Statement

Statement on Proposed Rule: "Prohibition Against Conflicts of Interest in Certain Securitizations"

Commissioner Hester M. Peirce

Jan. 25, 2023

Thank you, Chair Gensler. I support putting out a new proposal as a step toward compliance with a more-than-decade-old mandate from Congress,[1] but I have numerous questions about its content. The proposal should narrowly implement this mandate given the admitted lack of problems in the market. The release acknowledges that "[c]urrent market practices may be generally consistent with the re-proposed rule requirements as a result of market participants' current compliance with the existing rules and reputational incentives."[2]

The objective of this rulemaking is reasonable: prohibiting "transactions that effectively represent a bet against a securitization" by securitization participants.[3] A rule carefully designed to meet this objective would help to protect the integrity of the securitization markets, which are crucial to healthy credit markets. An overly broad rule, however, could harm the securitization market and, thus, the credit markets they support. Although the proposed rule cries out for some more care in its design, I trust that the thoughtful feedback commenters will supply in response to the many questions in the release will enable us to draft a workable final rule.

I have specific questions about eight general aspects of the rule:

- First, should we allow clear and robust disclosures to cure at least certain types of material conflicts of interest? Even if the statute did not explicitly contemplate this approach, it preserved the SEC's authority to tailor regulations if "necessary or appropriate in the public interest, and . . . consistent with the protection of investors."[4] As one commenter argued in response to the last proposal, "[t]he basic approach of the 1933 Act has long been to require proper disclosure rather than to pursue substantive regulation."[5]

- Second, is the definition of "sponsor" unreasonably broad and overly vague? Despite significant pushback from commenters on the 2011 proposal, the reproposal's definition encompasses

collateral managers[6] and other entities that do not fit within the traditional definition of "sponsor." It also includes anyone who "*indirectly*" "organizes and initiates an ABS transaction"[7] or "*causes the direction*" of the ABS's design or underlying asset composition.[8] Will it be clear how direct the causality chain must be for the prohibition to apply?

- Third, is the prohibition's trigger too vague? The prohibition would attach once someone takes "substantial steps to reach [] an agreement that such person will become a securitization participant."[9] Is this "substantial steps" language sufficiently clear? Are there enough instances where someone who took only "substantial steps" also engaged in conflicted behavior to justify including this provision? How would an affiliate or subsidiary of someone who took "substantial steps" be aware that the person had done so?

- Fourth, should the final rule include an exception for affiliates or subsidiaries of securitization participants that rely on information barriers? The statute applies the prohibition to subsidiaries and affiliates, but it does not preclude the SEC from exercising its exemptive authority. Affiliates and subsidiaries will find it difficult to comply with the prohibition, particularly because they may not even be aware of—and, in some instances, may be legally prohibited from knowing about—the conduct that has triggered it. Can large financial institutions comply with the rule as proposed? Would an exception based on information barriers facilitate evasion of the rule, as the release suggests?

- Fifth, does the inclusion of an anti-circumvention provision unnecessarily cloud the rule's perimeters? The proposed rule would prohibit "transaction[s] that circumvent[] the [proposal's] prohibition."[10] Is an anti-evasion provision necessary given the breadth of the prohibition? If it is, could we modify the language to clarify what types of transactions we are trying to reach?

- Sixth, is the proposed rule adequately harmonized with the Volcker Rule? While the proposed rule tracks the Volcker Rule in some places, differences remain. Do the similarities and differences make sense?

- Seventh, is the scope of the exceptions for bona fide market-making and risk-mitigating hedging appropriate? These exceptions are key to ensuring that the rule works.

- Finally, does the proposal make appropriate accommodations for different types of entities?

    - The rule exempts government-sponsored enterprises ["GSEs"] as long as they "operat[e] under the conservatorship or receivership of [the Federal Housing Finance Agency] with capital support from the United States."[11] In the short term, will the proposed exclusion create an uneven playing field? In the long term, will the proposal make it less likely that the GSEs will exit conservatorship?

    - The proposed rule is not tailored for small entities. Should small entities be afforded a longer implementation period or some other accommodation to ease their compliance burden?

- The proposed rule would apply to municipal entities. Given that municipal entities are unlikely to engage in conflicted transactions, should the final rule exempt them from the prohibition altogether? Even though the rule does not require entities to establish compliance procedures, any entity covered by the rule is likely to put such procedures in place as a defense in the event of an enforcement investigation, which will entail unnecessary costs.

I look forward to comments. I apologize for the proposal's unnecessarily short comment period, which continues a troubling pattern in the face of public and Congressional concern.[12] What makes the short comment period here particularly puzzling is that an extra month or two for comments would not add materially to the amount of time that has passed since Congress mandated us to adopt this rule. For comparison, the comment period last time around extended to almost five months after two extensions.[13]

Thank you to the staff for this recommendation. I would like to thank Renee Jones in particular, who is leaving the Commission soon after this meeting. Although we have often disagreed on matters of substance, I appreciate Renee's commitment to the work of the Commission and her ability to shepherd the Division through a very busy time for rulemaking and disclosure review. With respect to this rulemaking, special thanks go to Corey Klemmer on Chair Gensler's staff, incoming director Erik Gerding, Rolaine Bancroft, Ben Meeks, and Deanna Virginio. I would also like to thank staff in the Division of Trading and Markets, the Office of General Counsel, the Office of Municipal Securities, and the Division of Economic and Risk Analysis.

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[1] Section 27B(b) requires the SEC to issue rules implementing this provision "[n]ot later than 270 days after the date of enactment of this section," which was in July 21, 2010.

[2] Release at 133.

[3] Release at 6.

[4] 15 U.S.C. § 77z-3. Elsewhere in Dodd-Frank, Congress prohibited the exercise of exemptive authority.*See, e.g.*, Dodd-Frank Act § 772 (prohibiting invoking the Commission's exemptive authority in connection with security-based swaps reforms). *See also* Commissioner Hester Peirce, *Erroneous Clawbacking: Statement at Open Meeting to Consider Listing Standards for Recovery of Erroneously Awarded Compensation*, SEC (Oct. 26, 2022), https://www.sec.gov/news/statement/peirce-statement-clawbacks-102622 (pointing out the Commission's inappropriately dismissing its exemptive authority when implementing Section 954 of Dodd-Frank).

[5] Comment Letter from the American Bar Association Business Law Section at 6 (Feb. 13, 2012), https://www.sec.gov/comments/s7-38-11/s73811-31.pdf.

[6] *See, e.g.,* Comment Letter from American Securitization Forum at 23 n.36 (Feb. 13, 2012), https://www.sec.gov/comments/s7-38-11/s73811-40.pdf ("We do not believe the definition of 'sponsor' should cover servicers, custodians or collateral managers, since those who merely service or manage the assets underlying an ABS, by definition, do not play a role in structuring an ABS and are not, therefore, in a position to design the ABS to default or fail"); Comment Letter from the Loan Syndications and Trading Association at 7-10 (Feb. 10, 2011), https://www.sec.gov/comments/s7-38-11/s73811-24.pdf (suggesting that the investment adviser status of collateral managers and their fee structure makes the types of conflicts at issue unlikely).

[7] Proposed 17 CFR § 230.192(c) (emphasis added).

[8] *Id.* (emphasis added).

[9] Proposed 17 CFR § 230.192(a)(1).

[10] Proposed 17 CFR § 230.192(c).

[11] Release at 35.

[12] *See* H. Rept. 117-393 – Financial Services and General Government Appropriations Bill, 2023, House Report 117-393 (Jun. 28, 2022), https://www.congress.gov/congressional-report/117th-congress/house-report/393/1?overview=closed ("We are concerned with the volume of rules being proposed by the SEC and that they are doing too much too fast and are not focused on their core mission."). The year-end omnibus's Joint Explanatory Statement adopted this report as Congressional intent. *See* Division E – Financial Services and General Government Appropriation's Act Statement FY23, https://www.appropriations.senate.gov/imo/media/doc/Division%20E%20-%20FSGG%20Statement%20FY23.pdf ("The joint explanatory statement accompanying this division is approved and indicates Congressional intent. Unless otherwise noted, the language set forth in House Report 117- 393 carries the same weight as language included in this joint explanatory statement and should be complied with unless specifically addressed to the contrary in this joint explanatory statement.").

[13] *See Prohibition Against Conflicts of Interest in Certain Securitization*, Release No. 34-66058 (Dec. 23, 2011), https://www.sec.gov/rules/proposed/2011/34-66058.pdf (extending comment period for Section 621 proposal to Feb. 13, 2012 for proposed rule that the SEC initially issued on September 19, 2011).