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United States Senate

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February 10, 2014

The Honorable Shaun Donovan
Secretary
Department of Housing and Urban Development
451 7th Street SW
Washington, DC 20410

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

The Honorable Martin J. Gruenberg
Director
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

The Honorable Mary Jo White
Chair
The Securities and Exchange Commission
100 F Street NE, Room 10700
Washington, DC 20549

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street SE
Washington, DC 20019

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Secretary Donovan, Chair Yellen, Director Gruenberg, Chair White, Comptroller Curry, and Director Watt:

On August 28, 2013, your agencies proposed a rule that re-proposes with modifications a previously proposed rule to implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. While the re-proposal improves upon the proposed joint rulemaking published on April 29, 2011—particularly with respect to home mortgage securitizations— I am concerned that problems remain with respect to the provisions regarding collateralized loan obligations ("CLOs").

CLOs finance nearly three hundred billion dollars worth of loans to American companies who rely on CLOs as an essential component of corporate finance in the United States. Unfortunately, the re-proposal puts that important source of capital at risk. Indeed, you acknowledge in your re-proposal "that the standard form of risk retention in the original proposal could, if applied to open market CLO managers, result in fewer CLO issuances and less competition in the sector." Nevertheless the re-proposal retains the original proposal, which would require CLO managers to satisfy the minimum risk retention requirement for each CLO securitization transaction that it manages, despite the fact that CLO managers do not originate the underlying assets and have limited balance sheets with which to retain a 5 percent share of the CLO.

Recognizing the shortcomings of the original proposal, the re-proposa introduces a new option that is intended to avoid "significant disruption to the CLO market". Under this proposal, arrangers of a loan syndication that includes a "CLO-eligible" tranche would be required to hold a 5 percent share of that tranche until the loan is repaid, matures or defaults, and would be prohibited from selling or hedging such exposure. This is a concerning proposal because a prohibition on actively managing exposure runs counter to safe and sound banking practices and is at cross-purposes with prudential regulation. Loan syndications are a traditional product that banks use to provide capital to corporate America while managing their exposure to credit risk. The loans they syndicate are held by a large array of institutional investors including mutual funds, insurance companies as well as CLOs and are not subject to risk retention under Section 941.

I am concerned that the risk retention requirements regarding CLOs, if finalized in their present form, would eliminate the incentive to arrange or manage a CLO, and would significantly damage this important source of financing for American businesses. Many companies that rely on CLOs for financing could be forced to set aside plans for business expansion. Your collective effort in fashioning a Qualified Residential Mortgage definition that struck a balance between responsible underwriting and the promotion of homeownership is to be commended. I respectfully request that you work in the same spirit of collegiality to solve the problem that risk retention presents for the CLO market.

Respectfully,

Kay R. Hagan

United States Senator Kay Hagan