Cornerstone
HEALTHCARE GROUP

January 16, 2014

By Electronic Submission

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Washington, D.C. 20219

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Secretary
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Executive Secretary
Attention: Comments
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Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500

Re: **Notice of Proposed Rulemaking, Credit Risk Retention**
SEC (File No. S7-14-11); FDIC (RIN 3064-AD74); OCC (Docket No. OCC-2013-0010); FRB (Docket No. R-1411);
FHFA (RIN 2590-AA43); HUD (RIN 2501-AD53)

Ladies and Gentlemen:

Cornerstone Healthcare Group ("Cornerstone") is pleased to submit these comments in response to the joint Further Notice of Proposed Rulemaking, 78 Fed. Reg. 57928 (Sept. 20, 2013; originally released Aug. 28, 2013) ("FNPRM"), concerning risk retention and the implementation of Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

I. Overview.

Cornerstone is a company that has borrowed funds through credit markets supported to a significant extent by capital provided through CLOs and is knowledgeable about the scope and operation of those credit markets. We submit these comments to address how the agencies' proposed regulations would adversely affect important commercial loan markets and borrowers

dependent upon them by severely curtailing the formation of CLOs. That impairment of credit markets would harm companies like ours and the employees, owners, and consumers dependent on those companies. The harm to the public interest that would arise from the agencies' proposed rules would be entirely unnecessary in light of the absence of offsetting benefits the rules would produce and the alternative courses available to the agencies.

II. Our Experience with Credit Markets Dependent on Open Market CLOs.

Cornerstone specializes in the treatment of medically complex patients who require individualized, interdisciplinary acute care for an extended recovery time. We are headquartered in Dallas, Texas and conduct business in Texas, Louisiana, Oklahoma, Arizona, Arkansas and West Virginia. We have depended on the CLO market for financing for a number of years and we are concerned about the recent risk retention rule and how it will impact our ability to affordably finance our operations and continue to create jobs in the states we operate.

Cornerstone's market role and experience provide us with a clear understanding of the current commercial loan markets supported in large measure by CLOs, CLOs' role as intermediaries channeling capital to those credit markets, and how those credit markets would be adversely affected if CLOs' formation and scale are curtailed.

III. The Proposed Rules Would Adversely Affect Us, Other Companies Seeking to Access Important Credit Markets, and the Employees, Owners, and Customers of Those Companies.

Our understanding of the relevant leveraged and syndicated commercial loan markets leads to our deep concern that the proposed rules would significantly and adversely affect the availability and pricing of credit in these markets. This would occur as a result of the sharp reduction the rules would produce in the formation and scope of future CLOs, which are an essential component of the efficient functioning and capabilities of these credit markets.

The requirement that Open Market CLO managers retain five percent of the face value of the CLO's assets – in addition to the significant credit risks already assumed through the CLO managers' deferred compensation structure – would drastically reduce CLO formation. Many CLO managers are too small to secure or devote funds of that magnitude for positions that cannot be disposed or hedged. For other CLO managers that might have that financial capacity, holding such a position would require a restructuring of current business models and anticipated returns – making a once viable business much less profitable, requiring that managers instead devote those funds to other, more productive uses.

Consistent with our market understanding, we are aware of the survey of CLO managers that indicated that the decrease in CLO offerings is anticipated to be in the order of 75 percent.[1] We are also aware of the broad range of comments and record evidence that establish that the proposed rules would adversely affect the formation and continued operation of the CLO

[1] See LSTA Letter Comment, July 29, 2013 at 3–6.

market.[2] Indeed, the agencies themselves anticipate adverse effects on CLOs and competition.[3]

The reduction in CLO formation and scale that the proposed rules would produce will have significant, adverse effects on important commercial loan markets. At any particular time, CLOs hold commercial loan assets of approximately $275-300 billion. For leveraged and syndicated commercial loans not issued directly by banks and institutions, we understand that CLOs have in recent years provided more than 50 percent of the capital for these loans. In certain periods, CLOs provided up to 70 percent of the support for these loan markets. The loan markets relevant to CLOs provide in excess of $100-125 billion of credit annually, supporting companies in many of the most important sectors of the economy.

If capital made available to these commercial loan markets through CLOs were to significantly diminish, as we and others expect if the agencies proceed with their proposed rules, the potential substitute sources of capital would be considerably less extensive and more expensive. Arranging banks already seek alternative sources of funds to support the credit extended to commercial borrowers in these markets, and those alternative sources cannot provide nearly the amount of capital or the liquidity provided through CLOs. This is largely because CLOs have evolved into a highly efficient and successful channel of capital from investors to commercial loan borrowers. This role has developed as a result of CLO managers' demonstrated track record of selecting high-quality loans, the alignment of investor and manager interests created by the compensation structure typical of CLOs, and the broad array of structural protections and safeguards that Open Market CLOs offer to investors. Alternative vehicles for directing investors' capital to these commercial loan markets are inferior in important respects for many investors and, as a result, simply do not and will not for the foreseeable future have nearly the capacity to support the loan markets as CLOs do.

For these reasons, if the agencies proceed with their proposed rules, less credit will be available in these commercial loan markets and the credit that is extended will be more expensive. This is so because there would be less capital directed to support these commercial loan markets and because much of the remaining sources of capital would be provided less efficiently. Increased credit costs and decreased availability can be traced to decreased competition in the provision of credit, to increased costs associated with its provision, and the operation of simple principles of supply and demand where the supply of capital materially decreases even as there is continued demand for credit.

The practical result of these effects of the agencies' proposed rules on the commercial loan markets is clear. Fewer commercial borrowers will be able to secure credit. Limited credit will flow toward higher-credit borrowers, locking out of the market an array of companies that have successfully secured credit over the past years. Those companies will, in turn, be less able

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[2] See LSTA Letter Comment, Aug. 1, 2011 at 14–17; LSTA Letter Comment, Apr. 1, 2013 at 14–16; LSTA Letter Comment, July 29, 2013 at 3–9; SIFMA Letter Comment, June 10, 2011 at 70; American Securitization Forum Letter Comment, June 10, 2011 at 137; JP Morgan Chase & Co. Letter Comment, July 14, 2011 at 50; Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 32; Bank of America, Letter Comment, Aug. 1, 2011 at 29-30; Wells Fargo Letter Comment, July 28, 2011 at 29; White & Case Letter Comment, June 10, 2011 at 2.

[3] See 78 Fed. Reg. 57962.

to add employees, fund innovation, and increase production to more efficient levels. That is, their cost structure and competitive capabilities will worsen, with harmful consequences for their owners, employees, customers, and the public at large. Competition will be impaired. And, for those companies still able to access these commercial loan markets, borrowing costs will increase. The adverse results for them are similar, if less stark, than for their peers that are excluded from the credit markets: their cost structure would increase, diminishing their ability to grow and produce efficiently. That would have similarly adverse effects for competition and for their employees, owners, and customers.

IV. The Proposed Rules Are Especially Unwarranted Because They Are Unnecessary and Would Produce No Benefits for the Public.

In addition to harming the commercial loan markets and companies dependent upon them, the proposed rules would produce no offsetting benefits. This is so because the rules redress no market or structural failure associated with Open Market CLOs and because, even if Open Market CLOs posed some yet-to-be identified risk, far less harmful alternatives are available to the agencies.

Initially, Open Market CLOs present no market failure requiring a regulatory solution. The proposed credit risk retention rules fail to account for the significant factors that already ensure that Open Market CLO managers select and manage CLO assets prudently and in investors' interests. Open Market CLOs do not employ the "originate-to-distribute" model of securitization that contributed to the financial crisis and prompted Congress to enact Section 941. The nature of Open Market CLOs, and their role in the loan market and in the provision of securities to investors, ensures that they operate independently and that managers' interests are aligned with CLO investors' interests. This alignment of interests further arises from the deferred compensation structure that investors demand from CLO managers, the multiple levels of assessment and underwriting that inform CLO managers' selection of assets, the overcapitalization and other structural features that protect investors, and the commercial loan features that CLO managers and investors demand.

The historically strong performance of CLOs demonstrates the concrete and practical results of these unique features of CLOs. Despite the massive financial crisis that resulted in widespread losses among other asset classes, CLOs performed exceptionally well. We are aware of numerous comments submitted in this rulemaking that confirm the strong performance of CLOs during the financial crisis.[4] Although CLOs experienced ratings downgrades, the vast majority of CLO notes that were originally rated AAA retained ratings of AA or higher during the crisis.[5] And most significantly, CLOs experienced de minimis events of default and even

[4] See LSTA Letter Comment, Aug. 1, 2011 at 7; LSTA Letter Comment, April 1, 2013 at 19; LSTA Letter Comment, July 29, 2013 at 2 and Appendix A; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 90-93; American Securitization Forum Letter Comment, June 10, 2011 at 134-135; SIFMA Letter Comment, June 10, 2011 at 69; Morgan Stanley Letter Comment, July 27, 2011 at 18; Bank of America Letter Comment, Aug. 1, 2011 at 23; Wells Fargo Letter Comment, July 28, 2011 at 29; The Center for Capital Markets Competitiveness of the United States Chamber of Commerce Letter Comment, Aug. 1, 2011 at 4; Cong. Himes and other Members of Congress Letter Comment, July 29, 2011 at 2.

[5] See LSTA Letter Comment, August 1, 2011 at 7.

lower rates of financial loss.[6] The Board of Governors of the Federal Reserve has acknowledged the low default rate among CLOs during the financial crisis, which it attributed in part to the incentive alignment mechanisms inherent to CLOs.[7]

We agree with other commenters that have analyzed the language and purpose of Section 941 and have shown that Congress did not intend to impose risk retention requirements on Open Market CLO managers.[8] Presumably, Congress did not intend to do so precisely because Open Market CLOs present none of the problems Section 941 was designed to fix. We also agree with commenters that, in light of the high costs and absence of benefits arising from imposing credit risk retention requirements on Open Market CLO managers, the agencies should exercise their statutory powers to exempt those managers from the credit risk retention requirements – assuming that those requirements even apply.[9] If the agencies believe that certain types of CLOs pose a risk to investors, or that further restrictions on which CLO managers can qualify for an exemption are appropriate, a commercially sensible set of "ring-fencing" qualifications has been proposed in the comments.[10]

Other, less harmful alternatives are available to the agencies as well. For example, the LSTA has proposed that CLO managers could retain credit risk, consistent with the statutory requirements, by holding a set of securities that embody the compensation structure currently endorsed by the market and purchasing an interest in the CLO's equity.[11] Both the securities and the equity interest would confirm the alignment of interests between the CLO manager and the CLO investors. Other proposals would have the agencies reduce any risk retention requirement on a pro rata basis to the extent that a CLO's assets are comprised of higher-quality loans. A material portion of the loans that CLO managers select are higher-quality loans under any commercially reasonable definition, present minimal risks to investors, and should be taken into

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[6] Id.

[7] See Board of Governors of the Federal Reserve, Report to Congress on Risk Retention 62, Oct. 2010.

[8] See, e.g., LSTA Letter Comment, Aug. 1, 2011 at 7–14; LSTA Letter Comment, Apr. 1, 2013 at 17–19; LSTA Letter Comment, July 29, 2013 at 9–10; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 93–95; SIFMA Letter Comment, June 10, 2011 at 68–69; American Securitization Forum, June 10, 2011 at 135–136; JP Morgan Chase & Co. Letter Comment, July 14, 2011 at 53–60; The Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 31–32; Morgan Stanley Letter Comment, July 27, 2011 at 21; Bank of America Letter Comment, Aug. 1, 2011 at 23–30; Wells Fargo Letter Comment, July 28, 2011 at 26–29; White & Case Letter Comment, June 20, 2011 at 1–7; Cong. Himes and other Members of Congress Letter Comment, July 29, 2011 at 1–2.

[9] See, e.g., LSTA Letter Comment, Aug. 1, 2011 at 17–19; LSTA Letter Comment, Mar. 9, 2012; LSTA Letter Comment, Apr. 1, 2013 at 23; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 93–95; SIFMA Letter Comment, June 10, 2011 at 71–72; American Securitization Forum, June 10, 2011 at 138–139; The Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 33; Bank of America Letter Comment, Aug. 1, 2011 at 30; Wells Fargo Letter Comment, July 28, 2011 at 29; Loan Market Association Letter Comment, Aug. 1, 2011 at 2.

[10] See LSTA Letter Comment, Mar. 9, 2012 at Appendix A.

[11] See LSTA Letter Comment, Apr. 1, 2013.

account in setting the amount of any credit risk that the CLO manager must retain. In addition, we are aware that various commenters are proposing that parties associated with the CLO manager be able to retain credit risk in a manner that would satisfy Section 941's requirements.

While our understanding of the relevant markets leads us to believe that these regulatory alternatives are unnecessary, they would be far less harmful to the commercial loan markets than the rules currently proposed by the agencies.

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Cornerstone appreciates the agencies' consideration of these comments and would be pleased to provide additional information or assessments that might assist the agencies' decision-making. Please feel free to contact David Smith at dsmith@chghospitals.com in the event you have questions regarding these observations and conclusions.

Sincerely,

David Smith
President
Cornerstone Healthcare Group