts that fall within the scope of transactions that Section 621 was intended to prohibit. In contrast to the material conflicts of interest created in the "designed to fail" transactions cited by Senators Merkley and Levin, many other potential conflicts of interests are inherent in securitizations. These conflicts should be disclosed to investors and other transaction parties to the extent they are material, but should otherwise be permitted and fall outside of the scope of Section 621. While Senators Merkley and Levin assert that disclosure alone may not eliminate the problematic nature of certain conflicts, SIFMA believes that conflicts created in the normal course of a securitization are sufficiently known by, or disclosed to, investors and do not fall under the intended scope of Section 621. SIFMA and its members have endeavored to describe some of the potential conflicts that may arise as part of ABS transactions involving a Designated Party (in addition to the general conflict in the transfer of risk that is inherent in the nature of securitization, as described in Part II of this letter), though it should be noted that the following paragraphs are not an exhaustive list of all of the conflicts involving a Designated Party that could potentially arise in connection with the issuance of ABS and should still otherwise be permitted. The list is organized by general categories and includes some specific examples.

SIFMA believes that the following potential conflicts of interest do not fall under the scope of Section 621 given the legislative history for this provision and the focus of Senators Merkley and Levin on prohibiting the "designed to fail" transactions described in Part I of this letter:

A. Ownership of an Interest in ABS

Ownership of a single class/certain classes of securities. Holders of different classes of securities within an ABS transaction may have conflicting interests. As noted previously, losses on the underlying assets of the ABS will be borne first by the junior most holders of ABS who are disadvantaged by their terms relative to the more senior holders of ABS. In the event the collateral pool needs to be liquidated following default or as part of a deal unwind, senior holders of ABS may favor remedies that would result in faster liquidation and could produce less liquidation proceeds, so long as the more senior class or classes of ABS are paid off in full, while more junior holders of ABS may favor a slower liquidation process in order to maximize liquidation proceeds available to repay the principal balance of the junior ABS. In other circumstances, different classes of investors will favor faster or slower payments on the underlying ABS assets. Holders of principal-only securities will favor prepayments on the assets underlying the ABS so they can realize par on their investment in such ABS as opposed holders of interest-only securities who generally want the underlying assets to remain outstanding as long as possible so they may continue to receive payments on their interest-only securities. Any Designated Party holding a single class of securities in a multi-class transaction, including a sponsor retaining ABS to fulfill a risk retention requirement (required risk retention is further discussed in the following paragraph), could be viewed as having a

potential conflict of interest with the holder of another class of securities from the same transaction.[10]

Risk retention. Mandated risk retention may take many forms. In order to satisfy a risk retention requirement, a sponsor may hold an interest in a single class of securities issued in a multi-class securitization, which would likely be the junior most class, an interest in each class of securities in a transaction or assets similar to the assets underlying a particular ABS. As the senior most class of securities may be the largest by principal balance, a sponsor retaining an equal percentage interest in each class may have interests most closely aligned with the interests of the senior securityholders. A sponsor retaining just an interest in the junior most class will have interests most closely aligned with the interest of that class. In any event, the retention of certain ABS by a sponsor or other Designated Party generally aligns that sponsor or Designated Party with investors, each of whom wants the transaction to succeed, as opposed to structuring a transaction where the sponsor or other Designated Party bets against the performance of the ABS. Risk retention, particularly to the extent mandated by other rules and regulations, should not be viewed as creating a material conflict of interest for purposes of Section 621, as it is being implemented under a regulatory regime intended to better align the interests of parties to a securitization. The concept of mandated risk retention is an acknowledgment by regulators that a Designated Party should be permitted to be a securityholder in an ABS transaction.

Excess Spread. In an ABS transaction where the sponsor retains the right to receive the excess spread or equity cashflows and also services or takes other action with respect to the asset pool, the sponsor may have an incentive to include higher yielding assets with a greater risk profile. Certain types of ABS transactions, including securitizations of auto loans and credit card receivables, are structured such that the transferor retains an interest in the excess spread. If the Commission were to prohibit retention of excess spread by a Designated Party, securitization of several asset classes could cease altogether. This feature of ABS transactions can be easily distinguished from the type of transaction in which a Designated Party bets against a deal it creates because the excess spread cashflow is generally correlated with positive performance of the underlying assets.

B. ABCP Liquidity Facility Providers

A Designated Party may provide a liquidity facility designed to provide liquidity for a transaction in the event of a market disruption. For instance, an affiliate of the sponsor of an asset-backed commercial paper ("ABCP") program could provide a liquidity facility for that program. The liquidity facility could have conditions to funding and the liquidity facility provider could assert that it is not required to fund at a time of market disruption because the conditions to funding were not satisfied, which could have adverse

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[10] We note that the exceptions in Section 27B(c) provide for bona fide market-making activities, where an underwriter or other Designated Party could, from time to time, hold positions in ABS, and hedging related to positions or holdings arising out of the underwriting, placement, initial purchase or sponsorship of ABS. These exceptions represent an acknowledgment that Designated Parties may act as securityholders in ABS transactions.

consequences to the interest of investors in the maturing ABCP. Liquidity facilities are structured to address market risk that is not dependent on the performance of the assets underlying ABCP, which risk can be distinguished from the concerns that Section 621 was meant to address. Potential conflicts arising in connection with these types of liquidity facilities should be disclosed to investors and otherwise permitted under the scope of Section 621.

C. Credit Enhancement

A Designated Party may provide credit enhancement for a securitization transaction, such as a letter of credit or guarantee, or an asset-specific credit enhancement, such as mortgage insurance. Because the party providing the credit enhancement may have the first risk of loss, its interests will diverge from those of senior noteholders and could be viewed as constituting a conflict of interest. However, a provider of credit enhancement may assert defenses at a time when it would otherwise be obligated to make payments for the benefit of investors. A provider of credit enhancement benefits when the underlying assets perform well and suffers when the underlying assets perform poorly. Therefore its interests are generally consistent with those of investors and distinct from those of a transaction party betting against the securitization transaction.

D. Control Rights

Potential conflicts may also arise among transaction parties who have been granted special rights under a securitization transaction and investors in the related ABS. For instance, a Designated Party in a residential mortgage-backed security, commercial mortgage-backed security ("CMBS") or other securitization transaction may have the contractual right to remove the servicer, appoint a special servicer, exercise a clean-up call or instruct a trustee or servicer to take certain actions with respect to the collateral underlying the ABS or against an issuer or other transaction party, which actions may not necessarily be aligned with the interests of some or all investors. A Designated Party may have voting rights as a securityholder or in another capacity in a transaction and may exercise such rights in light of its interests outside the transaction. The existence of, and the ability to exercise, certain contractual control rights is integral to basic securitization and should not be prohibited under Section 621. Disclosure of the existence of control rights and the transaction parties entitled to exercise such rights should be sufficient to inform investors of the possibility of such potential conflicts.

E. Hedging Activity That May Not Be Encompassed by the Exception in Section 27B(c)(1)

Section 27B(c)(1) allows "risk mitigating hedging activities in connection with positions or holdings arising out of the underwriting, placement, initial purchase or sponsorship of an asset-backed security" but does not explicitly address general hedging activity by a Designated Party. Financial institutions engage in hedging activities in many contexts and at many levels throughout an organization comprised of many business units, offices, trading desks and funds, each of which may be engaged in separate transactions that, in some cases, are walled off from other parts of the financial institution and may otherwise

be transacted for purposes other than betting against the specific ABS that is sponsored or underwritten by that financial institution or its affiliate. Curtailing such hedging activities — which are unrelated to the actual ABS sponsored or underwritten by financial institutions and their affiliates and are entered into as part of their risk management practices and not as a bet against that ABS — would have adverse and unintended effects on everyday operations and risk management practices of financial institutions and their affiliates.

F. Financing Facilities

A Designated Party may provide a collateral funding facility, such as a warehouse line, variable funding note purchase facility or ABCP program, pursuant to which the Designated Party provides financing to the sponsor to fund asset origination or purchases of assets. These facilities provide financing until the assets can be packaged into securitizations and sold into the debt markets. The Designated Party providing such a collateral funding facility will benefit from the completion of the securitization transaction and the purchase by the securitization vehicle of the assets at a price to allow repayment of the financing, which may be viewed as presenting a conflict.

Additionally, a Designated Party may provide financing to investors purchasing ABS in a particular transaction sponsored or underwritten by a Designated Party (*e.g.*, through a repurchase agreement, a margin account or a total return swap ("TRS") or other derivative), which may also create the appearance of a conflict of interest. The financing of assets as they are originated and of investors in ABS transactions is vital to the healthy functioning of the securitization markets. Regardless of whether financing occurs at the beginning of a transaction to fund asset accumulation or at or after the time of issuance of an ABS transaction to fund the purchase of ABS, in each case the party providing financing is exposing itself to the risk of default of the underlying assets or the ABS such that its interests are generally aligned with the interests of investors. If a potential conflict of interest is determined to exist with respect to a financing facility, this conflict should be permitted to exist.[11]

G. Service Providers

Securitization transactions involve many market participants who are vital to the completion and maintenance of a transaction, including servicers, collateral managers, trustees, custodians and derivative counterparties. Possible conflicts related to servicers, collateral managers and trustees are described in greater detail below.

Servicer. Many potential conflicts may arise between a servicer and the investors in a securitization transaction. Such conflicts can exist regardless of whether the servicer is the sponsor or another Designated Party or an unrelated third party. For example, servicers, some of whom may be Designated Parties, may be motivated by economic

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[11] Potential conflicts arising from providing financing to investors are already addressed by Section 11(d)(1) of the Securities Exchange Act of 1934 and, therefore, should not be prohibited pursuant to Section 621, since such activity is already subject to existing regulation.

incentives (such as incentive payments provided in government programs) to make loan modifications, sell assets in short sales or make adjustments to loan terms. Servicer interactions with obligors, such as loan modifications or favorable adjustments to loan terms that benefit the obligors, may be viewed as disadvantageous to certain classes of investors. While a servicer may intend to maximize the ultimate recoveries on a loan when agreeing to a modification, one or more classes of investors may question a servicer's actions especially if they are looked at with the benefit of hindsight and not taken on a loan by loan basis. A servicer may also own the servicing rights to a transaction, in which case the servicer would receive greater benefits the longer the transaction remains outstanding. This position can be contrasted with that of investors who may be less concerned about the length of a deal and more focused on their receipt of principal and interest owed. Servicers are vital to securitizations and restrictions on who can act as a servicer would create higher servicing costs and inefficiencies and may be detrimental to a transaction as a whole. It is generally in the best interest of investors to have the sponsor or an affiliate of the sponsor act as the servicer in an ABS transaction. Since inherent conflicts of interest can exist between servicers and investors regardless of the identity of the servicer, prohibiting Designated Parties from acting as servicers while the same potential conflicts would continue to exist in ABS transactions with unaffiliated servicers would often deprive investors of the best or most efficient servicing performance. Potential conflicts of interest arising in a transaction with an affiliated servicer should be disclosed to investors and otherwise permitted under the scope of Section 621.

Collateral Manager. Several potential conflicts may arise with respect to the various roles of a collateral or other asset manager in a securitization transaction. First, a collateral manager may acquire securities on behalf of itself or its other clients that would be appropriate investments for the securitization issuer but may not make such securities available for investment by such issuer, resulting in a conflict where the collateral manager and its other clients are competing with the issuer for investments. Based upon transactional, contractual, structural, legal or other considerations, the collateral manager may make different investment decisions for the issuer than it does for its own account or the accounts of other clients for which it acts as manager.

A collateral manager may engage in "agency cross" transactions in which the collateral manager or an affiliate thereof acts as a broker for compensation for both the issuer and the other party to the transaction. The collateral manager may also engage in "client cross" transactions in which the collateral manager or an affiliate thereof causes a transaction between a securitization issuer and another client of the collateral manager without the collateral manager or its affiliates receiving compensation.

A collateral manager may be entitled to receive an incentive fee or other fees, or may hold subordinated securities, intended to incentivize its performance. These fees or holdings may cause the collateral manager to take greater risks, which may be to the detriment of some classes of securities over others. A collateral manager's affiliates may act as a hedge, credit default swap ("CDS") or other derivative counterparty to a securitization issuer. As a result, the collateral manager may take into account such an

affiliate's interests in such other capacities when it performs its duties as collateral manager.

Like servicers, collateral managers play an essential role in certain ABS transactions. The potential conflicts should be disclosed to investors and otherwise permitted under the scope of Section 621. It should also be noted that many of these types of conflicts are already subject to statutory and regulatory provisions under the Investment Advisers Act of 1940.

Trustee. Trustees are generally not affiliated with the sponsor of a transaction, but may be affiliated with underwriters, placement agents or initial purchasers. If an indenture trustee was an affiliate of the sponsor, the independence of the trustee could be questioned. A sponsor or its parent may want to acquire a trustee or the trust business from the trustee. Affiliation of the sponsor and the trustee could be viewed as posing a conflict of interest. Trustees are also important transaction parties and potential conflicts involving affiliated trustees do not fall under the scope of the intent of Section 621.

It is also worth noting that there are potential conflicts inherent in any transaction where multiple classes of notes or multiple series of notes are issued. A trustee may at some point during a transaction face a conflict where investors have divergent interests. Accordingly, the Trust Indenture Act of 1939 provides direction on action to be taken by the trustee when such conflicting interests arise (Section 310(b)). Such conflicts are inherent and potentially exist in any multi-class transaction but only become actual and material if certain circumstances, such as a default, arise. As with potential conflicts related to affiliated servicers and collateral managers, potential conflicts arising in a transaction with an affiliated trustee (to the extent permitted by existing law) should be disclosed to investors and otherwise permitted under the scope of Section 621.

H. Derivatives

Swaps and Caps. Many ABS transactions involve the use of interest rate or currency swaps or interest rate caps which are bid out across market participants and are sometimes provided by affiliates of the underwriter. If the issuer defaults under a swap, the exercise of remedies by the swap provider could be adverse to ABS investors, including as a result of shifts in cashflow priorities resulting from such a default or a termination event, the effect of which is to divert payments away from such investors toward the swap provider. Conflicts of interest restrictions could prevent the affiliate of a Designated Party from providing a swap or cap, potentially depriving investors of the best possible execution. As more fully described in subsection I below, derivative counterparties should be permitted to receive payments for their services ahead of payments to investors so long as payment priorities are adequately disclosed to investors.

CDS, TRS and other Derivatives. In addition to interest rate and currency swaps, ABS transactions may also involve the use of CDS, TRS and other derivatives. Derivatives provide many benefits in structuring ABS transactions that satisfy investor demand. Designated Parties should continue to be permitted to provide and use derivative products in connection with ABS transactions so long as such participation is not undertaken with

the intention of designing an ABS to fail, consistent with the legislative intent behind Section 621.

I. Payments Received Ahead of Payments to Investors

A Designated Party may receive payments for performing a role in a securitization transaction or providing services ahead of some or all payments to investors. A Designated Party acting as servicer may receive a servicing fee payment and reimbursement of servicing advances prior to payments being made to investors. A swap or other derivative counterparty may receive payments prior to payments to investors or *pro rata* with a senior class but ahead of more junior classes. In certain ABS transactions (*i.e.,* a synthetic or certain cash transactions), an underwriter may receive a portion of its underwriting fee over time during the life of the ABS transaction ahead of payments to investors. Prohibiting a transaction party from receiving payments of this nature ahead of investors could result in such party being unwilling or unable to perform its role in the transaction. For instance, a bank regulator could determine that it is an unsafe and unsound banking practice for a bank to act as a servicer and receive its servicing payments only after payments to investors. Each securitization waterfall should clearly set forth the priority of payments for investors, including which payments are made prior to payments to investors, which disclosure should be adequate to permit the continuance of these arrangements.

J. Transactions That May Be Viewed As Causing Another Participant To Have a Conflict

Issuer or Subscriber Paid Rating Agencies, Accountants and Due Diligence Service Providers. Section 939F of the Dodd-Frank Act references "the conflicts of interest associated with the issuer-pay or subscriber pay models" for choosing rating agencies. Many participants in a securitization transaction, including accounting firms and third-party due diligence service providers, are paid by the sponsor. If the sponsor hires and pays for a rating agency or a Designated Party, such as any affiliate of an underwriter or placement agent, as an investor, pays for a rating, there could be a conflict with respect to investors, or other investors, in the transaction. It is unclear who would pay rating agencies, accountants and due diligence service providers if Designated Parties are prohibited from doing so. Other proposals and regulations that have been adopted are aimed at eliminating these types of potential conflicts and, as such, these issues should not be subject to further regulation under Section 621.

IV. Other Activities of a Designated Party

Financial institutions are often large firms with many different departments and specializations. For example, a Designated Party, such as an affiliate of an underwriter or placement agent, may provide market research to investors that may include negative commentary about a sponsor or its affiliates, a sector of consumer finance or specific ABS. Such research could adversely impact the market value of ABS issued with the participation of a Designated Party. A sponsor may also enter into a merger, acquisition or restructuring transaction that could be adverse to its ongoing securitization related activities. An

underwriter or placement agent may act as an advisor to a sponsor in connection with potential mergers, acquisitions or restructurings. These activities should be permitted under Section 621 because they are activities of the Designated Party but do not relate to specific ABS issued or underwritten by such Designated Party. Some of these activities are already regulated to prevent conflicts. For example, existing regulations govern the independence of research analysts to avoid the creation of potential conflicts.

In another example, a bank affiliate of an underwriter or placement agent may make loans to the sponsor of a securitization. If the sponsor defaults under the related loan agreement, the bank would want to exercise remedies against the sponsor, but exercising such remedies could be adverse to the interest of the investors in the sponsor's securitization transaction. In addition, a Designated Party that is a sponsor of a CMBS transaction may subsequently act as a lender or advisor to a borrower who has a loan in the CMBS. An underwriter or placement agent may act also as underwriter or placement agent in connection with securities issued by a competitor of the sponsor post-closing (ABS or securities issued in an initial public offering), which could put the sponsor at a competitive disadvantage or establish a new pricing benchmark that is adverse to the investors in the sponsor's securities. Again, these activities occur in the ordinary course of a bank or other financial institution's business without regard to specific ABS.

Finally, an underwriter may desire to hedge ABS it acquires as part of permitted market making activity within a year of such acquisition. As described in subsection E of Part III of this letter, financial institutions engage in hedging activities in many contexts and at many levels and in some circumstances where certain transactions are walled off from other parts of the institution. Like all of the activities described in this Part IV, these hedging activities are dissimilar from a Designated Party betting against a transaction and, as a result, should not be prohibited.

Each of the activities described in this Part IV may be vital to the business of a financial institution and only somewhat related, or not at all related, to the securitization activities of such institution. Prohibitions on unrelated business activities may adversely affect a firm's business operations and can be easily distinguished from "designed to fail" transactions.

V. **Conclusion**

SIFMA appreciates the opportunity to provide its comments and suggestions to the Commission in connection with the implementation of Section 621. Although we generally support the prohibition of material conflicts of interest of the type cited by Senators Merkley and Levin, we encourage the Commission to carefully consider the observations and recommendations set forth in this letter, as well as other issues or observations that may arise related to conflicts of interest but not otherwise specifically addressed in this letter, to ensure the most effective implementation of the provisions of the Dodd-Frank Act. The implementing rules should strike the proper balance between prohibiting Designated Parties from profiting from transactions they "designed to fail" and preserving the healthy functioning of the United States capital markets. By striking this balance, we believe the Commission will avoid adopting rules that could impede or even prevent the recovery of the securitization markets and will instead formulate rules which encourage securitization

activities outside the narrow scope of those transactions Congress intended to target. Finally, certain types of transactions and activities should not be prohibited under Section 621 regardless of whether such transactions and activities result in potential or actual conflicts if, as demonstrated by the examples provided in this letter, (i) such transaction or activity represents an overall alignment of the risk to the ABS or underlying assets similar to that borne by investors of the ABS, (ii) such transaction or activity is unrelated to the Designated Party's role in the specific ABS, (iii) disclosure of the transaction or activity of the Designated Party adequately mitigates the risk posed by the potential or actual conflict with respect to any investors in the ABS or (iv) another regulatory regime applies with respect to the potential or actual conflict of interest.

We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with the Commission and its Staff. If you have any comments or questions, please feel free to contact Richard Dorfman at (212) 313-1359 or rdorfman@sifma.org, Chris Killian at (212) 313-1126 or ckillian@sifma.org, or Andrew Faulkner of Skadden, Arps, Slate, Meagher and Flom LLP at (212) 735-2853 or afaulkner@skadden.com.

Sincerely,

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