October 30, 2023

VIA ELECTRONIC SUBMISSION

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Prohibition Against Conflicts of Interest in Certain Securitizations (SEC Release No. 33-11151; File No. S7-01-23; RIN 3235-AL04)

Dear Ms. Countryman:

The LSTA[1] appreciates the opportunity to comment on the reproposed Rule 192, Prohibition Against Conflicts of Interest in Certain Securitizations (the "Proposed Rule"), issued under Section 27B of the Securities Act of 1933, as added by Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] As we noted in our previous comment letter dated March 27, 2023,[3] because of the short time frame offered by the Securities and Exchange Commission (the "Commission") to comment on the Proposed Rule, the LSTA intends to submit three separate comment letters; this is our third letter.

I. Introduction

In our first letter[4] we addressed the negative implications of the application of the Proposed Rule to collateralized loan obligations ("CLOs") and the corporate loan markets that underlie them. In our second letter,[5] we focused on the securitization market more broadly and supported certain of the findings and recommendations included in the comment letter dated March 27, 2023 submitted by the Securities Industry and Financial Markets Association ("SIFMA"), the Asset Management Group of SIFMA and the Bank Policy Institute (the "SIFMA Letter").[6] In this letter, we support findings and recommendations of the second comment letter dated June 27, 2023 submitted by SIFMA, the Asset Management Group of SIFMA

[1] The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trade of commercial loans. The 600+ members of the LSTA include commercial banks, investment banks, broker-dealers, credit funds, mutual funds, insurance companies, asset managers, and other institutional lenders, as well as law firms, service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty. For more information, visit www.lsta.org.

[2] As published with commentary in the Federal Register, *Prohibitions against Conflicts of Interest in Certain Securitizations*, Release No. 33-11151, 88 Fed. Reg. 9678 (Feb. 14, 2023) ("Proposing Release").

[3] *See* Letter dated May 27, 2023 submitted to the Commission by LSTA, available at https://www.sec.gov/comments/s7-01-23/s70123-20161797-330673.pdf ("LSTA Letter 1").

[4] LSTA Letter 1.

[5] *See* Letter dated May 2, 2023 submitted to the Commission by LSTA, available at https://www.sec.gov/comments/s7-01-23/s70123-182539-335222.pdf ("LSTA Letter 2").

[6] *See* SIFMA Letter, available at https://www.sec.gov/comments/s7-01-23/s70123-20161806-330705.pdf.

and the Bank Policy Institute (the "Second SIFMA Letter"),[7] we explain how its recommendations could resolve a number of the problems facing CLOs in the Proposed Rule, and we highlight other protections that need to be included in any final rule in order to permit the CLO market to continue functioning without disruption.

II. *Executive Summary*

Our letter can be summarized as follows:

- The Proposed Rule as drafted could have many disruptive effects on CLOs, the corporate loan market and actors in this market, including on loan trading, hedging, loan and CLO ETFs, loan asset managers, the regular-way loan business, non-securitization business units, and subsidiaries and affiliates;
- We recommend narrowing the definition of "conflicted transaction";
- We recommend protecting non-securitization business units and subsidiaries and affiliates using either "indicia of separateness" or a rebuttable presumption construct;
- We recommend broadening the exception for risk-mitigating hedging activity to cover identified current and future positions and to protect activity that does not arise out of securitization activities;
- We recommend clarifying the exception for bona fide market-making activity to ensure that the licensing/registration condition is not required if the applicable securitization participant is exempt from licensing/registration or excluded from regulation for such activity;
- We recommend adding protection for pre-securitization activities such as hedging and warehousing;
- We recommend excluding investors from the definition of "sponsor";
- We recommend a specific start date for the compliance period;
- We recommend additional protections specific to the CLO Market for CLO and loan administration; and
- We reiterate comments from our prior letters regarding particular features of CLO transactions that make the Proposed Rule inappropriate and unnecessary, such as alignment of interests and transparency.

III. *Implications of the Proposed Rule on CLOs and the Corporate Loan Market*

As we discussed in LSTA Letter 1, the Proposed Rule has material negative implications for CLOs and the corporate loan market that underlies them. These implications are amplified by the fact that the assets securitized in CLO portfolios are US institutional corporate loans that, in the normal course of business, are originated, held, traded and/or hedged by some of the same institutions[8] that arrange, manage, distribute and trade the CLOs.[9] The existence of an active market for corporate loans and exposures to them, and the range of institutions that engage in the corporate loan market, means that the Proposed Rule has implications for the CLO and corporate loan markets that are more acute than for other asset classes. In particular, the broad and vague definition of "conflicted transaction" has the potential to capture ordinary course transactions that are key parts of a functioning corporate loan market. This would have dangerous and far-reaching consequences, potentially impeding even the most basic, constructive and everyday loan market and portfolio management activities. This interpretation cannot have been intended by the

[7] *See* Second SIFMA Letter, available at https://www.sec.gov/comments/s7-01-23/s70123-213659-436182.pdf.

[8] Or their affiliates and subsidiaries.

[9] For instance, more than $820 billion of syndicated loans were traded in 2022. (LSTA Trade Data Study). The very fact that the underlying collateral of a CLO can trade makes the Proposed Rule more complex and burdensome than for securitizations whose collateral does not actively trade.

Commission. However, the recommendations in the Second SIFMA Letter address many of the unintended consequences of the Proposed Rule and we largely support that letter's approach.

As a baseline for this discussion, it is critical to understand the important role that CLOs play in providing financing to companies. CLOs hold approximately 70% of the outstanding $1.4 trillion in institutional term loans[10] to US leveraged companies.[11] CLOs are long-term, match-funded lenders, whose indentures are governed by a suite of well-known tests and whose managers owe a fiduciary duty to the CLO. Many asset management companies that manage CLOs often employ other strategies managed by different personnel who have fiduciary duties with respect to those strategies. These other management strategies may include, for example, risk-mitigating hedging, long-short strategies and investments in other parts of the corporate obligors' capital structure. The managers of these strategies and the portfolio managers working on the CLOs may know little about each other's businesses, but they would be swept up in the Proposed Rule as written, with consequent material costs and disruption to the regular-way business of making loans.

With this background established, below are some of the key areas where the Proposed Rule would impede the healthy operation of the CLO and corporate loan markets.

A. Loan Trading

- Underlying assets and exposure thereto are actively traded,[12] which means that the Proposed Rule impacts CLOs in a manner that it does not impact other securitizations.
- In addition to regular-way market making, loan trading desks periodically provide liquidity to CLO managers in order to facilitate the ramp-up of CLO portfolios; this sometimes includes selling a loan to the CLO that the loan trading desk will need to source in the market after the fact.
- Because clause (iii) of the "conflicted transaction" definition vaguely references "asset pool", some of our members are concerned that trading activity involving loan exposures could be included in clause (iii) and hence prohibited were the Proposed Rule to take effect as written.

B. Hedging

- Securitization participants sometimes hedge risk through (i) puts or shorts on credit indices or index tranches, (ii) puts on equity indices, (iii) puts on exchange-traded funds (loan-based or CLO tranche-based), (iv) single name credit-default swaps (CDS) or (v) other hedging strategies. For example, banks use many of these strategies to hedge warehouse risk as well as in their regular course of business.
- LSTA members are concerned that this hedging in the regular course of business (and hedging outside of the securitization context) might not be permitted as defined by the Proposed Rule.

C. Loan and CLO ETFs

- Exchange-traded funds (ETFs) exist for both institutional term loans and CLO notes. These ETFs facilitate efficient investment in loans and CLOs for many parties. Some parties also hedge risk through ETFs. Some of our members are concerned that trading, investing or hedging activities utilizing loan or CLO ETFs might have been unintentionally captured in the "conflicted transaction" definition in the Proposed Rule.

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[10] Institutional term loans are loans typically held by non-bank lenders such as CLOs.
[11] *Refinitiv LPC's Leveraged Loan Monthly, September 2023* at 32.
[12] There was more than $820 billion of loan trading in 2022, according to the LSTA Trade Data Study.

D. Managers

- Loan asset managers often employ a number of strategies in addition to simply managing CLOs. For instance, long-short strategies employed by asset managers in non-securitization business units within a firm that has a business unit that arranges CLOs could involve short positions in the credit default swap index (CDX), loan ETFs or CLO ETFs. These asset managers have their own fiduciary responsibilities and generally are not undertaking short positions in connection with a CLO. Such activity may also be captured in the Proposed Rule.

E. Regular-way Loan Business

- Loans feature frequent and ongoing interactions between lender and borrower. Such interactions include but are not limited to ordinary course amendments[13] and waivers, refinancing, transactions that help companies manage leverage and interest service costs, loan administration, lenders' activities on creditors' committees, and work-out activity.
- Lender activities that occur regularly over the life of the loan, such as participating in a refinancing of the loan or voting on an amendment extending the maturity of the loan, potentially could fall afoul of the Proposed Rule if the lender or administrative agent also were a securitization participant. These activities affect assets in the asset pool – generally benignly – but could be perceived as benefiting the securitization participant and potentially resulting in what the Proposed Rule prohibits (such as loan refinancings that could facilitate faster amortization of the asset-backed security).

F. Subsidiaries and Affiliates

The Proposed Rule's extremely broad definition of "securitization participant" is particularly challenging for CLOs because many of the legal entities that participate in that market are affiliated with, or subsidiaries of, many other entities (including international affiliates and subsidiaries) that play no substantive role in (i) structuring, creating, marketing, or selling CLOs, (ii) structuring, creating, marketing, or selling the underlying leveraged loans or high-yield bond assets of a CLO, or (iii) selecting (initially or during the reinvestment period for CLOs) the assets backing the asset-backed securities. In addition, they frequently have business units within them that are not involved with the CLO business. These "non-participating entities" are nevertheless caught up under the Proposed Rule. Moreover, when coupled with the Proposed Rule's broad definition of "conflicted transaction" and the prohibition of reliance on classic information barriers, the definition of "securitization participant" as applied to non-participating entities is unworkable. Similarly, investment advisers and their advisory clients should not be considered securitization participants simply due to an affiliation with an underwriter, placement agent, initial purchaser or sponsor.

IV. *Support for SIFMA's Second Letter.*

A. Conflicted Transactions

In LSTA Letter 1 we identified substantial problems with the Proposed Rule's definition of "conflicted transaction." The majority of the problems stem from the vague and broad clause (iii). The Proposed Rule defined Conflicted Transaction as follows:

> *(3)* *Conflicted transaction*. For purposes of this section, a conflicted transaction means any of the following transactions with respect to which there is a substantial likelihood that a

[13] Amendments were used extensively for the LIBOR transition.

reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the asset-backed security:

(i) A short sale of the relevant asset-backed security;

(ii) The purchase of a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant asset-backed security; or

(iii) The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction through which the securitization participant would benefit from the actual, anticipated or potential:

(A) Adverse performance of the asset pool supporting or referenced by the relevant asset-backed security;

(B) Loss of principal, monetary default, or early amortization event on the relevant asset-backed security; or

(C) Decline in the market value of the relevant asset-backed security.

As noted above, clause (iii) could potentially capture many forms of regular-way loan and CLO business. This risk is exacerbated by the absence of an intent requirement for transactions captured under clause (iii). Many of the potentially prohibited transactions are fundamental to the efficient operation of both the CLO market and the corporate loan market, and the effect of prohibiting such transactions would have wide ranging negative effects on not only participants in the CLO market, but also the many companies that are financed by the corporate loans that underlie CLOs.

This result is contrary to the statement in the Proposing Release that the "conflicted transaction" definition is intended to "address concerns…about not unnecessarily prohibiting or restricting activities routinely undertaken in connection with the securitization process, as well as routine transactions in the types of financial assets underlying covered securitization."[14] In order to achieve the goal of not unnecessarily prohibiting or restricting routine transactions in the corporate loan market and CLO securitization process, the definition of "conflicted transactions" will need to be clarified and narrowed. The changes to the "conflicted transaction" definition in the Second SIFMA Letter would resolve many of our members' concerns. SIFMA's recommended refinement of the "Conflicted Transaction" definition is as follows:

(3) *Conflicted transaction*. For purposes of this section, and subject to the rebuttable presumption described in clause (4) below, a conflicted transaction means any of the following transactions that would involve or result in the securitization participant's interests being materially adverse to the interests of investors in the relevant asset-backed security:

(i) A short sale of the relevant asset-backed security;

(ii) The purchase of a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant asset-backed security; or

(iii) The purchase or sale of any financial instrument (other than the relevant asset backed security) or entry into a transaction that substantially replicates one or both of the types of transactions set forth in clause (i) or (ii) above by means of the securitization participant's shorting or buying protection on the asset pool underlying or referenced by the relevant asset-backed security.

The Second SIFMA Letter's proposed definition of "conflicted transaction" would preserve the core of the definition by leaving clauses (i) and (ii) untouched but avoid impairing the effective functioning of the loan market that would be occasioned by the adoption of clause (iii) as originally proposed. As an

[14] Proposing Release at 9694.

example, the regular-way amendments that occur frequently in the loan market should no longer fall afoul of the "conflicted transaction" definition. A series of single amendments (or refinancings) of loans in an asset pool still might potentially accelerate the amortization of CLO notes if the CLO is no longer reinvesting proceeds of refinancings[15] (a potential conflict in the original definition), but such an amendment or refinancing would not have the effect of substantially replicating (directly or synthetically) a short sale of the ABS notes or a bet against the ABS notes. Likewise, a short position in a loan or CLO ETF, while it might be somewhat correlated to a loan portfolio underlying a CLO, would not replicate a direct or synthetic short sale of the ABS notes or bet directly against the ABS notes.

These examples demonstrate why the recommended changes to clause (iii) of the "conflicted transaction" definition in the Second SIFMA Letter could resolve many of the problems that were created in actively managing CLO assets.

Additionally, as we discuss in more detail in Part IV.E. below, additional exceptions to the definition of "conflicted transaction" should be added to carve out routine securitization activities and corporate loan transactions.

B. Non-Securitization Subsidiaries and Affiliates

The Proposed Rule as written applies to underwriters, placement agents, initial purchasers and sponsors of an asset-backed security, as well as affiliates and subsidiaries of such persons. The Proposed Rule also declines to recognize both (1) the possibility of separate business units within entities and (2) information barriers.[16] Accordingly, any conduct by personnel with no knowledge of, or involvement in, securitization activity within the aforementioned entities (who thus can't really engage in what are commonly understood as "conflicted transactions" with respect to securitizations) find their conduct circumscribed to the same extent as securitization personnel who have the requisite knowledge of or involvement in securitization activity to engage in conflicted transactions. As noted above, many asset management companies that manage CLOs often employ other strategies managed by different personnel (either within the same entity, or within a subsidiary or affiliate) who have fiduciary duties to investors in those strategies. Accordingly, the Proposed Rule is unworkable unless provision is made for employees who are removed from the securitization activity. Incorporating information barriers into any final rule would solve this problem and comport with other provisions in the U.S. securities laws. However, given the Commission's stated concerns about information barriers in the Proposed Rule,[17] we support the alternatives proposed in the Second SIFMA Letter, namely Alternative 1 – Multi Factor Indicia of Separateness[18] and Alternative 2 – Rebuttable presumption.[19]

C. Risk-Mitigating Hedging Activities

We applaud the inclusion of a risk-mitigating hedging exception[20] in the Proposed Rule. However, we believe that the exception needs to be modified.

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[15] CLOs have distinct reinvestment periods – where they reinvest proceeds of refinanced loans – followed by an amortization period where repayments typically pay down the CLO notes. Thus, if a securitization participant participates in a refinancing, it theoretically could facilitate a faster amortization of the CLO notes.
[16] Proposing Release at 9720.
[17] Proposing Release at 9720.
[18] Second SIFMA Letter at 4-5.
[19] Second SIFMA Letter at 5.
[20] Proposed Rule, Rule 192(b)(1).

First, the application of the exception to only hedging activities related to "positions, contracts or other holdings of a securitization participant ***arising out of its securitization activities***" is far too narrow. A securitization participant that satisfies the conditions set forth in Rule 192(b)(1)(ii) of the Proposed Rule should be able to avail itself of the risk-mitigating hedging exception for any hedging activity, regardless of what the hedging activity relates to.

This change is necessary because the Proposed Rule as written could capture hedging activities that are related to positions that did not arise out of securitization activities. For example, if an affiliate of a sponsor engages in hedging activity in connection with ABS of the sponsor that such affiliate acquired in its ordinary course of business, that affiliate could be seen as engaging in a conflicted transaction because (i) affiliates of sponsors are securitization participants and (ii) the hedge would fall within clause (iii)(A) of the "conflicted transaction" since there could be a benefit flowing to the affiliate if the ABS declines in value. However, this hedge would not fall within the risk-mitigating hedging exception because the affiliate's acquisition of ABS did not arise out of securitization activities.[21] Similarly, an affiliate of a sponsor would not be able to rely on the risk-mitigating hedging exception for hedging activity entered into by it in connection with loan exposures it owns related to underlying assets of a securitization issued by the sponsor because the affiliate did not acquire such exposures in connection with securitization activity.

As illustrated by the two examples above, the limitation of the risk-mitigating hedging activity to hedging activity related to positions, contracts and other holdings arising out of a securitization participant's securitization activity has the perverse result of making the exception unavailable to the securitization participants that are least related to the securitization at issue. Similarly, the exception would not be available to non-securitization related hedging activity of a securitization participant even though such activity may have been entered into in a securitization participant's ordinary course of business, with no intention of betting against the securitization. This cannot be the intended result.

Even if the Commission were to include either Alternative 1 or Alternative 2 from the Second SIFMA Letter in a final rule, and thus provide some relief for parties who have no role in or knowledge of the securitization activities, these parties should have at least as much protection for their own risk-mitigating hedging activity as is provided for risk-mitigating hedging activity that arises out of securitization activities.

Second, the requirement that the risk-mitigating hedging activity be "designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant"[22] is too narrow. At a minimum, the "identified positions, contracts or other holdings" need to include not only current positions, contracts or other holdings, but also future positions, contracts or other holdings, as hedges are sometimes arranged in advance.

[21] Ironically, the Proposing Release indicates that the risk-mitigating hedging exception is intended to apply if a securitization participant undertakes hedging activity in connection with its retention of a portion of an ABS issuance. *See* the Proposing Release at 9700. However, as currently drafted, the risk-mitigating hedging exception would only apply to acquisition of ABS if such acquisition were to occur as part of the securitization activity (e.g., retention of ABS by a sponsor), but would not apply if the ABS were to be acquired by a securitization participant that did not take part in any type of securitization activity.

[22] Proposing Release at 9726.

Third, the ongoing recalibration and monitoring requirements set forth in paragraph (b)(1)(ii)(B) and (C) of the Proposed Rule[23] are unduly cumbersome. It should be sufficient that the primary purpose of the protected risk-mitigating hedging activity is risk reduction, as proposed in the Second SIFMA Letter.[24]

Accordingly, we recommend that the Commission adopt the revisions to the risk-mitigating hedging activity exception contained in the Second SIFMA Letter.[25]

D. Bona Fide Market-Making Activities

We commend the Commission's decision to expand the bona-fide market making exception to include market-making activities in connection with and related to the assets underlying asset-backed securities and financial instruments that reference such asset-backed securities or underlying assets.[26] This is a welcome change for the corporate CLO and corporate loan markets because corporate loans and exposures to such loans are actively traded. Accordingly, a market-making exception that applies to market-making activities related to corporate loans and corporate loan exposures is crucial to maintain the health of the corporate CLO market and the corporate loan market.

However, we have certain concerns, outlined below, about the conditions to the exception set forth in section (b)(3)(ii) of the Proposed Rule. Specifically, in the Proposing Release, the Commission stated that the requirement in section (b)(3)(ii)(D) that securitization participations be licensed or registered to engage in market-making activity in accordance with applicable law and self-regulatory organization ("SRO") rules will not apply if "the relevant person is exempt from registration or excluded from regulation with respect to such activity under applicable law and SRO rules."[27] We agree with the reasoning of the Commission on this point—if applicable law and SRO rules do not require registration, the Proposed Rule should not impose a separate registration requirement. However, the text of the Proposed Rule does not clearly state that registration will not be required under the Proposed Rule if it is not required under applicable law and SRO rules. For clarity, we request that the exception to registration be expressly included in the Proposed Rule.

Accordingly, we recommend adding the following language (in blue) to section (b)(3)(ii)(D) of the Proposed Rule:

> (D) The securitization participant is licensed or registered to engage in the activity described in paragraph (b)(3) of this section in accordance with applicable law and self-regulatory organization rules**; except that this condition will not apply if the securitization participant is exempt from licensing or registration requirements or excluded from regulation with respect to such activity under applicable law and self-regulatory organization rules**; and

E. Securitization Formation Activities

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[23] Id.

[24] Second SIFMA Letter at 6.

[25] Id. We also note that the change to remove the language "arising out of its securitization activities" would conform the risk-mitigating hedging exception in the final rule with the comparable exception under the Volcker Rule, which applies to all "risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity" without regard to the reason the banking entity has such position, contract or holding. 12 C.F.R. 248.5(a).

[26] Proposing Release at 9706.

[27] Proposing Release at 9708.

CLO arrangers and CLO managers engage in various types of transactions that could potentially be considered "conflicted transactions" under the Proposed Rule, such as the following:

1. Interest Rate, Foreign Exchange and Index Hedging. Interest rate, foreign exchange and index hedging are essential risk mitigation tools used by participants in the CLO and corporate loan market.

2. Transactions Prerequisite or Necessary to the Formation or Consummation of the Securitization. Many transactions are necessary to either put together or manage a securitization, which transactions are not bets against the securitization and should be explicitly excluded from the "conflicted transaction" definition. Examples of such transactions include warehousing of loans pre-securitization and acquisition of assets during a ramp-up period or reinvestment period. Prohibiting such activities would be directly contrary to the Commission's desire to "not unnecessarily prohibiting or restricting activities routinely undertaken in connection with the securitization process."[28]

The Second SIFMA Letter suggests language that would protect many pre-securitization transactions, including but not limited to pre-securitization hedging transactions, pre-securitization financing transactions and pre-securitization transfers.[29] Accordingly, we support the changes proposed in the Second SIFMA Letter. However, the CLO market is a bit different than other ABS markets as discussed above. Accordingly, we believe additional protection for activity that occurs outside of (and after the closing of) a CLO transaction needs protection as well. We discuss those additional protections in Part V below.

F. Sponsor Exclusions

As we noted in LSTA Letter 2, the definition of "sponsor" should be consistent with its ordinary and plan meaning, and not include investors, credit rating agencies and third-party service providers.[30] The changes to the "sponsor" definition in the Second SIFMA Letter[31] would address our members' concerns. Accordingly, we recommend the revisions to the "sponsor" definition contained in the Second SIFMA Letter.

G. Compliance Period

As we also noted in LSTA Letter 2, the beginning of the compliance period should be clarified and more closely linked to the date of the first sale. The changes to section (a)(1) outlined in the Second SIFMA Letter would have the prohibition begin 30 days prior to the first closing of an asset-backed security.[32] This clarification would address our members' concerns. Hence we support the changes suggested in the Second SIFMA Letter, and we recommend that they be incorporated.

V. *Additional Protections Necessary to Protect the CLO Market.*

As noted in Part III, the existence of an active market for corporate loans and exposures to them, and the range of institutions that engage in the corporate loan market, means that the Proposed Rule has implications for the CLO and corporate loan market that are more acute than for other asset classes.

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[28] Proposing Release at 9694.
[29] See proposed sections (b)(4) and (5) in Second SIFMA Letter at 8.
[30] LSTA Letter 2 at 5.
[31] Second SIFMA Letter at 10.
[32] Second SIFMA Letter at 4.

Accordingly, additional protections not covered by the Second SIFMA Letter are necessary to prevent disruption to the CLO market.

For example, regular-way loan trading and other loan market activities continue to occur outside of and away from CLOs after those CLOs have closed. These activities are often conducted by securitization participants (even under a narrower definition contemplated above) and can include loan trading activity and hedging activity such as those discussed in Part IV.E.1. Accordingly, a blanket protection needs to be included for post-securitization-closing (1) trading activity in the corporate loan asset class and (2) interest-rate, foreign-exchange and index hedging.

CLOs and the underlying corporate loan assets included therein require ongoing administration. For example, collateral managers and other securitization participants are required to take certain actions and perform certain duties pursuant to the CLO transactions or the loan documents related to the underlying assets. For example, a placement agent for a CLO may also be an administrative agent under a loan that underlies a CLO. As administrative agent, it has various duties that must be performed under the loan documents. In order to avoid this tension, we recommend adding an exception for actions taken by securitization participants pursuant to their duties under the CLO documents or underlying loan documents. The CRE Finance Council in its letter dated July 5, 2023 recommended that clause (ii)(C) of the definition of "sponsor" be revised to provide for activities relating to "the ongoing administration of the entity that issues the asset-backed security or the ongoing servicing of its related assets".[33] Those changes would address our members' concerns. Accordingly, we support the changes suggested in the CREFC Letter, and we recommend that they be incorporated.

VI. *Additional Comments.*

As we explained in our first two letters, the LSTA believes that the Proposed Rule fails to adequately take into account (i) the alignment of interests between participants in the CLO market; (ii) the transparency of the CLO market and (iii) the costs of the Proposed Rule as applied to CLOs.[34] As a result, the costs of the Proposed Rule as applied to CLOs will outweigh any perceived benefits.

Alignment of Interests. CLOs are actively managed by professional asset managers whose remuneration structure aligns their interests with that of the CLO's debt and equity investors, and when combined with other credit enhancement features, has driven CLO performance over this timeframe. CLO managers only do well when their investors do well. Managers typically are remunerated through three fee streams. First is a senior fee on managed assets that is paid before the debtholders receive their quarterly interest payments. This fee helps the manager cover operating costs. After all the debtholders receive the payments they are due, the manager receives a "subordinated" fee on managed assets. If the debtholders do not receive their interest payments, the manager's subordinated fee is deferred until they do. Some CLOs also have an "incentive fee", which is paid with equity distributions after all other payments once the CLO equity investors earn a negotiated IRR. This incentive structure ensures CLO managers do best when both their debt holders and equity holders do well. Selecting assets for failure would only hurt the manager, both financially and reputationally.

Transparency.[35] CLOs are extraordinarily transparent securitizations whose investment portfolios consist of highly visible assets. The transparency afforded by CLOs helps mitigate concerns about conflicts of interest and information asymmetries. Investors receive a wealth of detailed asset and portfolio level

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[33] See Letter dated July 5, 2023 submitted to the Commission by the CRE Finance Council, available at https://www.sec.gov/comments/s7-01-23/s70123-218839-458682.pdf ("CREFC Letter").

[34] *See* LSTA Letter 1 at 4-11.

[35] *See* LSTA Letter 1 at 5, 6 for a more detailed discussion of the transparency available in the CLO market and corporate loan market.

information. First is a very detailed monthly "trustee report," which typically discloses information about each individual asset in the collateral portfolio.[36] A trustee report can run several hundred pages as it provides information on all of the collateral assets and shows measurements on compliance with each of the collateral quality tests, portfolio concentration limits and coverage tests required by the CLO.

In addition to the trustee report, there are several subscription services that CLO investors use to monitor their CLO investments. Intex, Bloomberg, LPC Collateral, Trepp, Kanerai, Valitana and Vichara all provide additional analysis of the information available through the trustee report. This includes intra-period rating changes and secondary market loan prices and pricing history, asset and industry exposure across CLO portfolios, market-implied default probabilities, and more.[37] Moreover, there are CLO analysts at banks that publish research on CLO market trends, as well as performance and style by individual manager, loan exposure per name per manager, upgrade/downgrade/ratings watch information for each loan in a CLO, and performance on CLO quality tests.

In addition to the monthly reports described above, investors also receive a quarterly report in advance of each quarterly payment date. These quarterly reports include all information in the monthly report and, in addition, provide a calculation of interest due and payable on the payment date for each tranche of debt, the amounts to be distributed in accordance with the waterfall on the related payment date and the balance of each account.

VII. *Conclusion.*

As was discussed in the first letter, the CLO and corporate loan markets are a crucial component of the economy. The negative implications of the Proposed Rule on the operation of the CLO market and the corporate loan market would have wide-ranging negative effects on the economy. Accordingly, the LSTA urges the SEC to consider the concerns raised in this letter and to implement changes to the Proposed Rule along the lines outlined in this letter. In addition, we want to underscore the interdependent nature of our comments (and of the comments in the Second SIFMA Letter). For example, were the Commission not to narrow the definition of "conflicted transaction" as we have recommended, we would recommend additional changes to other parts of the rule, including but not limited to the expansion of (and addition to) the exceptions contained in the Proposed Rule.

The LSTA appreciates this opportunity to comment and stands ready to assist the Commission in its rulemaking. Please feel free to contact Meredith Coffey at (347) 420-3932 (mcoffey@lsta.org) or Tess Virmani at (212) 880-3006 (tvirmani@lsta.org).

Sincerely,

Meredith Coffey
Executive Vice President – Research, Co-Head of Policy

[36] A copy of a redacted trustee report was attached as Appendix A to LSTA Letter 1 to show the kind of detailed information an investor would typically receive.
[37] An example of Refinitiv LPC's Leveraged Loan Monthly was attached as Appendix B to the LSTA Letter.

Tess Virmani
Deputy General Counsel & Co-Head of Policy