March 23, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Prohibition Against Conflicts of Interest in Certain Securitizations (Release No. 33-11151; File No. S7-01-23)

Dear Ms. Countryman:

The American Securities Association (ASA)[1] submits these comments in response to the proposal issued by the Securities and Exchange Commission (SEC) regarding conflict of interest prohibitions in certain securitizations (Proposal). The ASA is concerned that as currently drafted, the Proposal would disincentivize legitimate market activity and raise costs for borrowers and investors that rely on an efficient and competitive securitization market. We believe that certain modifications are necessary to the Proposal in order to mitigate these consequences when the SEC issues a final rule.

General

The Proposal would implement Section 621 of the 2010 Dodd-Frank Act which made it unlawful for an underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security (ABS) to "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." This prohibition against conflicted transactions lasts for one year after the first closing of the sale of an ABS. The SEC initially proposed rules to implement Section 621 in 2011, however those rules were never finalized.

Section 621 was added to address so-called "designed to fail" asset-backed securities whereby a financial institution creates an ABS it knows will decline in value, then immediately bets against that ABS using a derivative once the transaction is closed. Such activity was the subject of Congressional hearings and regulator inquiries leading up to passage of the Dodd-Frank Act. The ASA agrees that such behavior should be prohibited and has no place in our capital markets.

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

However, regulators must make a distinction between ABS that are intentionally designed to fail against ABS structures that benefit both investors and the end consumer. The latter may decline in value for other reasons, but ultimately regulators should avoid second-guessing bona fide business transactions entered into by financial institutions involving ABS. The ASA's fundamental view of the Proposal is that it is unnecessarily broad and goes well beyond the scope and intent of Section 621. Accordingly, the ASA wishes to provide the following recommendations and observations regarding the Proposal.

Municipal Securitizations Should Be Exempted From the Final Rule

The Dodd-Frank Act mandated that the SEC issue rules to implement Section 621. In the proposing release, the SEC acknowledges in the Proposal that it has fairly wide latitude to determine which types of securitizations meet the definition of ABS under the Exchange Act. In the context of municipal securities, the Proposal asks whether and what types of municipal securitizations could be exempted from a final rule.[2]

To answer this question, it must be noted that the types of transactions DFA was seeking to eliminate with Section 621 had little to do with the municipal market. The municipal bond market continues to function well, and has for decades, despite different market cycles and economic shocks.

The municipal bond market has also been defined by an extremely low default rate: There were no municipal defaults due to the height of the COVID-19 pandemic in 2020 and the average five-year default from 2011-2021 was just .12% - over 60 times less than the corporate debt default rate during the same period.[3]

There are generally two approaches to municipal securitizations. The first involves a financial institution that packages municipal bonds into a security as a way for investors to gain diversified access to the municipal market. The other approach is when entities such as state housing authorities package mortgages into either a taxable or tax-exempt bond. The purpose of these bonds is to support creation of affordable housing markets for individuals and working families within a particular state that may have a difficult time obtaining a traditional mortgage.

Municipalities and those defined as securitization participants under the Proposal often use swaps or other financial instruments to manage risks associated with these offerings. However, the proposed categories of material conflicts of interest contained within the Proposal will likely disincentivize certain transactions intended to manage these risks and seem to be seeking to solve a problem that does not exist in the municipal market. We remind the Commission that

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[2] Proposal at 18

[3] https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/fixed-income/moodys-investors-service-data-report-us-municipal-bond.pdf

municipal bonds and their related securitizations were not the target of Congress when it drafted Section 621 of the Dodd-Frank Act.

Furthermore, as the Proposal notes, the SEC has already applied the risk-retention rules under Section 941 of Dodd-Frank to municipal securitizations so participants in these offerings are already required to hold a specific amount of risk related to each securitization on their books.[4] For these reasons, municipal securitizations should be viewed as very different from traditional ABS under the Proposal and they should be exempt from the final rules.

<u>The Scope of "Material Conflicts of Interest" Contained in the Proposal is Too Broad</u>

Upon an initial purchase of an ABS, it is widely understood that there will often be trading of financial instruments in connection with that ABS. This trading can –for good reason – involve the underwriting firm that worked on the securitization. These underwriters may enter into a swap to mitigate the risk associated with the security and should not be automatically perceived as "betting" that the ABS will fail.

The SEC should avoid prohibiting an initial purchaser of an ABS from trading in the market for that security, even if the purchaser acted as an underwriter. Under the current Proposal, every trade that an underwriting firm wished to enter into could be deemed a "conflict of interest" and therefore prohibited.

We do not believe this is what the SEC intends, nor is this what Congress had in mind when the Dodd-Frank Act was passed. We urge the SEC to limit the universe of what constitutes a "material conflict of interest" to include, for example, short selling transactions or transactions involved in an offering that was designed to fail from the beginning.

Additionally, the Proposal would prohibit certain transactions within the following timeline:

- Starting on "the date on which [a securitization participant] has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant"
- And ending on "the date that is one year after the date of the first closing of the sale"[5]

In practice, this prohibition could last for more than one year. Any one securitization can be highly complex take the involvement of a wide range of industry professionals to put together.

[4] Proposal at 11
[5] Proposal at 56

The SEC should not restrict a trader's ability to handle unrelated order flow simply because the trader's firm is in a potentially conflicted position as it works on a securitization.

Conclusion

The ASA appreciates this opportunity to provide comments on the Proposal. We understand that the SEC is bound by the statutory mandate of Dodd-Frank even though market practices have evolved and other requirements (e.g. risk retention) have since been put in place that already address some of the same goals in Section 621. We hope that the SEC considers the suggestions in our letter to make certain the final rule does not disrupt well-functioning markets and needlessly raise costs for investors and municipalities.

Sincerely,

Jessica Giroux
General Counsel
American Securities Association