Vanessa A. Countryman, Secretary
Securities and Exchange Commission 100 F
Street, N.E.
Washington, DC 20549-1090 USA

27 March 2023

Re: AFME Comments on the Proposed Rule 192 Under the Securities Act of 1933 (File Number S7-01-23)

Submitted via E-mail to rule-comments@sec.gov

Dear Ms. Countryman,

The Association for Financial Markets in Europe ("**AFME**"), described in the Annex is pleased to respond to the request for comment by the Securities and Exchange Commission (the "**Commission**") on Release No. 33-11151 (the "**Release**")[1] proposing new Rule 192 (the "**Proposed Rule**") being a re-proposal of Rule 127B dated 2011 (Release No. 34-65355)[2] (the "**Original Proposed Rule**"). The Proposed Rule seeks to implement the prohibition under Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**") on material conflicts of interest in certain securitisations.

We appreciate the Commission's efforts in addressing public feedback on the Original Proposed Rule, but we are very concerned that without significant further changes the Proposed Rule will have the unintended effect of "unnecessarily hindering routine securitization activities that do not give rise to the risks that Section 27B was intended to address."[3]

Background

We endorse both the general spirit and detail of the comments made by the members of our sister organisation, the Securities Industry and Financial Market Association ("**SIFMA**") in its letter to the Commission in response to the Proposed Rule (the "**SIFMA Letter**").

The aim of our response is therefore to emphasise our members' views of the key points and themes raised in the SIFMA Letter and reiterate the need for clarity surrounding the distinction between the specific types of misconduct to be prohibited by the Proposed Rule

[1] Prohibition Against Conflicts of Interest in Certain Securitizations, Supplemental Proposed Rule, Release No. 33-11151 (25 January 2023).
[2] Prohibition Against Conflicts of Interest in Certain Securitizations, Proposed Rule, Release No. 34-65355 (19 September 2011), 76 Fed. Reg. 60320, 60340 (28 September 2011).
[3] Proposed Rule Release, Section I. B.

Association for Financial Markets in Europe
London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540
Frankfurt Office: Neue Mainzer Straße 75, 60311 Frankfurt am Main T:+ 49 (0)69 710 456 660
www.afme.eu

Company Registration No: 6996678 Registered Office: 39th Floor, 25 Canada Square, London E14 5LQ
AFME is registered on the EU Transparency Register, registration number 65110063986-76

and other legitimate activities undertaken in connection with the securitisation process.

Comments

Our comments with respect to the Proposed Rule are set out below:

1. Construct of the Proposed Rule

We are pleased that our comments[4] on the Original Proposed Rule have been considered by the Commission and that the Commission has attempted to propose a more precise rule and definitions of key terms (e.g., in relation to covered persons) "to provide an explicit standard for determining which types of transactions would be prohibited"[5].

However, our members share SIFMA's and other industry associations' fundamental concern that the general prohibition is now overly broad, potentially capturing every possible transaction arising in the context of asset-backed securities and all participants (or non-participants) in the securitisation markets in the United States or abroad. It is effectively a prohibition on a number of ordinary-course securitisation activities, including normal prudential risk management activities of banks and other financial services companies and the extension of consumer and commercial credit, the impact of which the Commission itself recognises in the Proposed Rules Release may not have been adequately identified and quantified.[6] The Proposed Rule's extremely broad scope would have a significantly detrimental impact on cash-flow securitisations, synthetic securitisations, repackaging transactions and other types of transactions frequently used in Europe with broader spill-over effects into the wider economy.

Although the construct of the Proposed Rule is a step in the right direction since the Original Proposed Rule, we request that the Commission goes further to clarify the proposed broad concepts, including by adding specific and clearly defined exclusions from the Proposed Rule, as we discuss further in this letter.

2. Extraterritorial Scope – Foreign Safe Harbor

As currently drafted, the Proposed Rule is silent as to its jurisdictional scope, and, therefore, potentially applies to transactions that lack a clear US connection (e.g., even transactions that occur "outside the U.S." and are designed to rely on safe harbor provided by Regulation S of the Securities Act). The extraterritorial reach of the Proposed Rule is of significant concern for our members in the context of their European market activities. It is particularly concerning that this issue was not further developed as part of the Proposed Rule when we, and other industry associations, clearly expressed our concerns over the extraterritorial reach of the Original Proposed Rule.

We strongly believe that Section 621 was specifically designed to prevent ABS transactions that were designed to fail to the detriment of U.S. investors, and not to regulate conflicts of

[4] Joint AFME, ASIFMA and ICMA Letter to the SEC dated 13 February 2012 in relation to the Original Proposed Rule.
[5] Proposed Rule Release, Section I. B.
[6] Joint industry associations' letter to the SEC dated 16 February 2023.

interest in the global ABS markets where there is limited nexus with, or impact on, U.S. investors. Therefore, in order to ensure that the extraterritorial reach of the Proposed Rule is clear, we strongly request that the Commission provide a safe harbor for ABS transactions that are not offered or sold to U.S. investors as part of the primary issuance. We further believe that the regulatory needs in relation to conflict of interest issues in non-US securitisation transactions are best assessed and addressed by local regulators and local investor legal protections.[7]

While we completely agree with SIFMA's request that the Proposed Rule include a safe harbor for certain foreign transactions, we believe that the design of any such foreign safe harbor should follow the well-established and -understood principles behind the foreign safe harbors used for other Exchange Act rules designed to protect U.S. investors investing in ABS transactions, such as those used for Rule 17g-5 and Rule 15Ga-2, rather than the foreign safe harbor (the "**RR Safe Harbor**") designed for Section 15G of the Exchange Act of 1934 (15. U.S.C. 78o-11), as added by Section 941 of the Dodd-Frank Act and implemented by the final rules promulgated thereunder by the U.S. Securities and Exchange Commission (the "**U.S. Risk Retention Rules**").

The U.S. Risk Retention Rules were designed not only to protect the interests of U.S. investors in ABS, but also to promote sound underwriting standards and risk management practices.[8] When designing the RR Safe Harbor, the U.S. Risk Retention Rules clearly stated that its objective was "to exclude only those transactions with limited effect on U.S. interests, underwriting standards, risk management practices, or U.S. investors."[9] On the other hand, the protection of Section 621 of the Dodd-Frank Act clearly has a more narrow objective (i.e., to protect the interests of U.S. ABS investors) which is why we are of the strong view that any safe harbor must then be designed with a commensurate scope (i.e., to exclude any transaction not offered or sold to U.S. investors in a primary offering).

Such an approach would be consistent with the foreign safe harbors designed in connection with other Exchange Act rules designed to protect the interests of U.S. ABS investors (including against conflicts of interests). Specifically, we would highlight the foreign safe harbors that have been designed for Rule 17g-5 (designed to protect U.S. ABS investors from conflicts of interest from issuer provided ratings) and Rule 15Ga-2 (designed to disclose to U.S. ABS investors findings made in connection with third-party provided due diligence reports), in each case, of the Exchange Act. In particular, we believe that foreign safe harbor contained in paragraph (e) of Rule 15Ga-2 of the Exchange Act (the "**15Ga-2 Safe Harbor**")

[7] In the EU and the UK for instance, issues relating to conflicts of interest are largely addressed by The Markets in Financial Instruments Directive II (2014/65/EU), as also retained in the UK following Brexit by virtue of the European Union (Withdrawal) Act 2018 ("**MiFID II**"). The main objectives of the MiFID regime were to strengthen investor protection, eliminate barriers to cross-border trading and enhance competition in the securities industry across the EEA, with the ultimate aim of encouraging the integration of capital markets and creating a level playing field for firms providing investment services across the EEA.

[8] U.S. Risk Retention Rules at section III.(E), pages 275-276.

[9] U.S. Risk Retention Rules at section III.(E), pages 274.

to be sufficient in its scope.[10] The 15Ga-2 Safe Harbor also has the added benefit that it is tied to the principles contained in the Regulation S foreign safe harbor for offerings "outside of the U.S.", which are well-known and understood in the European ABS markets.[11]

3. Covered Persons

While we appreciate the inclusion of definitions for the various securitisation participants, in many cases these start with the corresponding definitions under federal securities laws (such as Regulation AB or the Securities Exchange Act) and are then expanded in such a way that create ambiguity as to their overall reach or, in some cases, appear to contradict the regulatory base definitions. Clarifying these definitions by limiting them to their US securities laws' equivalent and then including qualifications to limit the scope, where such scope would have an impact beyond the spirit of the Proposed Rule, is essential in our view, particularly as some of these terms are potentially subject to different interpretations by non-US market participants.

In this regard, we agree with SIFMA's request that the definition of "securitization participant" be narrowed and clarified for the reasons set out in the SIFMA Letter.[12] From a European perspective, we are especially concerned by the Proposed Rule's application to all of securitisation participant's affiliates and subsidiaries anywhere in the world regardless of their knowledge of, or participation in, the transaction, or the presence of information barriers. As SIFMA points out, the Proposed Rule effectively characterises all affiliates and subsidiaries of an underwriter, placement agent, initial purchaser or sponsor as "securitisation participants" regardless of whether they are in fact participants in the relevant securitisation, thus losing connection with what a "conflict of interest" actually is and what the Proposed Rule is intended to protect the investors from. Additionally, and as already alluded to in Section 2 above with respect to the extraterritorial scope of the Proposed Rule, this has the result of interfering with, and negatively impacting, non-U.S. securities markets, without regard to regulatory regimes in place in those markets, and would have serious consequences for our members in Europe. As one example of such extraterritorial impact, members pointed out a very common situation where a U.S. licensed broker dealer entity acting as an underwriter on a U.S. offering would commonly engage its European office's sales team to place the Regulation S notes in Europe. This European office would often be a subsidiary or affiliate of the U.S. broker dealer, but would not be involved in the structuring of the transaction. It would therefore be very far-fetched and, in our view, inappropriate to impute to such foreign office the securities laws duties that would arise in

[10] 17 C.F.R. § 240.15Ga-2: "*(e) The requirements of this rule 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 of 1933; (2) The issuer of the rated security is not a U.S. person (as defined in § 230.902(k)); and (3) All offers and sales of the security by any issuer, sponsor, or underwriter linked to the security will occur outside the United States (as that phrase is used in §§ 230.901 through 230.905 (Regulation S))*".

[11] Although we strongly believe that the 15Ga-2 Safe Harbor is the more appropriate precedent for a foreign safe harbor for the Proposed Rule, we would nonetheless be supportive of a foreign safe harbor that is similar in scope to the RR Safe Harbor (except that the definition of "U.S. person" in Regulation RR should conform to the definition of "U.S. person" in Regulation S) as is more fully articulated in the SIFMA Letter.

[12] SIFMA Letter, Part V.

connection with the underlying securitisation structuring, in order to conclude that a conflict of interest with that entity's own self-interest could arise in such circumstance.

We are also very concerned that the definition of "securitization participant" is so wide that in some instances it would even capture investors in related securitisations where they are actively involved in the design and/or negotiations of the transaction, the very investors it seeks to protect. This would have the counterintuitive result of preventing investors from financing their purchases via repurchase transactions posting securities as collateral. Investors would also be prevented from hedging their currency or interest rate exposure or even their counterparty credit risk to the bank, which would in turn reduce investor appetite to become involved in such transactions.

Similarly, for a typical repackaging transaction structure, the definition of "securitisation participant" under the Proposed Rule would capture both the bank (as arranger and/or placement agent) and repack investor (as initial purchaser and/or sponsor), as well as any subsidiaries and affiliates thereof. For large banks, this would mean that any branch, office or division within any part of the banking group would be subject to the prohibition on conflicting transactions relating to the repack notes and underlying collateral. The result would be severe and disproportionate to the nature of the risk that the Proposed Rule is intended to address, and we are concerned that it could inadvertently diminish much of the European repacks business to the detriment of the investors who are unable to unlock the benefits of these transactions.

Lastly, we support the feedback provided in the SIFMA Letter on the definition of "sponsor"[13] which exceeds the term's ordinary and natural meaning and is significantly broader than that included in Regulation AB, therefore introducing a high degree of ambiguity in its interpretation.

4. Covered Products – Scope of the Definition of "Asset-Backed Security"

We support SIFMA's concern that the definition of "asset-backed security"[14] is too wide and consequently market participants will find it difficult to identify those transactions that are caught by the Proposed Rule. While it is clear that certain products, such as corporate-credit based secured financings, should not be within scope and are clearly not of the type that the Proposed Rule is intended to address, application of the proposed new regime to other type of financings is less clear.

(a) Synthetic Asset-Backed Securities

We support SIFMA's view that the term "synthetic asset-backed security" should be defined in the final rule and agree with the definition proposed by SIFMA[15]. We disagree with the Commission's assertion that the meaning of the term "synthetic securitisation" is "well understood".[16]

[13] SIFMA Letter; Part II.
[14] As such term is defined in Section 3 of the Securities Exchange Act of 1934 (as amended).
[15] SIFMA Letter; Part VIII.
[16] Proposed Rule Release, II. A.

Any definition of synthetic ABS should be appropriately calibrated, together with the scope of "conflicted transaction" (on which, see Section 6 below) and related carve-outs, so as to permit the continued use of the appropriate transaction structure for each bank, particularly in the EU and the UK where a wide a variety of structures are used, and to avoid creating unintended incentives for some structures to be favoured over others. Moreover, such definition should not inadvertently conflict with other aspects of the Proposed Rule and/or the market.

In particular in the EU and the UK, these transactions represent an important credit risk and balance sheet management tool for banks, regulatory capital management no longer being the sole motivation. EU and UK prudential and capital requirements regulations contain express provisions for allowing banks to transfer the default risk of credit exposures retained on their balance sheet in order to achieve capital relief or manage concentration limits or generally hedge tail risk in their loan books and free up credit lines that may be used for further lending.[17]

Synthetic securitisations for transferring risk have been used increasingly since 2008 under continuous regulatory scrutiny from the European Central Bank and various national regulators such as the Prudential Regulation Authority in the UK, overstepping in 2018 the highest pre-crisis volumes and increasing steadily since, while arbitrage transactions have disappeared completely from the European market. [18]

Synthetic securitisation was also identified as an important capital optimization and balance sheet management tool for the EU and UK banking sector in the post-Covid world and, in recognition of their tested use and performance, synthetic securitisations have been allowed from April 2021 to benefit from the STS (Simple, Transparent and Standardized) label[19] previously only available to cash securitisations. [20]

---

[17] European Banking Authority Report on STS Framework for Synthetic Securitization under Article 45 of Regulation (EU) 2017/2402 dated 6 May 2020, available at https://www.eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation. See Section 3.2.2 Market developments, paragraph 29.

[18] European Banking Authority Report on STS Framework for Synthetic Securitization under Article 45 of Regulation (EU) 2017/2402 dated 6 May 2020, available at https://www.eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation. See Section 3.2.2 Market developments, paragraphs 21 and 22. Industry associations can provide further volume data on continuing increase in volume of synthetic securitisations in the EU and UK since 2018.

[19] European Banking Authority Report on STS Framework for Synthetic Securitization under Article 45 of Regulation (EU) 2017/2402 dated 6 May 2020, available at https://www.eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation. STS label would afford the bank retaining the senior tranche the benefit of preferential capital treatment.

[20] Two regulations amended the EU Securitisation Regulation and the Capital Requirements Regulation: (i) Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012; (ii) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as amended.

Private investors are non-bank private entities, which are usually highly specialised in credit investing and experienced in portfolio due diligence (namely, hedge funds, pension funds, asset managers and increasingly insurers). The main motivation for investors to invest in synthetic securitisation is the search for a higher yield and enhanced diversification of their investments. Public investors consist mainly of 0% risk-weighted multilateral development banks. This includes the European Investment Bank (EIB) / the European Investment Fund (EIF), which continues to be an important investor dominating the SME synthetic market. Under the European Commission's investment plan for Europe (the 'Juncker Plan'), the EIB/EIF have played an important role in providing credit protection to banks, with the mandate to promote lending to SMEs and reuse the freed-up capital in new SME lending. As the monoline insurers have disappeared, the banks retain the senior tranches. [21]

Finally, data provided to the European Banking Authority shows that so far the default performance of balance-sheet synthetics is better than that of the traditional securitisations, for all selected asset classes, indicating that originators tend to systematically choose 'core' exposures for synthetic securitisation, with better default and loss performance than comparable exposures held on the balance sheet, showing that losses to investors arising from scenarios which the Proposed Rule seeks to prevent have not materialized in the mature EU and UK market. [22]

Any impact of the Proposed Rule that would prevent the use of synthetic securitisation in the EU, UK and rest of the world would be unfortunate as they would deprive banks of a useful credit risk and balance sheet management tool, allowing them to free up credit lines to further lend and as a result have undesired consequences for the banking sector and the wider economy.

(b) Insurance-linked securities

In line with SIFMA's request that the Proposed Rule should exclude insurance policies or contracts, we would encourage the Commission to consider an exemption for insurance-linked securities as proposed by SIFMA. This would be consistent with the definition of "asset-backed security" in the Exchange Act (which is incorporated by reference in this rule) and the definition of "synthetic asset-backed security" proposed by SIFMA.[23]

(c) Repackaging Transactions

Beyond traditional or synthetic securitisation, any repackaging of a pool of assets or collateral may fall within the scope of the Proposed Rule. Instruments issued by so-called "repack" special purpose vehicle, where the underlying pool or collateral is comprised of any

---

[21] European Banking Authority Report on STS Framework for Synthetic Securitization under Article 45 of Regulation (EU) 2017/2402 dated 6 May 2020, available at https://www.eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation. See Section 3.2.2 Market developments, paragraphs 34 -37.

[22] European Banking Authority Report on STS Framework for Synthetic Securitization under Article 45 of Regulation (EU) 2017/2402 dated 6 May 2020, available at https://www.eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation. See Section 3.2.3 Historical Performance.

[23] SIFMA Letter, Part X., E.

type of self-liquidating financial asset that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, are usually captured by the definition of "asset-backed security" under the Securities Exchange Act.

We are concerned that the Proposed Rule would substantially erode the EU and UK repacks markets by prohibiting banks from offering these services due to the implications for other lines of business and offices. We would expect the impact to be felt most acutely by investors who rely on these structures to manage their risk profiles. As a result, our proposals in this regard are two-fold:

(i) Some repack SPVs change the characteristics of an underlying investment in a way that is specifically requested or structured by the investor in the repack notes. For instance, investors may wish to re-profile the cash flow generated by the underlying collateral through a swap overlay so as to mitigate their exposure to certain risks arising from such cash flows or as part of a balance sheet optimisation tool. Under the current formulation of the Proposed Rule, such transactions are likely to be conflicted transactions. Therefore, we suggest introducing a clarification to the Proposed Rule that any apparent conflict that is necessarily part of the asset-backed securities transaction, and has been appropriately disclosed to investors in the transaction, should be carved out from the scope of the prohibition.

(ii) To the extent that only part of an asset or portfolio is re-packaged within an asset-back security, in our view the sponsor of that transaction should not be prohibited from entering into other transactions in respect of the remaining portion of such asset or portfolio that is not subject to such asset-backed security. This would be consistent with the stated intent of the Proposed Rule by avoiding conflicts arising in relation to the underlying assets (or portions thereof) of the asset-backed securities, while still enabling sponsors to enter into risk-mitigation activities or other transactions in respect of remaining assets (or portions there) that are not subject to the re-packaging transaction.

5. Covered Conflicts Of Interest – Prohibited Conduct

The Proposed Rule contains a prohibition on certain conduct involving or leading to a material conflict of interest if such conduct involves engagement in a "conflicted transaction". The Commission explains that the formulation is "designed to effectuate Section 27B by prohibiting a securitization participant [from placing] a bet against ABS that such securitization participant created and/or sold to investors" and that the prohibition together with the definition of "conflicted transaction" provide an "explicit standard for determining which types of transactions would be prohibited"[24].

We have described above certain issues with respect to the definitions in relation to the covered products and covered persons, which are used in the proposed prohibition, thus making it overly broad. The wording of the prohibition itself contains additional ambiguities around the conduct involved as well as a duration specification which in practical terms (in the context of the various types of transactions that may be involved) is unclear and

[24] Proposed Rule Release, Section I. B.

potentially far-reaching.

Our members support SIFMA's proposal to include a compliance date that includes a transition period, which would provide some certainty around the duration of the prohibition.[25] Ideally, this approach would be complemented by specific exclusions proposed in the second component of the prohibition which is the definition of the "conflicted transaction" (as discussed in Section 6 below).

6. Material Conflicts of Interest – Conflicted Transaction

The prohibition in the Proposed Rule applies to a "conflicted transaction" defined as any one of 3 proposed subsets of transactions, in each case subject to a materiality standard of a "reasonable investor" being satisfied (in this respect see Section 7 below).

The definition of "conflicted transaction" includes "[a] short sale of the relevant [ABS]" and "[t]he 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 [ABS]."[26] These prongs appear to capture the transactions that concern Commission as "direct bets" against the relevant ABS. It is the third prong that SIFMA views, and our members agree, as problematic.

(a) Conflicted Transaction under 3(iii)

Prong (iii) of "conflicted transaction" is intended as a catch-all to capture any transaction which "creates an opportunity for the securitization participant to benefit […] from the actual, anticipated or potential adverse performance of the asset pool supporting or referenced by the ABS or a decline in the market value of the ABS." The Commission appears to consider this opportunity to be the critical element in determining whether an activity should be prohibited, while pointing out that it does not consider it necessary for a securitisation participant to intentionally design a securitisation to fail or default in order to trigger the rule's prohibition. Not only does this construct directly contradict the Commission's aim to provide an "explicit standard" for prohibited transactions, the Proposed Rule appears to impose strict liability for engaging in a transaction that results in a conflict of interest. In contrast to Section 17(a)(1) of the Securities Act of 1933 and Rule 10b-5 under the Securities Exchange Act of 1934 Act, there is no requirement of "scienter".

The Proposed Rule might therefore result in a participant being subject to a proceeding by the Commission without having intent or even reckless disregard. This poses a concern given that there is currently a significant degree of vagueness surrounding what constitutes a conflict of interest which would result in many ordinary course activities of many market participants being inadvertently captured. We therefore urge the Commission to remove the strict liability requirement, or alternatively narrow prong (iii) in a manner proposed by SIFMA[27], including by (a) more clearly identifying the proposed category of conflicted transaction, which should be a functional trading equivalent of a short sale or synthetic short of the relevant asset-backed security intended to evade the prohibitions in prongs (i) and (ii)

[25] SIFMA Letter, Part XII.
[26] Proposed Rule 192(a)(3)(i)-(ii).
[27] SIFMA Letter, Part VI., D.

of the definition of "conflicted transaction; (b) the use of "materially adverse" standard (which is a prohibition standard) rather than a "reasonable investor" standard (which is a disclosure standard) in this prong specifically, (c) carving out intrinsic elements of the principal transaction so that only entirely separate/new transactions could be caught, and (d) adding a knowledge qualifier tied to a dependency element so that a securitisation participant must know or should have known that it will achieve a benefit contingent upon the adverse performance of the asset-backed security.

From a synthetics perspective (which has the most pressing relevance to the European and UK market participants and our members), we support the comments made by the members of the International Association of Credit Portfolio Managers ("**IACPM**") in its letter to the Commission on the Proposed Rule (the "**IACPM Letter**").[28] In particular, we agree with their assertion that prong (iii) is so wide that it would potentially capture any activity anywhere else in the banking group, where contrary positions may be taken on assets in the underlying pool of the synthetic ABS by other teams that operate behind information barriers and are therefore not aware that the relevant asset is referenced in a risk transfer synthetic securitisation structured by the credit risk management function of the bank. Even actions of loan officers related to refinancing, restructuring or working out a defaulted loan referenced in the pool may constitute a conflicted transaction, where in fact every synthetic securitisation originator undertakes contractually that the servicing of the loans will continue as before, without regard to the protection purchased under the synthetic securitisation. The Proposed Rule in its current form would make it impossible for big and medium size banking groups to engage in synthetic securitisations if as a result they have to control the actions of other parts of the business and in the process divulge the existence of the risk transfer trade. If banks are unable to engage in credit risk portfolio hedging, they may reduce or disengage from the lending activity creating the risk resulting in a lack of financing for consumers and corporate borrowers.

By way of example, often a bank will enter into a synthetic securitisation for significant risk transfer that references a portion of certain loans on its balance sheet, and subsequently enter into a second balance-sheet synthetic transaction referencing the remaining portions of such loans (while still retaining 5% of the risk in accordance with the EU and UK securitisation rules). Such a construct is often necessary due to market appetite or as a result of the applicable concentration limits imposed by investor demands and/or regulatory requirements for STS transactions in the EU and the UK. Such transactions should not be prohibited under the Proposed Rule.

As an additional example, following the crisis, originators changed their involvement in the synthetic securitisation market, placing, as far as possible, only mezzanine/first loss tranches with investors. This is a reflection of various factors, such as materially different funding, the macro-economic and regulatory environment and changes in the investor base (withdrawal of monoline insurers and other relevant parties from the market). The large senior tranche is retained by the originator bank and it is not clear whether it could be construed as a conflicted transaction.

[28] Our comments here are based on the latest draft of the IACPM letter that we received ahead of our submission.

In this regard, we strongly support SIFMA's comment that intrinsic features of asset-backed securities transactions that shift risk from the sponsor to investors do not constitute a "conflict of interest", particularly in the context of credit-risk transfer transactions and that the exception to the prohibition related to risk mitigating hedging activities be modified and expanded.[29] See Section 8 below.

(b) Exclusions

SIFMA have identified certain transactions and securities that should be expressly exempt from the definition of "conflicted transactions", including without limitation (i) transactions involving the purchase or sale of an index including asset-back securities where those asset-backed securities constitute a de minimis (no more than 10%) portion of the overall index and (ii) certain pre-securitisation transactions (such as pre-securitisation hedging transactions, pre-securitisation warehousing or repo financings in relation to the pool of assets that becomes the subject of a securitisation afterwards) and pre-securitisation transfers of assets that become subject to the securitisation afterwards. The latter would help clarify the otherwise far-reaching duration of the prohibition as discussed in Section 5 above.

7. Materiality and Disclosure of Conflicts

The Proposed Rule stays away from the use of disclosure as a method of addressing conflicts of interest in securities offerings, as was the case with the Original Proposed Rule. The Commission argues that disclosure would be insufficient in the context of, and would undermine, a rule designed to prohibit a certain type of activity, and that although disclosing a conflict of interest may reduce the likelihood that an investor would invest in a tainted ABS, it would not wholly eliminate the incentive for a securitisation participant to enter into the conflicted transaction. Nevertheless, the Commission drafted its proposed prohibition using a disclosure standard (a materiality standard of a "reasonable investor")[30], which appears to contradict the Commission's argument, is confusing to legal practitioners and will prove difficult to apply in practice.

We have previously advocated that such approach represents a fundamental departure from existing US securities laws, which have historically allowed investors to form an independent judgment as to the merits of the proposed securities on the basis of full disclosure by the issuer. Our members are of the view and support SIFMA in their assertion that provisions of existing securities legislation such as the Volcker Rule, the US Risk Retention Rules, FINRA, the Investment Advisers Act of 1940 and, most recently, the Investment Adviser Marketing Rule provide compelling examples for the Proposed Rule in this respect. The Investment Advisers Act in particular provides more flexibility regarding conflicts of interest than the Proposed Rule, namely full and fair disclosure and informed consent despite the fact that investment advisers have a fiduciary duty to their advisory clients. A conflict of interest between them belongs to the most troubling category of conflicts of interest under the law because the fiduciary duty standard is the highest standard of duty implied by law. No

[29] SIFMA Letter, Part VI., B.
[30] See Basic v Levinson, 485 U.S. 224(1988).

securitisation participant has a fiduciary duty to investors.[31]

Should the Commission not provide for a general disclosure alternative in the final rule, we support SIFMA's assertion that the Commission could nevertheless do so with respect to any "catchall" category of conflicted transactions,[32] such as the proposed prong (iii) of the definition of "conflicted transaction" (as discussed above) given the overly broad reach of that provision.

8. Prohibited Conduct - Excepted Activity

The Commission proposes to narrow the scope of the exemptions from prohibited conduct proposed under the Original Proposed Rule, given that it feels they should not undermine the overall aim of the proposed prohibition. To this end, the Commission specifically identifies synthetic ABS as a point of focus.

As described in Section 4(a) above, synthetic securitisations as a credit risk and balance sheet management tool (including in order to achieve regulatory capital relief under the specific regimes of prudential regulators) represent a mature market in Europe and the UK. Banking institutions in those geographies frequently enter into synthetic securitisations in respect of books of loans on their balance sheet, in order to manage exposure limits in respect of assets that remain on the consolidated balance sheet of the originator's group or achieve capital relief under applicable capital rules (such as the Significant Risk Transfer regime set out in the EU's Capital Requirements Regulation (CRR)[33]). The Significant Risk Transfer transactions are notified to the competent prudential regulators (at EU or national level), who review the application for capital relief and either approve it or raise an objection. These types of transactions have been an essential tool for EU and UK financial institutions and any extra territorial reach of Rule 192 (which may in its proposed form be interpreted as prohibiting such transactions or significantly limiting other transactions in a bank group perceived as related) would have a significant adverse effect on the ability of institutions to continue to use this very helpful risk management tool, with overarching implications across the global economy. As a result, we support SIFMA's position to expressly exclude such transactions from the scope of the prohibition as a new category of permitted risk-transfer transactions, such as (i) synthetic securitisation or credit risk mitigant entered into or benefiting a financial institution or its affiliate intended to satisfy the regulatory requirements applicable to such institution or its affiliate; and (ii) any synthetic securitisation or credit risk mitigant entered into by any other person or entity in which such person or entity manages risk in a manner intended to be similar to that specified under the regulations applicable to a regulated financial institution.][34] In addition, we fully agree with the comments made in the IACPM Letter that the risk mitigating hedging exemption is too narrow to allow banks to engage in the ordinary range of transactions relating to credit portfolio risk management activities. Banks must be permitted to engage in effective credit portfolio hedging in order to ensure the continued viability of such activities.

[31] SIFMA Letter, Part VII., A.
[32] SIFMA Letter, Part VII., B. & C.
[33] Regulation (EU) No. 575/2013, including as retained in the UK following Brexit by virtue of the European Union (Withdrawal) Act 2018.
[34] SIFMA letter, Part X, A 2.

We also support SIFMA's proposal to clarify the Proposed Rule's current exception for risk – mitigating hedging activities in order to avoid unintended consequences on the banks risk mitigating hedging activity. [35]

Our members reiterate our prior argument that interest rate, currency and other non-credit related trading and hedging activities should be included in the Commission's list of typical activities undertaken in connection with a securitisation transaction that do not fall within the scope of the Proposed Rule. Such hedging activity is completely unrelated to the concerns that motivated Section 27B and we fully agree with SIFMA that as recent events highlight, no rule under Section 27B should make it more difficult for banks and other financial institutions to mitigate their interest-rate, currency and other non-credit related risks. [36]

We believe the above suggestions to represent a sensible approach and that it would be beneficial, in order to achieve clarity of the scope of application of the final rule, to expressly list the types of transactions not intended to be caught by the prohibition.

9. Use of Information Barriers

As we observe above, the broad scope of the Proposed Rule might have unintended consequences for the affiliates and subsidiaries of securitisation participants. We believe that the Proposed Rule does not satisfactorily accommodate the way in which many large financial institutions are organised; specifically, the current language could potentially restrict legitimate business activities that are conducted through various business units, offices and trading desks in different jurisdictions.

We appreciate the Commission's consideration of comments by market participants and industry organisations on the Original Proposed Rule, and its request for specific input on this Proposed Rule with respect to how information barriers could be implemented in a way that would not undermine the overall objective of the Proposed Rule.

SIFMA addresses the specific proposals by recommending that the Commission re-propose a rule under which information barriers are part of a multi-factorial analysis used to establish and demonstrate the 'separateness' of non-participating entities and securitisation participants. [37] As noted in the SIFMA Letter, the effectiveness of information barriers has been established in the context of many existing securities laws, including mostly notably to manage the potential misuse of material non-public information, as well as in providing important exemptions under the Volcker Rule.[38] Moreover, in lieu of introducing a new set of standards for information barriers that are specific to the Proposed Rule, which could create additional compliance burdens for market participants and potentially result in overlapping information barriers, SIFMA suggests that such re-proposed rule should follow the Volcker Rule's standard for information barriers.[39]

This is consistent with the approach in the EU and the UK, where the corresponding

[35] SIFMA letter, Part X, A 1.
[36] SIFMA letter, Part X, A 3.
[37] SIFMA Letter, Part V, C 1-3.
[38] 17 C.F.R. §§ 255.7(b)(2)(ii), 255.15(b)(2)(ii).
[39] SIFMA Letter, Part V, C 3.

regulation (for example, MiFID II) permits authorised firms to manage potential conflicts through organisational and administrative arrangements (including information barriers and segregation of functions). The use of information barriers is also accepted practice for managing certain activities under MAR.[40] We would encourage the Commission to adopt an approach that does not inadvertently create a tension with such existing EU regulation and practice.

Our members therefore strongly support SIFMA's proposal that information barriers based on the Volcker Rule standard should be a component in establishing separateness of non-participating entities and securitisation participants.

10. Anti-circumvention

Commission includes an anti-circumvention provision in relation to the general prohibition. This appears superfluous and inconsistent with the drafting of the proposal given that the Proposed Rule's general construct is inherently calibrated to providing an absolute prohibition of any activity that could "lead to attempts to evade the rule."[41]

We refer the Commission to SIFMA's analysis of anti-circumvention provisions in other Commission's rulemakings and support SIFMA's view[42] that a targeted anti-evasion provision relating to specific sections of the Proposed Rule such as the exceptions and safe harbors would be more appropriate along the lines of the approach taken in the RR Safe Harbor.

11. Economic analysis

We are concerned by the Commission's statement that it was "unable to reliably quantify" the economic effects of the Proposed Rule, and its admission that such quantification is "challenging due to the number of assumptions that we need to make"[43]. The Commission is requesting the public to assist it with the economic analysis.

We would again like to draw the Commission's attention to the joint industry associations' letter (which AFME also contributed to and signed) to the SEC dated 16 February 2023, requesting extension of the comment period in relation to the Proposed Rule. We strongly believe it is simply impossible to meaningfully consider the economic analysis of the rule for the reasons that the Commission itself recognises. We would appreciate being afforded more time to work with other associations and market participants to be able to assist the Commission in this task, as well as to provide a more detailed analysis of the Proposed Rule including constructive and workable solutions.

[40] The Market Abuse Regulation (596/2014/EU) as also retained in the UK following Brexit by virtue of the European (Union Withdrawal) Act 2018. Its aim was to introduce a common EU legal framework on market abuse, as well as measures to enhance investor protection and confidence in those markets.
[41] Proposed Rule Release, Section II. D. I.
[42] SIFMA Letter, Part IX.
[43] Proposed Rule Release, Section III. A.

Conclusion

We concur with SIFMA's caution against an overly broad approach and encourage the Commission to address the points raised in the SIFMA Letter. In this way, we very much hope that an appropriate balance will be maintained between prohibiting specific types of misconduct without restricting other activities inherent in the ordinary course of a securitisation and, in particular, without interfering, beyond what is necessary and appropriate to protect the functioning of the US markets and the activities of its participants; with the functioning of markets outside the United States.

Thank you for soliciting our comments as part of your Proposed Rule. We would be pleased to assist the Commission further if required. If you have any questions or desire additional information regarding any of the comments set out above please do not hesitate to contact Shaun Baddeley on + 44 203828 2698 or by email at shaun.baddeley@afme.eu and Maria Pefkidou on +44 (0)20 3828 2707 or by email at maria.pefkidou@afme.eu.

Yours sincerely,

Shaun Baddeley
Managing Director, Securitisation

shaun.baddeley@afme.eu

+44 (0)20 3828 2698
+44 (0)7584 582 759

Annex

The Association for Financial Markets in Europe

The Association for Financial Markets in Europe ("**AFME**") represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association ("**SIFMA**"). AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of SIFMA and the Asian Securities Industry and Financial Markets Association ("**ASIFMA**"). For more information, visit the AFME website, www.afme.eu.