February 14, 2011

VIA E-MAIL: rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attn: Elizabeth M. Murphy, Secretary

Re: Release No 34-63452; File No. S7-39-10—Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" and Release No. 34-63557, File No. S7-44-10, Process for Submission for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter in response to the request of the Securities and Exchange Commission (the "SEC") for comments regarding (i) Release No. 34-63452.; File No. S7-39-10, dated December 1, 2010 (the "Definitions Release"), issued jointly with the Commodities Futures Trading Commission (the "CFTC" and collectively with the SEC, the "Commissions") relating to the definitions of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" under Section 761(a)(77) and Section 761(a)(66), respectively, of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") and (ii) Release No. 34-63557, File No. 87-44-10, dated December 15, 2010, Process for Submission for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations (the "Mandatory Clearing Process Release," and collectively with the Definitions Release, the "Proposing Releases"). ASF supports appropriate reforms within the over-the-

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

counter ("OTC") derivatives market as it relates to the securitization market and we commend the SEC for seeking industry input regarding its proposed rules on these critically important issues. Over the past decade, ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to the SEC and other agencies on issues affecting our market. Our views as expressed in this letter are based on feedback received from our broad membership.

I. Background and Use of Security-Based Swaps by Structured Finance Participants

Title VII of Dodd-Frank creates new categories of regulated security-based swap entities, "Security-Based Swap Dealer" and "Major Security-Based Swap Participant," which, in the case of the "Major Security-Based Swap Participant" category, could depend upon whether the Security-Based Swaps utilized by the relevant entity are used for the purpose of "hedging or mitigating commercial risk." If determined to fall within either of these two categories, then a number of regulatory requirements will apply to such a security-based swap user, including registration, capital and margin, recordkeeping and business conduct standards. Therefore, whether an entity will be subject to these regulatory requirements will depend in large part upon how the SEC defines these terms. Further, Section 763(a) of Dodd-Frank amends the Securities Exchange Act of 1934 (the "Exchange Act") to provide that it is unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a derivatives clearing organization ("DCO") registered as prescribed under Dodd-Frank or a derivatives clearing organization that is exempt from registration as prescribed under Dodd-Frank, subject to certain exceptions. In the Mandatory Clearing Process Release, the SEC proposes a series of rules under Part 240 of the rules under the Exchange Act to specify the process used, and standards to determine, whether security-based swaps should be required to be cleared pursuant to Section 3C of the Exchange Act.

The ASF believes that Structured Finance Participants (as hereinafter defined) should not, standing alone, be considered to be either Security-Based Swap Dealers or Major Security-Based Swap Participants under Dodd-Frank, the mandatory clearing requirements should not apply to Structured Finance Security-Based Swaps (as hereinafter defined) entered into by Structured Finance Participants and the definition of "hedging or mitigating commercial risk" as set forth in proposed Exchange Act rule 240.3a67-4 should be applied so as to not preclude Structured Finance Participants from meeting this definition. Accordingly, we organize this letter into three parts. The first part addresses the Definitions Release and sets forth ASF's comments in relation to the definitions of Security-Based Swap Dealer and Major Security-Based Swap Participant. The second covers the rationale supporting an exception to the mandatory clearing requirement for Structured Finance Security-Based Swaps and the third part covers the definition of "hedging or mitigating commercial risk" as it applies to the use of Security-Based-Swaps by Structured Finance SPVs. Prior to setting forth these sections, however, we would like to provide some background on the use of security-based swaps by Structured Finance Participants.

A universally accepted definition of structured finance does not seem to exist. However, the definition used by the Bank of International Settlements can be instructive in setting forth an operational definition:

> Structured finance instruments can be defined through three key characteristics: (1) pooling of assets (either cash-based or synthetically created); (2) tranching of liabilities that are backed by the asset pool…; (3) de-linking of the credit risk of the collateral pool from the credit risk of the originator, usually through the use of a finite lived, standalone special purpose vehicle.[2]

Structured finance special purpose vehicles ("Structured Finance SPVs") are typically legal entities created by the sponsor or originator by transferring assets to the Structured Finance SPV, to facilitate a specific purpose or defined activity, or a series of such transactions. Structured Finance SPVs have no other purpose than the transactions for which they were created, and the Structured Finance SPV can make no operational decisions; the rules governing them are prescribed in advance and carefully limit their activities. The legal entity for a Structured Finance SPV may be a limited partnership, a limited liability company, a trust or a corporation. See Frank J. Fabozzi, Henry A. Davis and Moorad Choudhry, "Introduction to Structured Finance: Introduction" (Wiley & Sons 2006) ("Introduction to Structured Finance"). Structured Finance SPVs may be structured to be either off or on the balance sheet of the sponsor or originator.[3] In particular, with respect to structured financings that are "synthetic,"[4] the only assets that the Structured Finance SPV itself may own are the security-based swaps it enters into as counterparty. Frequently for these structures the only business or commercial purpose of these vehicles are to enter into the security-based swaps and manage the exposure relating thereto, which management may entail terminating, closing-out or entering into new swaps or security-based swaps.

Financing structures commonly included within structured finance include securitization, cash flow or synthetic collateralized debt or loan obligations and structured notes, including credit-linked notes. Depending upon the particular structure, participants in a structured financing generally can include originators and/or sellers of assets, servicers (collectively, the "Sponsoring Group") and the Structured Finance SPVs (collectively with the Sponsoring Group, the "Structured Finance Participants"), which typically act as the issuer of the debt instruments that back the particular asset pool.

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[2] See "The Role of Ratings in Structured Finance: Issues and Implications," Committee on the Global Financial System, Bank for International Settlements, 2005. Notwithstanding the second characteristic, structured financings do not necessarily have to involve tranching of liabilities.

[3] Typically, off-balance sheet Structured Finance SPVs have the following characteristics: (a) they do not have independent management or employees; (b) their administrative functions are performed by a trustee who follows set rules with regard to the distribution of cash; there are no other decisions; (c) assets held by the SPV are serviced through a servicing agreement; and (d) they are structured so that they are bankruptcy remote. See Introduction to Structured Finance, Introduction.

[4] Under a "synthetic" structured financing, there is no legal transfer of assets or a collateral pool as you would have in a cash transaction. Rather, the credit risk of the underlying asset pool (which in the case of collateralized debt or loan obligations are bonds or loans, respectively) is transferred to the Structured Finance SPV through the use of derivatives, such as credit default swaps or total return swaps.

Structured Finance Participants utilize many different types of security-based swaps, including single-name credit default swaps and certain equity derivatives. There are many different features that vary among the security-based swaps used by Structured Finance Participants, but frequently security-based swaps used by such entities are either entered into by the Structured Finance SPV directly ("SPV Security-Based Swaps") and/or are not margined with cash or liquid securities but share in the collateral pool underlying the structured finance issuance as security (these types of swaps, collectively with the SPV Security-Based Swaps, the "Structured Finance Security-Based Swaps").

In the context of synthetic collateralized debt or loan obligations, often the members of the Sponsoring Group are banks or other financial institutions that have bonds or loans on their books. The Structured Finance SPV then enters into a credit derivative transaction with the Sponsoring Group whereby the latter buys credit protection in the event that certain credit events occur with respect to the obligor under the referenced bonds or loans.

II. The terms "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" should not be defined and applied in a manner that would aggregate SPV Security-Based Swaps with the security-based swaps of the Sponsoring Group or the SPV Security-Based Swaps of other Structured Finance SPVs sponsored by the same Sponsoring Group

In the Definitions Release, the Commissions raised the issue of whether the Major Security-Based Swap Participant tests should, in some circumstances, aggregate the swap and security-based swap positions of entities that are affiliated. In seeking to address this issue and avoid evasion, the Commissions preliminarily adopted the position that the Major Security-Based Swap Participants tests may appropriately aggregate the subsidiary's security-based swaps or security-based swap positions at the parent for purposes of the substantial position analysis. The Commissions requested comment to address whether the security-based swaps of corporate subsidiaries should be attributed to an entity that itself is not the majority owner of the direct counterparty to a swap or security-based swap. The Commissions further requested comment as to whether this type of attribution should apply when one entity controls another entity and asked for comments on how the concept of control should be defined further.

The ASF believes that the test for attribution of security-based swaps between related or sponsored entities should not focus on strict ownership tests or whether one entity controls the other. Rather, consistent with the focus of Dodd-Frank on preventing systemic risk, the test should be whether a significant part of the economic risks of a transaction has been transferred to the Structured Finance SPV or retained by the Sponsoring Group, whether directly or through guarantees. Sponsors or originators may have established the Structured Finance SPV with a majority of ownership held by the sponsor or originator (directly or through its affiliates) and/or through the board of directors to the extent that it may exercise a certain amount of control over the Structured Finance SPV. The economic risk of the issuance and the Structured Finance Swap, however, often remains with the Structured Finance SPV. The assets that are the subject of the structured financing are transferred to the Structured Finance SPV and typically become the source of repayment and cash flows for the servicing of the structured finance debt instrument as well as the Structured Finance Security-Based Swap. The transfer is typically the subject of a true sale opinion and as mentioned above, a characteristic of Structured Finance SPVs is that they are structured to be bankruptcy remote. Accordingly, the failure of the

Structured Finance SPV to meet its obligations under the Structured Finance Security-Based Swap (or in general) is not likely to have ripple effects to the Sponsoring Group where there is no or little recourse to the assets of the Sponsoring Group.

While we do not believe that a strict percentage test is warranted, nonetheless we offer that were the Commissions to adopt such a test, they should set the threshold at least at the predominant level, namely that where the Sponsoring Group has either guaranteed or was directly obligated to meet a majority of the obligations of the Structured Finance Security-Based Swap, it would then be appropriate to attribute such portion so guaranteed or obligated, to the Sponsoring Group for the purposes of determining whether the Sponsoring Group should be considered a "Security-Based Swap Dealer" or "Major Security-Based Swap Participant."

Aggregating the Structured Finance Security-Based Swaps with the Sponsoring Group so as to cause such Structured Finance SPVs to be deemed to be Security-Based Swap Dealers or Major Security-Based Swap Participants would have negative consequences for structured finance issuances. As special purpose vehicles, the Structured Finance SPVs would not be able to comply with these requirements standing alone. Applying margin, capital, clearing and business conduct standards to Structured Finance SPVs would face the Sponsoring Group with a choice to either retain more of the economic risk of the structured finance issuances[5] or forego such issuances. The resulting effect will be less liquidity in these markets (e.g. for mortgages, auto loans and credit cards) thereby creating adverse consequences as the economy struggles to recover. These same effects may occur if the Structured Finance Security-Based Swaps are attributed to the Sponsoring Group. Accordingly, we respectfully request that the definitions of Security-Based Swap Dealer and Major Security-Based Swap Participant be clarified and applied in such a manner so as to not encompass Structured Finance SPVs that, standing alone without attribution or aggregation with the security-based swaps of the Sponsor Group, would not qualify independently as Security-Based Swap Dealers or Major Security-Based Swap Participants.[6]

III. Structured Finance Security-Based Swaps should not be subject to the Mandatory Clearing Requirement because Structured Finance Security-Based Swaps are not clearable

Section 763(a) of Dodd-Frank provides that the SEC shall take into account a number of factors when making the determination as to whether a security-based swap should be cleared, including, without limitation, "the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded…" and "the

[5] The regulation of retention of economic risk by Sponsoring Groups is the subject of other provisions of Dodd-Frank, notably Section 941. There is no evidence that the Title VII derivatives provisions were also intended to be applied in a manner so as to reinforce securitization risk retention requirements contained elsewhere in Dodd-Frank.

[6] If a Structured Finance SPV has directly entered into an amount of Structured Finance Security-Based Swaps that qualify independently as "substantial" under the Definitions Release and proposed regulations and on its own would meet any of the definitions of Security-Based Swap Dealer, then we have no objection to it being considered a Security-Based Swap Dealer or Major Security-Based Swap Participant and the corresponding requirements should apply.

effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of derivatives clearing organizations available to clear the contract".

Applying these factors in particular, we believe that an exemption from clearing should be made for Structured Finance Security-Based Swaps. Structured Finance Security-Based Swaps are not standardized and typically come in many different sizes and tenors, depending upon the economics of the underlying structured finance transaction. It would be extremely difficult, if not impossible, for a DCO to clear a Structured Finance Security-Based Swap, without forcing the counterparties to modify the material terms.

Further, as set forth above, the collateral for Structured Finance Security-Based Swaps are typically not cash or liquid securities, but the pool of assets underlying the structured financing itself. This raises a host of questions as it relates to clearing: (a) How will the DCO evaluate the underlying collateral pool? (b) On what basis can the DCO take a security interest in such collateral? and (c) What will happen if there is overcollateralization? Attempts to answer these questions reveal the difficulties inherent in a DCO accepting this collateral in satisfaction of its margining requirements. They do not have the credit support infrastructure to make this evaluation. Accordingly, the result of this would be to force the Structured Finance SPVs to post liquid collateral to the DCO.

This result may render many structured financings uneconomic as the Structured Finance SPV would be required to post cash and liquid securities which it does not have. As mentioned above, the source of repayment for structured financings is generally the cash flow from the assets or receivables which is generated over time. Requiring the posting of liquid collateral would affect the cash flow analysis for a structured financing and cause adverse effects on the functioning of this market, including ultimately resulting in a reduction in the available amount of loans or other financing for the assets underlying the structured financing.

Moreover, it is difficult to see how requiring the clearing of such security-based swaps would mitigate systemic risk. In fact, it could increase systemic risk either by forcing Structured Finance SPVs to forego hedging their risk or by spreading the performance risk of the pools of assets that underlie the structured finance transactions. Under the typical Structured Finance SPV this bankruptcy risk is borne by the investors and the counterparty. If such a risk was then transferred to a DCO, the risk of performance of many different asset classes, such as mortgages, auto loans and credit cards, would now be transferred to the DCO.

IV. <u>The definition of the term "hedging or mitigating commercial risk" in the Definitions Release should be clarified and interpreted by the SEC so as not to preclude SPV Security-Based Swaps from meeting this definition</u>

Proposed Exchange Act Rule 240.3a67-4(a) provides that:

> a security-based swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when: (a) such position is economically appropriate to the reduction of risks that are associated with the present conduct and management of a commercial enterprise, or are reasonably expected to arise in the

> future conduct and management of the commercial enterprise, where such risks arise from: (1) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise; (2) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise or (3) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise. . .

The ASF requests that the foregoing definition should be interpreted in such a manner as to not preclude Security-Based Swaps used by Structured Finance SPVs from meeting this definition. As set forth above, Structured Finance SPVs are special purpose vehicles which typically do not have ongoing operational activities, but whose activities consist either of servicing a pool of assets or monitoring the performance of swaps or security-based swaps in the case of synthetic structured financings. The actual performance of such activities is typically done not by the Structured Finance SPV itself, but by the servicer in the case of cash flow structured financings, and an asset or collateral manager in the case of synthetic structured financings. In addition, the administrative functions are usually conducted not by the Structured Finance SPV itself but by a trustee. A narrow construction of the meanings of “economically appropriate” and “conduct and management of a commercial enterprise” so as to mean only those entities that directly or through affiliates conduct operational activities such as manufacturing or services would effectively eliminate Structured Finance SPVs (and, in fact, most other special purpose vehicles) from consideration for any exception or exclusion under Dodd-Frank that rests upon the meaning of “hedging or mitigating commercial risk.” The “commercial enterprise” of a synthetic structured financing is to manage the risks associated with the security-based swaps that it owns and we request that this term be so applied in the context of SPV Security-Based Swaps.

In addition, for the reasons articulated in Section III above, we believe that a limited interpretation of the phrase “hedging or mitigating commercial risk” that is contrary to that proposed in this Section IV would cause adverse effects on the structured finance market, without having a correspondent reduction in systemic risk.

We would like to emphasize, that, while we make this comment regarding the definition of “hedging or mitigating commercial risk” in the context of the Definitions Release, we note that our comments in this section apply equally to the term when used elsewhere in Title VII of Dodd-Frank, specifically the end-user exception to the mandatory clearing of Security-Based Swaps contained in Section 763(a) of Dodd-Frank. See Footnote 124 of the Definitions Release.

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ASF very much appreciates the opportunity to provide the foregoing views in connection with the SEC's rulemaking process. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, Evan Siegert, ASF Associate Director, at 212.412.7109 or at esiegert@americansecuritization.com, or ASF's outside counsel on this matter, Evan M. Koster of Dewey & LeBoeuf at 212.259.6730 or at ekoster@dl.com.

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum