WHITE & CASE

White & Case LLP
1155 Avenue of the Americas
New York, New York 10036-2787

Tel + 1 212 819 8200
Fax + 1 212 354 8113
www.whitecase.com

June 10, 2011

Securities and Exchange Commission
Elizabeth M. Murphy, Secretary
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-14-11 – Credit Risk Retention

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attn: Comments
550 17th Street, NW
Washington, DC 20429

Re: RIN 3064-AD74 – Credit Risk Retention

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Re: Docket Number OCC-2011-0002 – Credit Risk Retention

Federal Housing Finance Agency
Alfred M. Pollard, General Counsel
Attn: Comments/RIN 2590-AA43
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: RIN 2590-AA43 – Credit Risk Retention

Board of Governors of the Federal Reserve System
Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket Number R-1411 – Credit Risk Retention

Department of Housing and Urban Development
451 7th Street, SW
Room 10276
Washington, DC 20410-0500

Re: Credit Risk Retention

Ladies and Gentlemen:

This comment letter is respectfully submitted on behalf of a group of participants in the collateralized loan obligation market in response to question 1 of Credit Risk Retention, 76 Fed. Reg. 83 (proposed Mar. 29, 2011) (the "**Proposed Rules**"). Our working group includes lawyers, portfolio managers, investment bankers, investors and other professionals who work for or with investment advisers, law firms, investment banks and organizations familiar with the collateralized loan obligation market.

After careful review of the Proposed Rules and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 ("**Dodd-Frank**" or the

"**Dodd-Frank Act**"), we believe that the decision of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and the Federal Housing Finance Agency (collectively, the "**Agencies**") to impose risk retention requirements upon an investment adviser to *managed* collateralized loan obligation funds ("**CLOs**") under the proposed risk retention regime is not authorized by the Dodd-Frank mandate. A plain language review of the statute supports this conclusion. By definition, an investment adviser to a CLO is not a "securitizer" under Dodd-Frank and therefore is not an appropriate party to retain credit risk under the Proposed Rules.

If the Agencies ultimately designate a CLO's investment adviser as a sponsor for purposes of risk retention, they will impose a financial burden on individuals and institutions and threaten the viability of an industry that provides necessary capital to businesses that employ thousands across the country without any support in the Dodd-Frank Act's plain language. Below we have provided some background on CLOs, which are distinct from other forms of securitization from the initiation of the transaction to the motivation of the parties involved to the creation and acquisition of the assets. We then set forth our analysis of the plain language of relevant portions of the Dodd-Frank Act as it pertains to CLOs. *As explained below, this comment letter pertains solely to CLOs that purchase bank loans at the direction of an investment adviser pursuant to an independent*[1] *investment process and is not intended to apply to balance sheet CLOs.*

1. <u>Overview of the Structure of CLOs</u>

It is important to understand how a managed CLO is structured in order to understand why the role of a CLO's investment adviser does not meet the requirements of the definition of "securitizer" under Dodd-Frank or "sponsor" under the Proposed Rules.

The securitization structures that issue "collateralized loan obligations" primarily come in two basic forms: (1) managed leveraged investment funds[2], where the loans securing the debt securities issued by a CLO are selected by an investment adviser and (2) originator-sponsored vehicles, where the loans securing the debt securities issued by a CLO are selected by an originator. In managed CLOs, the investors in the most subordinated tranche invest with the goal of achieving income through the difference between the interest accrued on the assets purchased by the CLO and the interest paid on the securities issued by the CLO. The purpose of

---

[1] Where large financial firms have loan origination businesses and asset management businesses, independence should be determined in accordance with existing regulatory guidance. *See, e.g.*, Richard Ellis, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4121 (Sept. 17, 1981).

[2] Managed CLOs may sometimes be referred to by other names, including among others "cash flow deals", "arbitrage CLOs" or "open market CLOs".

such a CLO is to provide investors with exposure to corporate bank loans on a diversified and leveraged basis. In originator-sponsored vehicles, on the other hand, the purpose is to raise capital for the originator and/or to provide regulatory capital relief to the originator. Such a transaction is commonly referred to as a "balance sheet CLO" because the assets come from the balance sheet of the originator of the loans, as opposed to being selected by a third-party investment adviser.

In the general course of business, the process of establishing a managed CLO begins when an investment adviser, together with one or more prospective investors, determines that there is sufficient investor interest to support the creation of a new CLO. The investment adviser then engages an investment bank or other structurer (the "**Arranger**"), who works with one or more national statistical rating organizations ("**rating agencies**") to obtain ratings for the CLO's debt securities, assist in the marketing of the CLO's securities and, in some cases historically, assist the investment adviser in establishing the CLO itself (i.e. the issuer).

The debt securities issued by a CLO, which are typically rated by one or more rating agencies, are often Rule 144A eligible and issued in accordance with a detailed offering memorandum which describes the securities, the CLO, the investment adviser, risk factors and other legal and structural information material to the investors, including a priority of payments specifying how cash is distributed to investors, both when the CLO is performing and upon a default. In addition, the offering memorandum includes a description of the eligibility criteria for the loans that may be purchased by the CLO and the covenants governing the content of the entire loan portfolio, including obligor concentration limits, minimum ratings for individual assets and average ratings for the portfolio, minimum estimated recovery rates, a minimum weighted average spread test and more.

The investment adviser uses the investment criteria established for the CLO to select the loans to be included as collateral for the transaction. Further, the investment adviser is responsible for complying with the investment parameters established in the transaction documents in accordance with rating agency criteria and/or as negotiated by investors in the securities of the CLO. The investment adviser selects loans for the CLO to purchase from market participants, including brokers and originating banks, which may include affiliates of the Arranger, and the investment adviser determines the amount of each loan to be purchased and negotiates the purchase price for each such loan. The investment adviser selects all such loans for the CLO to purchase on an arm's length basis.

As with any investment fund (e.g., an open or closed ended mutual fund), the primary purpose of a managed CLO is as an investment vehicle. The ultimate return to the CLO's debt investors, and the incentive compensation for the investment adviser, will be most significantly impacted by the ability of the investment adviser to select loans that will not default or decrease in market value. Thus, the primary job of the investment adviser is to protect the portfolio from losses, first by selecting loans that will not default and then actively monitoring the assets and selling any assets that weaken the portfolio, both at the inception of the CLO and on an ongoing basis.[3]

2. Statutory Interpretation

Understanding the role of the CLO's investment adviser is essential to understanding why we believe a plain language analysis of Dodd-Frank excludes the CLO's investment adviser from the securitizer definition. Our analysis of the applicability of the risk retention rules to CLOs begins with a close look at the plain meaning of the Dodd-Frank Act and the Proposed Rules.

The Supreme Court's first rule of statutory construction is that analysis of the purpose and meaning of a statute begins with the statute's plain language, i.e., "courts must presume that a legislature says in a statute what it means and means in a statute what it says..."[4] Where the language of the statute is plain, courts must look no further than the statute and enforce it according to its terms.[5] Proper statutory construction avoids delving into legislative intent unless the plain meaning of the language is ambiguous or unclear.[6] Courts, and regulators by default, do not have the authority to rewrite a law to implement the legislature's intent: "Judges interpret laws rather than reconstruct legislators' intentions. Where the language of the law is clear, we are not free to replace it with an unenacted legislative intent."[7]

Section 941(b) of the Dodd-Frank Act mandates that the Agencies "jointly prescribe regulations to require any ***securitizer*** to ***retain*** an economic interest in a portion of the credit risk for any asset ***that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys*** to a third party."[8] The Dodd-Frank Act is explicit that a "securitizer" must "retain" some interest in the credit risk that it transfers, sells or conveys to others. The Dodd-Frank Act did not define what it means to "retain", but it did define a securitizer as "(A) an issuer

---

[3] While the investment adviser does not typically own any of the loans ultimately transferred to the CLO, its advisory fees are usually directly tied to the performance of the assets it selects. Typically, if the portfolio does not perform at or above expectations, the bulk of the anticipated fees payable to the investment adviser will be deferred and/or subordinated to payments owed to the CLO's debt investors, further incentivizing the investment adviser to build a long-term performance-oriented portfolio of assets. The investment adviser does not receive any compensation from the origination of the loans held by the CLO.

[4] *Conn. Nat'l Bank v. Germain*, 503 US 249, 253-54 (1992).

[5] *Id.* ("[W]hen the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'") (quoting *Rubin v. United States*, 449 U.S. 424, 430 (1981)); *see also Caminetti v. United States*, 242 US 470, 485 (1917).

[6] *See Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994) ("[W]e do not resort to legislative history to cloud a statutory test that is clear.")

[7] *I.N.S. v. Cardoza-Fonseca*, 480 U.S. 421, 452-53 (Scalia, J., concurring).

[8] Dodd-Frank Act § 941(b) (as codified at § 15G(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78o-11, §78o-11(b), (c)(1)(A), and (c)(1)(B)(ii)) (emphasis added).

of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer[.]"[9]

The Agencies ultimately concluded that the "issuer" of an asset-backed security is the same as a depositor.[10] The Agencies also concluded that the "sponsor" of a transaction, and not the depositor (or issuer), is responsible for risk retention, thereby effectively abandoning the first prong of the securitizer definition.[11] Clause (B) of the Dodd-Frank Act's definition of securitizer thus became the Agencies' definition of sponsor under the Proposed Rules: "a person who **organizes and initiates** an asset-backed securities transaction **by selling or transferring assets**, either directly or indirectly, including through an affiliate, to the issuer[.]"[12]

The plain meaning of the definition is clear: to be a sponsor, and therefore to be subject to the requirement to retain credit risk, a party to a securitization must both (1) organize and initiate an asset-backed securities transaction and (2) do so by selling or transferring assets to the issuer (whether directly or indirectly). The use of the phrase "*by selling or transferring assets*" unambiguously limits the type of activities that makes one a securitizer, and cannot be ignored to achieve a result beyond the text. Pursuant to the plain meaning of the definition, steps taken to organize and initiate an asset-backed securities transaction do not make one a securitizer unless such steps include the sale or transfer of assets to the issuer.

In Footnote 42 of the Proposed Rules, the Agencies proposed that the investment adviser of a managed CLO would be the sponsor of the CLO: "[I]n the context of CLOs, the CLO manager generally acts as the sponsor **by selecting the commercial loans to be purchased** by an agent bank for inclusion in the CLO collateral pool, and then manages the securitized assets

---

[9] Dodd-Frank Act §941(b) (as codified at §15G(a)(3) of the Securities Exchange Act).

[10] Proposed Rules at 30-31, providing:

> The term "issuer" when used in the federal securities laws may have different meanings depending on the context in which it is used. For example, for several purposes under the federal securities laws, including the Securities Act and the Exchange Act and the rules promulgated under these Acts, the term "issuer" when used with respect to an ABS transaction is defined to mean the entity—the depositor—that deposits the assets that collateralize the ABS with the issuing entity. The Agencies interpret the reference in section 15G(a)(3)(A) to an "issuer of an asset-backed security" as referring to the "depositor" of the ABS, consistent with how that term has been defined and used under the federal securities laws in connection with ABS.

[11] *Id.* at 31 ("[T]he Proposed Rules generally would apply the risk retention requirements of section 15G to a sponsor of a securitization transaction (and not the depositor for the securitization transaction)."). The Agencies focused on the second prong of the definition of securitizer, equating it with the definition of "sponsor" in the SEC's Regulation AB and asserting that the application of risk retention requirements to the sponsor of an asset-backed security "is appropriate in light of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting the assets to be securitized." *Id.* at 29-30.

[12] *Id.* at 29 (emphasis added).

once deposited in the CLO structure."[13] However, in the case of a managed CLO, this text either (1) presupposes that the investment adviser performs each of the actions required in the definition of sponsor or (2) purports to expand the scope of "sponsor" beyond the clear language of the definition in order to capture investment advisers in its purview.

As described above, an investment adviser is typically involved in initiating and organizing a CLO and therefore appears, in most cases, to satisfy the first element of the definition of sponsor. However, to be a sponsor, a person must initiate the transaction *by* selling or transferring assets to the issuer.[14] As previously discussed, in a typical managed CLO, the investment adviser does not sell or transfer assets to the issuer. Rather, the investment adviser selects the loans to be included as collateral and purchases the selected loans from sellers on an arm's length basis. The investment adviser is responsible for complying with the investment parameters set by investors and the rating agencies when purchasing such loans. The investment adviser selects loans for the CLO to purchase from market participants, and the investment adviser negotiates the amount of a loan to be purchased as well as the purchase price for the loan. However, the investment adviser does not own the loans and does not sell or otherwise transfer the loans to the issuer.

3. Conclusion

Despite what the Agencies assert in footnote 42, a person who *selects* assets for inclusion in a securitization transaction cannot be equated to the person who *sells or transfers* the assets to the CLO (either directly or indirectly[15]) simply by virtue of such person's selection activity.

---

[13] *Id.* at 30 n. 42 (emphasis added). We note that the Proposed Rules in footnote 42 provide that loans are purchased by an agent bank. In our experience in the managed CLO market, a direct purchase by the agent bank is unusual and typically avoided as it can result in dual assignment fees as well as dual trading and settlement processes.

[14] Some have asked whether the Arranger could be the "sponsor" of a managed CLO; in a typical managed CLO, however, the Arranger also does not fit within the statutory definition of securitizer. The Arranger neither (1) "initiates" the transaction when it is engaged by the investment adviser nor (2) effectuates the initiation and organization by selling or transferring assets to the CLO. It is possible that an Arranger's affiliates sell assets to the CLO, but those sales are on market terms with the investment adviser selecting the assets, and that syndication and trading business is separate and apart from the activity of organizing and initiating the transaction. Without a more direct link between (1) an Arranger's activity in assisting with organization of the CLO and (2) its selling or transferring of assets (directly or indirectly) to a CLO, concluding that an Arranger would be a sponsor significantly stretches the text of the Dodd-Frank Act and the Proposed Rules. Note that, in the Proposed Rules, the Agencies made no assertions that an Arranger would be a sponsor or an originator or otherwise be required to retain credit risk. While courts will often give regulators leeway to interpret a statute's intent when the language is ambiguous, they will not typically allow a regulator to rewrite the text when the plain language expresses a clear Congressional intent. *See, e.g., Cal. Livestock Prod. Credit Ass'n v. Farm Credit Admin.*, 748 F.Supp. 416, 419 (E.D. Va. 1990).

[15] The statutory language specifies that the sale or transfer of assets "through an affiliate" would be an indirect transfer. The inclusion of sales by affiliates in the definition's language is the only example of an indirect transfer expressly stated and provides insight as to the type of transaction meant to be covered. In other words, the use of the word "indirectly" in the definition does not expand the scope of the definition indefinitely. The word "indirectly" means "deviating from a direct line or course: not proceeding straight from one point to another: proceeding

Control of the asset selection process is not enough; Congress sought to regulate the behavior of the persons engaging in the transfer or sale of the assets included in a securitization, or, in other words, the owner of the assets.[16] The Agencies must work within the meaning of the Dodd-Frank Act's text, and, on the face of the text, it is clear there is no "sponsor" of a managed CLO within the plain meaning of the language.

Respectfully submitted,

White & Case LLP

obliquely or circuitously," or "not directly aimed at or achieved." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY. The adverb "indirectly" does not vary or enlarge the scope of the verb it modifies. To do some action indirectly means only to do that action by a complicated or circuitous method and does not change what that action is. *See Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176 (1994) (rejecting the S.E.C.'s "novel argument that the use of the phrase 'directly or indirectly' in the text of § 10(b) covers aiding and abetting" because aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity; aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do.")

[16] In fact, the required level of risk retention put forth in Section 941 is set in reference to the assets transferred. The Congressional mandate requires retention of "not less than 5 percent of the credit risk for any asset...that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer." Dodd-Frank Act §941(b) (as codified at §15G(c)(1)(B)(i)(I) of the Securities Exchange Act). By applying the risk retention requirements to an investment adviser of a CLO, the Agencies would, in effect, be requiring risk assumption from the investment adviser, since risk retention, by any definition of the word, is impossible for the investment adviser to do: one cannot retain that which one did not own.