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Via e-mail: rule-comments@sec.gov

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

Re: Release No. 34-65355; File Number S7-38-11

Ladies and Gentlemen:

The International Association of Credit Portfolio Managers (the "*IACPM*")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "*Commission*") proposed rule 127B ("*Proposed Rule 127B*") implementing the prohibition under Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "*Dodd-Frank Act*" or "*DFA*") on material conflicts of interest in connection with securitizations.[2] The Commission's release included, in addition to the text of Proposed Rule 127B, an interpretation of its application (the "*Interpretation*" and, together with Proposed Rule 127B, the "*Proposal*").

IACPM recognizes the importance of addressing conflicts between sponsors and underwriters of securitizations and investors but believes that the Interpretation goes beyond the Congressional intent, particularly with respect to what is a "material conflict of interest." Item 1(A) of the "material conflict of interest" test set forth in the Interpretation would prohibit any transaction where a securitization participant would "benefit directly or indirectly" from the adverse performance, default or decline in value of the asset-backed securities ("*ABS*"). This ignores that fact that there may be "benefits" to a participant that result from normal market dynamics, are important for safety and soundness and are completely unrelated to the type of conduct DFA § 621 was intended to prevent.

We are particularly concerned with two aspects of the Proposal, as follows:

- the suggestion that banks will simply be prohibited from transferring or hedging balance sheet risk[3] on non-retail assets through synthetic securitizations if the bank or an affiliate of the bank is the underwriter, placement agent or initial purchaser of securities sold as part of the synthetic securitization or sponsor of the securitization vehicle (such capacities referred to collectively in this letter as the "*underwriter*", and the term "*underwritten*" having a correlative meaning); and

- the Proposal's implications for hedging transactions and actions undertaken by banks in connection with the servicing of commercial credits in the ordinary course of business that are reference assets for synthetic securitizations for which they are credit protection buyers as a result of their portfolio management activities.

It is critically important that the Proposal not preclude portfolio managers from hedging balance sheet risk through synthetic securitizations of corporate credits involving affiliated underwriters. Corporate credits are generally difficult to transfer and in some cases can be securitized only in synthetic transactions. This is particularly true where the underlying exposures are to borrowers in jurisdictions outside of the United States whose local laws – principally bank secrecy laws – effectively preclude risk transfers (and hence prudent portfolio management) through securitizations (whether traditional or synthetic) using unaffiliated underwriters. Even where such laws do not preclude transfers outright, transfers generally require borrower consent, which raises serious practical concerns given the large numbers of loans in a typical securitization transaction. Synthetic securitizations are typically marketed to sophisticated investors that are capable of understanding and evaluating any potential conflicts of interest that securitization participants may have and, where the reference assets are obligations of issuers that are publicly reporting entities or that have borrowed in the syndicated loan or Rule 144A markets, these investors have access to the same information as is available to the credit portfolio managers responsible for these transactions.[4] Our concerns rest only secondarily on commercial considerations. The primary considerations are prudential and supervisory – the fundamental importance of not unnecessarily interfering with the ability of banks subject to the Proposal to manage portfolio risk. Moreover, although the concerns over conflicts that gave rise to DFA § 621 are important and real, we do not believe that synthetic balance sheet securitizations through affiliated underwriters raise the types of conflict that gave rise to DFA § 621.

The Proposal has broad implications for our member firms, and many of them will comment directly or through other industry associations on many aspects of the Proposal. Our comments in this letter will focus on the two matters identified above, both of which are critically important to credit portfolio managers. We have set forth below in Part I certain background and contextual information concerning IACPM and the Proposal and, in Part II, a discussion of our specific concerns.

I. Background and Context

A. Synthetic securitizations are an essential prudential tool for maintaining a financial institution's safety and soundness.

While the IACPM member firms comprise the world's largest financial institutions, the IACPM represents the teams within those institutions who have responsibility for managing credit portfolios. IACPM members are the group responsible for managing the bank's loan portfolio, including actively controlling concentrations, adding diversification and managing the return of the portfolio relative to the risk, and managing counterparty risk related to derivatives exposure.

In carrying out these responsibilities successfully, credit portfolio managers contribute to maintaining the safety and soundness of their respective financial institutions. Effective credit portfolio management is critically important to our prudential supervisors and to policy makers more broadly because of its role in supporting financial institutions' ability to lend.

Banking regulators, both in the United States and abroad, have long recognized synthetic securitizations as an effective risk transfer tool.[5] Importantly, properly structured synthetic securitizations that are recognized as risk mitigants for regulatory capital purposes "free up" financial institutions' regulatory capital, enabling them to make more credit available to their customers, which is so vitally important in the current environment.

In a typical transaction, the financial institution originating the portfolio assets will purchase credit protection as a balance sheet hedge from a special purpose entity ("*SPE*") sponsored by the institution or one of its affiliates. The SPE, with the assistance of the financial institution or an affiliate acting as underwriter, issues synthetic ABS to sophisticated U.S. or foreign investors,[6] investing the proceeds in U.S. Treasury securities or other high quality collateral to secure its obligations to investors under the ABS and to the financial institution in respect of the credit protection. The financial institution's purchase of credit protection from the SPE customarily would be documented as a credit default swap ("*CDS*") between the financial institution, as buyer of credit protection, and the SPE, as seller of credit protection. In contrast, in a traditional securitization the SPE would use the proceeds of the issuance of its ABS to purchase the pool assets from the financial institution rather than to purchase collateral, and it typically would not enter into a CDS with the financial institution.

B. The Proposal appears to preclude balance sheet hedging by means of synthetic ABS transactions using affiliated underwriters.

Section 27B of the Securities Act, added by DFA § 621, prohibits an underwriter or sponsor of an ABS, or any affiliate or subsidiary thereof, from engaging in a transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity within one year after the date of the first closing of the sale of the ABS. Section 27B explicitly excepts from this prohibition certain risk-mitigating hedging activities in connection with the underwriting or sponsorship of an ABS associated with positions or holdings arising out of such underwriting or sponsorship. The Interpretation included in the Proposal indicates that engaging in any transaction would involve or result in a material conflict of interest between the securitization participant and investors in the relevant ABS for purposes of the rule if a securitization participant has a "short position" and there is a substantial likelihood that a reasonable investor would consider the conflict important to his or her investment decision. The Interpretation would define a "short position" as a transaction in which the securitization participant would benefit directly or indirectly from the actual, anticipated or potential (1) adverse performance of the asset pool supporting or referenced by the relevant ABS, (2) loss of principal, monetary default or early amortization event on the ABS or (3) decline in the market value of the relevant ABS. The Proposal elaborates on the

Interpretation by presenting four examples, each of which encompasses one or more scenarios with a common theme.

The IACPM is particularly concerned with Example 3B, in which the securitization participant purchases credit protection from the SPE pursuant to a CDS under which its short exposure offsets its existing long exposure to the same credit underlying the ABS. In the Proposal, the Commission expresses its preliminary belief that Example 3B would generally involve a material conflict of interest between the securitization participant and the ABS investors that would be prohibited by the proposed rule.

II. Discussion

A. DFA § 621 does not require the Commission to prohibit synthetic securitizations involving affiliated underwriters as raising impermissible conflicts.

The IACPM believes that prohibiting transactions resembling Example 3B would undermine necessary portfolio hedging by casting doubt on the legality of synthetic balance sheet securitization transactions and that it is neither sensible nor required by DFA § 621.

First, the statutory language does not prohibit transactions resembling Example 3B, and we do not believe policy or other considerations warrant an expansive reading that would encompass Example 3B. The statute's inclusion of an express exception for risk-mitigating hedging activities in connection with holdings arising out of the underwriting or sponsorship of an ABS does not imply that other hedging activities automatically involve a material conflict of interest or that hedging activities are prohibited if not expressly permitted by the statute. Rather, it prohibits engaging in transactions that would result in or involve material conflicts of interest in connection with securitizations and then identifies certain classes of transactions that are not prohibited. The Proposal suggests that a securitization participant might enter into the CDS because it has come to believe that the assets will perform poorly and that it might be seeking to benefit from a decline in the ABS at the expense of ABS investors. We do not believe that such a presumption is warranted in light of the information barriers that typically exist between the bankers who originate the assets and those who engage in portfolio management transactions such as synthetic balance sheet ABS.

Second, a financial institution that implements a synthetic securitization of the type described in Part I.A of this letter, as to economic substance, is not short exposure on the underlying assets after giving effect to the synthetic securitization, taking into account both the CDS and the ABS investors in securities of the SPE. The synthetic securitization is a risk transfer transaction from the bank to the ABS investors in the same manner that a traditional securitization is, with the intermediate role of the SPE and its entering into a CDS supported by U.S. Treasury securities or other high-grade collateral purchased by the SPE with the proceeds of the ABS simply being the operational steps necessary to effect the risk transfer.

Third, prohibiting synthetic securitizations that hedge balance sheet risk while permitting traditional securitizations that hedge balance sheet risk is not logically sustainable because it would have the consequence of treating economically identical transactions differently merely because of the means through which they are implemented. Notably, neither DFA § 621 nor the Proposal prohibits a financial institution that sells or grants participations in financial assets to an SPE in a traditional securitization from underwriting or having a subsidiary or affiliate underwrite the SPE's ABS. Nor would DFA § 621 or the Proposal prohibit a lender from purchasing credit protection or insurance on corporate loans in bilateral transactions with counterparties other than securitization vehicles. All of these transactions – the traditional securitization of assets that are sold or participated to the SPE and the bilateral purchase of credit protection without an SPE – could have identical outcomes to the transactions that Example 3B identifies as involving a material conflict of interest. As in a synthetic ABS transaction referencing the same assets, in each of these scenarios some or all of the risk of adverse performance of the assets, including the loss of principal or monetary default, is shifted from the lender to sophisticated counterparties. The apparent benefit that the securitization participant achieves from the "short transaction" represented by the CDS between the lender and the SPE – really the sale of the risk without the sale of the asset – is indistinguishable from the benefit it would have obtained in a permissible traditional securitization or bilateral transaction.

We believe that in Example 3B and under the Commission's proposed Interpretation, the securitization participant should not be prohibited from entering into a CDS transaction with the ABS issuer in a synthetic securitization if the following conditions are met:

a) All investors in the synthetic securitization, other than the securitization participant and any subsidiary or affiliate thereof, are "qualified institutional buyers" within the meaning of Rule 144A under the Securities Act and "qualified purchasers" as defined in Section 2(a)(51) of the Investment Company Act.

b) At the closing of the first sale of ABS, the securitization participant is not creating a "naked short" position which respect to any issuer of reference obligations covered by the CDS.[7]

c) Prominent disclosure is made to the offerees of the related synthetic ABS (in the offering document for the synthetic securitization, if one is prepared, or in a certificate or letter delivered to each offeree) that a subsidiary or affiliate of the sponsor or underwriter of the transaction may benefit from a decline in value of the reference assets of the CDS underlying the synthetic ABS. The offering document, certificate or letter may also state that such subsidiary or affiliate may enter into additional transactions that may benefit from a decline in value of such reference assets prior to the expiration of one year following the closing of the first sale of ABS in the securitization transaction provided that the potential gains (or losses) by the securitization participant from all such transactions, taken together with the potential gains (or losses) by the securitization participant from the CDS protection it purchased from the issuer would be directly offset by losses (or gains) from a long position held by the securitization participant.

These narrowly focused conditions would establish an appropriate balance between investor protection and financial institutions' need to manage credit exposure so as to satisfy risk-based capital requirements and continue to lend.

B. If Rule 127B in its final form prohibits balance sheet hedging synthetic securitizations through affiliated underwriters, banks will effectively be precluded from transferring or hedging risk on large portfolios in a number of European and emerging market jurisdictions. Workable alternatives simply do not exist.

Although there are permissible alternative transactions that are economically equivalent to the synthetic balance sheet securitizations that our members use to manage risk, if the Commission adopts Example 3B as proposed, financial institutions would as a rule would not be able because of the practical considerations described below to engage in these permissible transactions with respect to assets comprising large portions of their portfolios.

The absence of practical balance sheet hedging alternatives for large classes of assets that our member firms originate may force them to curtail their loan origination activities in market segments where borrowers do not have easy access to the capital markets, and as a result have a significant adverse effect on capital formation.

i. There are operational, legal and tax impediments to using traditional securitizations to hedge balance sheet risk.

First, sales and participations typically require borrower consent, while CDS transactions referencing the same assets do not because they enable the lender to transfer the economic risk without requiring the borrower to deal with another party. Many synthetic securitizations involve hundreds of loans, making it expensive and impractical to obtain the consent of each borrower for the sale of all or a portion of the loan. Many borrowers may be unwilling to consent to the transfer of the loan to an SPE because of the difficulties they may face dealing with an SPE if they need to modify or restructure the loan at a future date. Moreover, many commercial credit transactions include revolving credit facilities that are unfunded or partially funded. Even if they were assigned, revolving credits would not generate sufficient income to be securitized in cash transactions.

Second, in many European and emerging market jurisdictions, lenders in bilateral credit facilities are prohibited by applicable bank secrecy laws from disclosing the identity of their borrowers. The constraints of bank secrecy laws cannot be addressed by using unaffiliated underwriters. Underwriters of securitizations – whether traditional or synthetic – uniformly require access to the names of the underlying borrowers as part of their due diligence review. Although offering circular disclosure for securitizations of non-retail assets does not generally include borrower names, underwriters need borrower names in order to evaluate the sufficiency of the disclosure. If a financial institution cannot disclose borrower names, it cannot retain an unaffiliated financial institution to underwrite a securitization of exposure to those borrowers because it cannot give them information that is essential to their due diligence process. Bank secrecy laws thus can make it impossible for lenders to avoid conflicts of interest prohibited by the proposed rule by entering into CDS transactions with SPEs that issue ABS underwritten by unaffiliated financial institutions.

Third, loan sales and participations may also raise tax issues where the lender (who may be a local affiliate of the securitization participant) is not organized in the same jurisdiction as the borrower.[8]

ii. Bilateral credit protection is not a practical alternative.

Although bilateral CDS transactions might in theory be used to replicate the economics of synthetic ABS transactions that are balance sheet hedges, in many cases they are not a practical substitute because they require active collateral management and strong counterparties. Where there are many investors in a synthetic securitization, the lender would have to enter into many bilateral transactions with respect to the same reference assets, further complicating the process.

C. Prohibiting synthetic securitizations that are balance sheet hedges would not promote investor protection.

Under existing securities laws, investors in securitizations are entitled to the same disclosures about actual or potential conflicts of interests regardless of whether the SPE owns the pool assets or has merely sold credit protection on them. The IACPM does not believe that prohibiting synthetic securitizations for purposes of Proposed Rule 127B while permitting economically indistinguishable transactions would promote investor protection.

As noted above, synthetic securitizations are marketed to sophisticated investors. These investors typically are very familiar with the origination policies and practices of the lenders whose securitization transactions they invest in. They require extensive disclosure – including industry, geographical and ratings breakdowns – impose concentration and other limits on pool composition and, where the transactions are conducted on a blind pool basis because of bank secrecy laws, insist that lenders retain a substantial interest in the reference assets. They are aware that the buyer of the credit protection owns the securitized assets. Indeed, many of these transactions are individually negotiated and structured, with the investor or a group of investors stipulating the nature of the reference assets in which they wish to invest and not infrequently imposing an express contractual requirement on the credit protection buyer to retain an unhedged interest in the securitized assets. As indicated in Part II.A above in our discussion of Example 3B, we would not object to the Commission requiring additional disclosure of potential conflicts of interest within the meaning of Proposed Rule 127B as a condition of entering into synthetic balance sheet securitization transactions.

D. Prohibiting synthetic securitizations that are balance sheet hedges while permitting synthetic securitizations that hedge assets originated or acquired in anticipation of securitization transactions would establish the wrong incentives and undermine other policy objectives of the Dodd-Frank Act.

At our member firms, there is typically separation between loan officers who originate assets and sales representatives who work with investors who wish to buy exposure to various asset classes. Loan officers seek to provide credit to clients based on their business needs and creditworthiness and the financial institution's loan origination policies as in effect from time to time. If the Commission adopts Examples 3B and 3C as proposed, synthetic securitization, as one of the most effective risk mitigation techniques for credit exposure currently available to our member firms, would only be available if they allow investor demand to drive their loan origination practices. Lending in market segments where there is no immediate investor demand would be discouraged since lenders who accumulate risk other than in anticipation of a synthetic ABS transaction would find their hedging opportunities for these assets severely circumscribed. To the extent the Proposal encourages lenders to originate to distribute by permitting synthetic ABS transactions only where the long exposure is acquired for purposes of effecting the ABS transaction, it would be working at cross purposes to other provisions of the Dodd-Frank Act, such as Section 941, that were intended to discourage the originate to distribute model.

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For the reasons set forth in Parts II.A through D of this letter, the IACPM believes that the Commission should revise the final Interpretation and Rule 127B to clarify that synthetic securitizations underwritten by an affiliate of the credit protection buyer are not precluded by Rule 127B, irrespective of whether the underlying exposures are pre-existing or acquired for purposes of effecting the securitization, and that the Commission should not take the view that transactions described in Example 3B would violate the rule if they meet the additional conditions we propose. If the Commission disagrees with our view that the narrowness of the hedging exception included in DFA § 621 does not compel it to define other hedging activities as engaging in a transaction that would involve or result in a material conflict of interest with respect to investors, the IACPM believes that the Commission should rely on its general exemptive authority under Section 28 of the Securities Act to adopt our proposed modifications to Example 3B, creating a disclosure based exemption for synthetic ABS that are balance sheet hedges and are marketed exclusively to institutions that are "qualified institutional buyers" under Rule 144A and "qualified purchasers" within the meaning of Section 2(a)(51) of the Investment Company Act. Disclosure that the securitization participant is acting as the credit protection buyer and that it owns the reference assets is not complicated, easy for investors to understand and already routine included in disclosure documents for these transactions.

E. Proposed Rule 127B should not prohibit or discourage ordinary course hedging and servicing of commercial credits referenced by synthetic securitizations.

The IACPM is also concerned that the Proposal may chill other activities that are now routinely undertaken with respect to commercial credits that are referenced by ABS transactions that its members undertake for balance sheet hedging purposes. For example, some or all assets in a credit portfolio may be included as reference assets in more than one synthetic securitization because market developments may make it possible or desirable to increase the amount of credit protection that the credit portfolio manager determines is appropriate. The Proposal appears to prohibit purchasing additional credit protection on issuers whose credit risk has been securitized within one year of the first closing of the sale of ABS, even if the securitization participant has disclosed that it may do so and even if the securitization participant still has a net long exposure to the issuer. To the extent that multiple transactions do not create a net short position and are consistent with any obligations that the securitization participant may undertake to investors with respect to retained risk and the possibility and implications of such transactions have been clearly disclosed to investors, the IACPM believes that such transactions do not involve a material conflict of interest.

Financial institutions may also have multiple exposures to the same customer, some of which (such as unsecured commercial loans) are amenable to synthetic securitization and others (such as letter of credit facilities and receivables financings) are not. In managing these exposures, loan officers may need to take actions to protect the institution that may be perceived as being in conflict with the interests of investors in securitizations based on the standard set forth in the Interpretation. Lenders may agree to loan modifications intended to maximize ultimate recoveries on assets that have been securitized. Individuals in other business units who are entirely unaware of the securitization may also engage in hedging and other ordinary course activities that are intended to manage risk but could be characterized as a short-transaction within the ambit of the Interpretation. The IACPM believes that where these actions are taken by individuals who are subject to information barriers with respect to such securitizations, they should be deemed not to be a material conflict of interest for purposes of Proposed Rule 127B.

F. Proposed Rule 127B should not apply to securitization transactions in which all ABS are sold prior to the effectiveness of the final rule.

DFA § 621(b) provides that Section 27B shall take effect on the effective date of final rules issued by the Commission under Section 27B(b), except that Sections 27B(b) (requiring the adoption of implementing rules by the Commission) and (d) (providing that it will not otherwise limit the application of Section 15G of the Securities Exchange Act) became effective immediately upon enactment. Since Proposed Rule 127B prohibits engaging in certain transactions at any time prior to one year after the closing of the first sale of ABS in a securitization transaction, it is not clear whether it would apply to transactions engaged in prior to its effective date. Our members are of course unable to anticipate whether the Commission will modify the Proposal or adopt it in its current form. Accordingly, basic fairness dictates that the Proposal should not apply retroactively. As an example of the difficulties that may arise absent a clear statement from the Commission, if a securitization participant enters into a securitization transaction with respect to any asset prior to the effective date of the rule and that asset is only partially hedged, and the Commission does not agree with our proposed modification to Example 3B, the securitization participant would risk being precluded from any further hedging transactions that reference the same asset until a year has elapsed from the first closing of the sale of an ABS. Accordingly, we believe that the rule should not apply to transactions in which all ABS are sold prior to the effective date of the final rule.

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The IACPM appreciates your attention to our thoughts and concerns. The IACPM's Board of Directors and I would welcome the opportunity to discuss these issues with the Staff of the Commission.

Sincerely,

Som-lok Leung
Executive Director
International Association of Credit Portfolio Managers

[1] The IACPM is an industry association established in 2001 to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on topics of common interest. Membership in the IACPM is open to all financial institutions that manage portfolios of corporate loans, bonds or similar credit sensitive financial instruments. The IACPM represents its members before legislative and administrative bodies in the US and internationally, holds conferences and regional meetings, conducts research on the credit portfolio management field, and works with other organizations on issues of mutual interest relating to the measurement and management of portfolio risk.

Currently, there are 87 financial institutions worldwide that are members of the IACPM. These institutions are based in 17 countries and include many of the world's largest commercial wholesale banks, investment banks and insurance companies, as well as a number of asset managers. Attached is a short document that provides additional information about the association, its members, and its board of directors. (More information about the IACPM may be found on our website: www.iacpm.org.)

[2] 76 Fed. Reg. 60320 (Sept. 28, 2011). Proposed Rule 127B implements Section 27B of the Securities Act of 1933 (the "*Securities Act*") as added to the Securities Act by the Dodd-Frank Act.

[3] In this letter, transactions that transfer risk relating to a pool of assets owned by a financial institution to one or more third parties are referred to as transactions that "*hedge balance sheet risk*" or "*balance sheet hedging transactions.*"

[4] Indeed, where ABS investors and the credit portfolio managers who are involved in structuring the transaction have the same access to information with respect to the relevant credits and institutional information barriers prevent the credit portfolio managers from having access to information not available to such investors, it is not clear to us what interests, if any, are served by making the ABS subject to Proposed Rule 127B.

[5] The Board of Governors of the Federal Reserve System (the "*FRB*") and the Office of the Comptroller of the Currency (the "*OCC*") first formally addressed synthetic securitizations in a November 15, 1999 joint release entitled "*Capital Interpretations – Synthetic Collateralized Loan Obligations*". The FRB and OCC noted in the introduction to that release that synthetic securitizations "allow economic capital to be more efficiently allocated". That release and a number of subsequent interpretive letters addressed the treatment of various synthetic securitization structures under the U.S. banking agencies' Basel I-based risk-based capital guidelines. The U.S. banking agencies' Basel II-based risk-based capital guidelines, like Basel II itself, have detailed provisions addressing synthetic securitizations and recognize them as an effective risk mitigant.

[6] These transactions are typically offered in reliance on Rule 144A under the Securities Act by entities that are exempt from the Investment Company Act (pursuant to Section 3(c)(7) thereof) to institutions that are "qualified institutional buyers" within the meaning of Rule 144A.

[7] The existence of a short position should be determined with respect to the issuer's obligations generally and not the specific assets that are reference assets of the CDS because it is often not practical or desirable from a market standpoint to refer to the assets actually owned by the securitization participant or the affiliated financial institution.

[8] In general, these problems cannot be circumvented by incorporating the SPE in the same jurisdiction as the borrowers because synthetic ABS often reference assets in numerous jurisdictions to diversify the risk and because of tax inefficiencies that arise in many cases if the investors are not domiciled in the same jurisdiction as the SPE is organized.