Written Statement of Kenneth E. Bentsen, Jr.

on behalf of the Securities Industry and Financial Markets Association

before the House Committee on Financial Services

January 15, 2014

Chairman Hensarling, Ranking Member Waters, and members of the Committee. My name is Ken Bentsen and I am President and CEO of the Securities Industry and Financial Markets Association (SIFMA)[1]. Thank you for providing me the opportunity to testify before you today regarding our member firms' concerns about the final regulations implementing the statutory text of what has come to be known as the Volcker Rule[2]. SIFMA represents a broad range of financial services firms active in capital markets all of whom are dedicated to promoting investor opportunity, access to capital, loans to families and businesses, and an efficient market system that stimulates economic growth and job creation. America's economic success depends on a vibrant financial system that provides reliable access to capital and credit and it is with that belief in mind that I appear here today.

The concept that proprietary trading by banks and their affiliates should be prohibited and fund investments should be restricted sounds fairly straight forward. At the level where the regulation impacts real businesses and investors in the real economy, time and experience have shown that it is, in fact, exceedingly complex. Those who have grappled with the Volcker Rule at

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] In this testimony, I will refer to the final Volcker Rule to mean the combination of the final regulations and the statutory text that they implement.

any level deeper than that of a media sound bite know that balancing the statutory mandate to both prohibit and permit certain activities and investments in a way that does not harm the capital markets and the businesses, governments and investors who rely on those markets, is a very serious business and horribly complex. Indeed, Congress struggled with the complex statutory text which became the Volcker Rule and for three and a half long years, five different regulatory agencies, plus the FSOC and the Department of the Treasury have strived to find a balance of prohibitions, exemptions, restrictions and compliance regimes which will be faithful to the statutory text's mix of prohibitions and exemptions as well as the overarching policy goal not to harm the real economy. It is no wonder that the proposed rule posed over 1,300 questions and that the final rule runs 71 pages with nearly 900 pages of commentary attached to it and we are not surprised that it took the regulators a long time to complete the Rule so we are appreciative of the attention with which they approached an exceedingly difficult task.

That being said, SIFMA and our members still believe the Volcker Rule is a policy response in search of a problem and we remind the Committee that no other country has adopted anything at all similar to the Volcker Rule. It is, however, the law of the land and our members are committed to complying fully with the rule and making the required changes and putting in place conformance plans and compliance programs. The capital markets have raised more than $6.3 trillion over the past six years for U.S. companies in more than 78 different business sectors and any regulation that could so negatively affect that lifeblood of the economy will need to be monitored. Our member firms will work closely with the regulators and if necessary, the Congress, to ensure a smooth implementation with as limited an impact as possible on the broader economy.

There is no doubt that the final Volcker Rule, as it was intended, will bring about changes in our markets. The Rule represents a significant and complex change that will impact every single bank and its capital markets affiliates in the U.S. and globally, no matter its size. As the Volcker Rule comes into full force, it will affect many markets and products. The agencies have appropriately extended the conformance period to provide the financial sector and the markets time to prepare though there will undoubtedly be many unintended consequences. We caution, however, that the Volcker Rule's complexity will inevitably raise a number of interpretive issues and it is important that these be resolved thoughtfully. We will work with the regulators and legislators to ensure appropriate treatment. For example, in the short term we expect, as noted below, questions with respect to the treatment of the required metrics and we would seek to continue the dialogue as to the appropriate and consistent approach for this important requirement.

Our preliminary assessment shows that beyond the general market quality impact that will result from the significant compliance costs associated with engaging in permitted activities, the following markets/areas will be impacted: venture capital, normal corporate structures such as equity joint ventures and acquisition vehicles, municipal financing via tender option bonds, loan and other securitizations, asset-backed commercial paper, commercial loans and lending via CLOs, CDOs and the trading of foreign sovereign debt.

Regarding CLOs, we have included as appendices to this testimony two letters that SIFMA and other trade groups sent to the regulators requesting guidance related to the definition of ownership interest in the final rule as it relates to CLO transactions. We believe that guidance such as we have requested would allow holders of CLO securities to become comfortable that they did not hold ownership interests, and that their holdings were permissible under the Volcker Rule. We continue to strongly encourage the regulators to issue such guidance so as to avoid disruptions to the CLO market, and increases in the cost of credit to the Main Street businesses that benefit from the market. We note that Members of Congress have introduced legislation that would allow banks to continue to hold securities issued by CLOs if they were issued before December 10, 2013 and we support the goals of this legislation. Indeed, we believe that the relief afforded by any legislation to TruPS CDOs should also be granted to CLOs – the definition of ownership interest is a common problem and the consequences of inaction regarding CLOs are very high. That being said, we hope that guidance from the regulators would take a principles-based approach and is therefore the preferable approach.

Our members are also beginning to focus on the conformance plans and the intense compliance programs that the final regulation requires. But this work by our member firms is not the end of the story. Just as the financial sector will have to develop and implement conformance plans, compliance programs, internal controls, independent testing and auditing, training and records retention, so too will regulators have more work to do to explain what certain provisions mean and how they are intended to work. A final regulation as significant as the final Volcker Rule, with broad market impacts and a global reach, will not be simple to implement, examine or supervise. In order to lessen the potential negative market impacts, regulators should consider, as issues arise, giving particular markets or products additional time to comply. Most importantly, just as the five regulators ultimately coordinated to write one rule they must now coordinate and be consistent in their interpretation, examination, supervision and enforcement of the final regulations. A lack of consistency will not only create unnecessary and costly confusion for the industry, our clients and the markets, it will undermine the Rule itself.

The lack of an explicit mechanism or process for ongoing regulatory coordination and resolution of interpretive, examination, supervision and enforcement differences has emerged as our member firms' greatest initial concern. The law tasked five different regulators, the Commodity Futures Trading Commission, Federal Reserve Board, Federal Deposit Insurance Corporation, Comptroller of the Currency and the Securities and Exchange Commission with writing the rule, but it did not task any one agency or the agencies collectively with the interpretation, examination, supervision or enforcement of final regulations. As firms (including global firms, smaller firms and regional banking entities that are now subject to these new compliance requirements) develop these procedures, a failure to have a clear, transparent and consistent approach to address and resolve regulatory issues will only increase costs and delay achievement of the regulatory goals. Without a defined process or mechanism there is a significant risk that agencies will have differing interpretations of similar provisions or activities covered by the Volcker Rule, resulting in inconsistencies in their examination, supervision and enforcement. This will undoubtedly raise additional compliance liabilities that will cause firms to needlessly restrict activities that are otherwise explicitly allowed, the net effect of which being the restriction of capital committed to certain markets and the resultant reduction in liquidity.

Let us consider some examples. What happens if the SEC, and its examiners, takes one point of view for the broker-dealer while the OCC takes another point of view for the national bank in the same affiliated institution? Now add in the complexity of the CFTC reviewing the activities of the national bank for its registered swap dealer activities. What if the FDIC takes one view for nonmember banks and the Federal Reserve another for member banks? What if regulators in other jurisdictions impose requirements that are incompatible with the approach required by one or more U.S. regulators?

As you know, the basic building block of the trading provisions of the final regulations is **not** a legal entity or functional regulation approach of the type we have traditionally seen. Instead, the basic building block is the trading desk which the agencies have made crystal clear is meant to cross legal entities. As a result, all compliance programs and metrics reporting will also cut across legal entities and the traditional system of functional regulation. The reality is that each trading desk could be subject to examination by multiple agencies.

This concern is significant as we move deeper into firms' planning for conformance, implementation and development of compliance regimes. For example, a number of the largest financial institutions must begin tracking certain metrics of their activities by July of this year with the first reports due by the end of August. A rush to meet this deadline, particularly in light of the long delays that followed the expiration of the comment period, will have ramifications for both the regulated bodies and the regulators. Our members have concerns as to how each agency will interpret the metrics described in the Rule, as well as how and to which agency they will be reported. Differences in approach across the agencies would make metrics reporting almost impossible, especially given the fact that metrics reporting will have to be programmed into computer systems. Inconsistency in approach could also undermine the transparency and the comparability of the information from institution to institution, thus making the information far less valuable.

Regrettably, the final regulations are completely silent on regulatory coordination. The final Volcker Rule does not address how interpretations and guidance will be meted out, how examinations will be coordinated in form and result, how the agencies will work together in supervision in any respect, or how various cross-border compliance and coordination issues will be addressed. It is completely unclear how the agencies plan to coordinate their efforts and avoid duplicative actions and undue costs and burdens on virtually every banking organization in the country.

The agencies acknowledged concerns about overlapping jurisdictional authority but while they noted an intent "to coordinate their examination and enforcement proceedings to the extent possible and practicable", they provided absolutely no guidelines or procedure on how to do so.

Indeed, we understand from our members that one of the lessons learned from the entire TruPS CDO and CLO problem is that no one agency can render an interpretation and getting five different agencies to agree requires more time. We believe that the top near-term goal should be for the agencies to articulate a transparent and consistent roadmap for coordination on both near-term interpretive guidance and the long-term examination and supervisory framework, including realistic goals on quantitative reporting that prioritize utility of the data. Any delay in providing transparency around structural coordination risks creating confusion that could disrupt our capital markets and the flow of credit to our broader economy, and may very well impede our members' ability to meet already tight compliance timelines. A roadmap for coordination should seek ultimately to ensure consistency in interpretation across agencies with guidance consistently applied.

We believe it is incumbent upon the FSOC to exercise its authority to coordinate supervisory activities with respect to the Rule, as Congress provided for in the FSOC's enabling statute and in the statutory Volcker Rule itself. Additionally, we strongly believe there is an oversight role for Congress to play in ensuring such coordination and the consistent application of the Rule applies, beginning with this hearing today. Considering the lack of a re-proposal, we also urge the regulators to be flexible and open to amending the Volcker Rule through an iterative process as problems arise going forward. We note that the Volcker statute requires that the regulators "consult and coordinate with each other, as appropriate" to assure that there is "consistent application and implementation" of the Volcker Rule.

In conclusion, I wish to stress again that there remain many outstanding questions as to how the Volcker Rule will be implemented and enforced and SIFMA and its members are still carefully reading the Rule to understand its consequences. There is a strong likelihood that significant issues may arise in the coming weeks or months that are simply not on our radar screen today—the

Volcker Rule is that complex. Failure to address this could result in more compliance burdens that would undermine activities beneficial to the economy such as market making and hedging. We look forward to working with Congress, our regulators, and other market participants to ensure the implementation of the Volcker Rule is not disruptive to the capital markets and the job creators they support. With that, I look forward to answering your questions.

December 24, 2013

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: "Ownership Interests" in Connection with Certain CLO Debt Securities

Dear Chairman Bernanke, Comptroller Curry, Chairman Gensler, Chairman Gruenberg, and Chair White:

The Loan Syndications and Trading Association ("LSTA"),[1] the Securities Industry and Financial Markets Association ("SIFMA"),[2] the Structured Finance Industry Group ("SFIG"),[3] the American Bankers Association,[4] and the Financial Services Roundtable[5] submit this letter in connection with certain aspects of the final rule implementing the Volcker Rule, adopted by your respective agencies ("Agencies") on December 10, 2013.[6] Specifically, we ask for confirmation that the term "ownership interest" as defined in §__.10(d)(6) does not include debt securities of collateralized loan obligation ("CLO") issuers that are covered funds where these CLO debt securities have a contingent right to remove a manager "for cause" or to nominate or vote on a nominated replacement upon a manager's removal for cause or resignation, but contain none of the other indicia of ownership interests listed in the definition.[7]

Section __.10(d)(6)(i)(A) of the Final Rule defines "ownership interest" to include "the right to participate in the selection or removal" of an investment manager of a covered fund, "(excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event)." We believe it is reasonable to interpret the "for cause" trigger relating to the right of the holders of CLO debt securities to remove a manager or nominate or

[1] The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trading of commercial loans. The 350 members of the LSTA include commercial banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers, and other institutional lenders, as well as service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty.

[2] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[3] SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

[4] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at aba.com.

[5] The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

[6] Final Rule, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 10, 2013) ("Final Rule").

[7] For the avoidance of doubt, our request does not extend to the "equity" tranche of a CLO, even where denominated as debt, given that it does have other indicia of ownership interests.

vote on a nominated replacement upon a manager's removal for cause or resignation to constitute a "right[ ] of a creditor to exercise remedies upon the occurrence of a default" since a "for cause" removal under the management agreement is typically linked to a significant breach of the manager's obligations under the CLO transaction documents. Nevertheless, this issue has resulted in considerable confusion among our banking entity and asset manager members as they seek to understand the impact of the Final Rule on holders of CLO debt securities.

We understand that, as a result of this uncertainty, a large number of our members, which include both large and small banks, are weighing whether they will be permitted to acquire or retain any covered fund CLO debt securities that have such a controlling class feature that is a protective creditors' right. We are concerned that, unless the Agencies provide guidance that the rights described herein do not amount to an ownership interest, banking entities (including a significant number of regional and community banks) could begin to dispose of these CLO debt securities and stop acquiring new covered fund CLO debt securities, even though we believe that these rights should not be read to constitute an ownership interest. Divestment of CLO debt securities will unnecessarily disrupt the CLO market, could result in immediate and substantial capital losses for banking entities, and will ultimately impair the availability of, and increase the cost of, corporate lending since banking entities play a significant role in providing continued liquidity to the CLO debt market and CLOs provide significant capital and liquidity to the corporate loan market.[8] The impact of these losses will not only be felt by banking entities but also by non-bank investors that hold CLO debt securities, as these securities will experience a loss in market value driven by the forced selling.

CLOs provide the holders of their debt securities with a number of creditor rights designed to protect their debt interests. Most of these rights are vested in the "controlling class," typically the most senior class of debt securities then outstanding. However, since CLO debt securities are paid serially, any class of these debt securities can become the controlling class after the prior classes have been paid in full. An important creditor's right is to remove the CLO manager for cause. Events constituting cause for removal may involve, for example, a willful breach by the manager of its obligations under the CLO transaction documents, the dissolution or insolvency of the manager, or fraud or criminal activity by the manager in connection with its investment management business. These types of events pose clear and direct threats to the interests of holders of debt securities as creditors of a CLO, and their ability to respond to and remediate these threats is properly viewed as an essential creditor's right, and not as an ownership interest.

In addition, the resignation of the manager is tantamount to a change of control of the issuer — a circumstance under which traditional bank lenders often receive consent rights or the right to be repaid. Investors thus view the ability to vote on a replacement manager, too, as an important creditors' right.

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[8] *See* Forbes, "Volcker Rule's Non-Exemption of CLOs with Bonds Holds Potential to Disrupt Markets," Dec. 17, 2013, available at http://www.forbes.com/sites/spleverage/2013/12/17/volcker-rules-non-exemption-of-clos-with-bonds-holds-potential-to-disrupt-market/.

In almost all CLOs, some percentage of the controlling class of holders of debt securities (sometimes with holders of other classes of debt securities as well) have the contingent right to remove the manager for cause.[9] In the event of a removal for cause or a manager's resignation, typically the controlling class of debt securities and the equity holders each have the right to propose to the other a successor manager. If the parties are unable to agree on a replacement, they, or even the CLO issuer or the resigning manager, may ask a court to appoint a successor.

While for cause removal and replacement upon resignation or removal rights are common creditor protective rights in CLOs, they are not typically structured to occur in the context of an event of default or an acceleration event under the CLO securities indenture, even though they are only triggered upon a manager's default under the CLO management agreement or its resignation. As such, there is some uncertainty as to whether CLO debt security holders that have these rights would or would not be deemed to have an "ownership interest" under the Final Rule.

If a CLO debt security with these contingent creditor protective rights is treated as an "ownership interest," a banking entity would be prohibited from, or severely limited in, acquiring or continuing to hold debt securities in any CLO that is a covered fund, even though none of the attributes of such debt securities has the characteristics of an equity or other typical ownership interest. Holders of CLO debt securities only have the right to specified principal and interest. They do not have the right or ability, directly or indirectly, to share in the CLO's profits or losses or to earn a return based on the CLO's performance. They also do not have the types of voting rights that typically attach to equity securities, like the right to vote on establishing an entity's objectives and policies or electing its board of directors. The contingent right to participate in the replacement of a manager in the remote event of a removal for cause or resignation is far narrower than rights that accompany equity-like interests and do not provide holders of CLO debt securities with the ability to control the decisions of the manager.[10]

Moreover, as a practical matter, it is very difficult to restructure an existing CLO or to obtain consent to amend CLO documentation to modify the rights of holders of debt securities. The Agencies recently indicated in a different context that banking entities could consider whether an investment structure could be restructured, for example to avail itself of an exemption under the Investment Company Act other than Sections 3(c)(1) or 3(c)(7), thereby taking it out of the scope of the covered fund definition.[11] However, each Investment Company Act exemption contains conditions that would be unworkable for existing CLOs. For example, if a CLO were to be restructured to rely on Investment Company Act Rule 3a-7, the manager could

[9] CLO equity holders may also have this right. Unlike the holders of CLO debt securities, however, and as noted above, the CLO equity holders satisfy most if not all of the indicia of "ownership interest" under the Final Rule, and we are not seeking clarification as to their interests in this letter.

[10] We understand that, to the extent that a CLO debt security in fact meets any of the indicia of "ownership interest" in the Final Rule (other than the limited right to participate in the selection or removal of a manager discussed above), such security would constitute an "ownership interest" and be subject to all applicable covered fund restrictions.

[11] We refer to the FAQ issued by the federal banking agencies on December 19, 2013, titled, "FAQ Regarding Collateralized Debt Obligations Backed by Trust Preferred Securities under the Volcker Rule."

be significantly limited in its ability to sell assets, even outside of the reinvestment period. Neither managers nor equity holders of actively managed CLOs would likely agree to such restrictions. There may also be significant logistical difficulties in amending outstanding CLOs (especially in the case of CLO debt securities held through a clearing organization whose holders are not known to the CLO issuer), and the amendment of a large number of outstanding transactions would require significant expense. Furthermore, even when all affected debt security holders are known, certain security holders that are not banking entities may be unwilling to give up what are considered to be important creditors' rights.[12]

We thus request confirmation from the Agencies in an interpretive letter, FAQ, or other appropriate form that the term "ownership interest" as defined in §__.10(d)(6) does not include debt securities of CLO issuers that are covered funds, where these CLO debt securities give holders a contingent right to remove a manager "for cause" or to nominate or vote on a nominated replacement upon a manager's resignation or removal, but contain none of the other indicia of ownership interests listed in the definition.

Please feel free to contact Elliot Ganz, LSTA's General Counsel, at (212) 880-3003 if you have any questions regarding this letter.

Sincerely,

R. Bram Smith
Executive Director
Loan Syndications and Trading Association

Christopher Killian
Managing Director
Securities Industry and Financial Markets Association

Richard Johns
Executive Director
Structured Finance Industry Group

[12] As of the date of this letter, the aggregate amount of U.S. CLOs outstanding is $303 billion, of which $153 billion were issued before September 2008.

Cecelia A. Calaby
Executive Director and General Counsel
American Bankers Association

Richard Foster
Senior Counsel for Regulatory &
Legal Affairs
Financial Services Roundtable

January 10, 2013

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
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The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: <u>"Ownership Interests" in Connection with Certain CLO Debt Securities</u>

Dear Chairman Bernanke, Comptroller Curry, Chairman Gruenberg, and Chair White:

The Loan Syndications and Trading Association ("LSTA") and the Securities Industry and Financial Markets Association ("SIFMA") are grateful to the staffs of the Federal Reserve Board ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Office of the Comptroller of the Currency ("OCC"), and Securities and Exchange Commission ("SEC") for taking the time to meet with us on Thursday.[1] We submit this letter on behalf of the undersigned organizations as a follow-up to the meetings and to our letters of December 24, 2013 and December 31, 2013 (the "December Letters"),[2] to clarify certain aspects of those letters and the discussions in the January 9 Meetings, and to propose language that would confirm, in a FAQ or other appropriate interpretive guidance, that the term "ownership interest" as defined in §__.10(d)(6) of the final rule implementing the Volcker Rule[3] does not include debt securities of collateralized loan obligation ("CLO") issuers that are covered funds, as described below, solely because they have the creditor-protective rights described below, whether or not an event of default or acceleration event exists under the CLO indenture.

Section __.10(d)(6)(i)(A) of the Final Rule defines "ownership interest" to include "the right to participate in the selection or removal" of an investment manager of a covered fund, "(excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event)."

As discussed in the December Letters, CLOs provide the holders of their debt securities with a number of creditor rights designed to protect their debt interests. Most of these rights are vested in the "controlling class," typically the most senior class of debt securities then outstanding.[4]

We have confirmed that most existing controlling class CLO debt security holders have the contingent right to participate in the removal and replacement of the CLO manager, but only for cause pursuant to the transaction documents. The definition of "cause" that would trigger the right of removal includes, for example, a willful breach by the manager of its obligations under the CLO transaction documents, the dissolution or insolvency of the manager, a material failure of a representation or warranty that is not timely cured, or fraud or criminal activity by the manager in connection with its investment management business.

Most existing controlling class CLO debt security holders also have the right to participate in the replacement of a manager after the manager's resignation. The resignation of the manager is tantamount to a change of control of the issuer — a circumstance under which traditional bank lenders often receive consent rights or the right to be repaid.

In the event of a removal of the manager for cause by the debt security or equity holders,[5] or the manager's resignation, typically the equity holders and/or the controlling class of debt security holders each have the right to propose to the other a successor manager. If the parties

[1] Representatives of the LSTA and SIFMA met with Federal Reserve, FDIC, and OCC staff on the morning of January 9, 2014, and with SEC staff that afternoon (the "January 9 Meetings").

[2] The undersigned organizations are the LSTA, SIFMA, the Structured Finance Industry Group ("SFIG"), and the Financial Services Roundtable ("FSR"). The December Letters, including the description of each of our organizations, are incorporated herein by reference.

[3] Final Rule, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 10, 2013) ("Final Rule").

[4] Since CLO debt securities are paid serially, any class of these debt securities can become the controlling class after the more senior classes have been paid in full.

[5] The equity holders also typically have the right to remove the manager for cause.

are unable to agree on a replacement, they, or even the CLO issuer or the resigning manager, may ask a court to appoint a successor.

As discussed in the December Letters and the January 9 Meetings, these "for cause" and resignation events pose clear and direct threats to the interests of holders of debt securities as creditors of a CLO, and their ability to respond to and remediate these threats is properly viewed as an essential creditor's right, and not as an ownership interest.

Importantly, CLO debt securities typically do not have any of the other indicia of ownership interest described in subsections (6)(i)(B) through (G) of Section __.10(d) of the Final Rule.[6]

We thus request confirmation from the Agencies in a FAQ or other appropriate interpretive guidance that the term "ownership interest" as defined in §__.10(d)(6) does not include debt securities of CLO issuers that are covered funds, where these CLO debt securities give holders only a contingent right to remove a manager "for cause" or to nominate or vote on or consent to a nominated replacement upon a manager's removal for cause or resignation, but contain none of the other indicia of ownership interests listed in the definition.

We believe that adoption by the Agencies of either proposed Alternative 1 or 2 below would allay the concerns of banking entities as to whether their debt securities represent ownership interests solely because of the removal and replacement rights described herein. These proposals are substantively identical but we have offered alternative constructions for your consideration.

Based on our meeting with the Federal Reserve, FDIC, and OCC, we are also offering a third alternative, which would require that the CLO collateral consist predominantly of loans. We continue to believe, however, that the creditor-protective rights described herein, standing alone (*i.e.,* without any of the other indicia of "ownership interest" in the Final Rule), should not qualify as an "other similar interest" regardless of the makeup of the covered fund. Indeed, the contingent right to remove a manager for cause generally needs action by a majority (or super majority) of a controlling class of CLO debt security holders.

<u>Proposed language</u>

Alternative 1:

> The Agencies confirm that the rights of a holder of debt securities of a CLO that is a covered fund to participate in the removal of a manager solely "for cause," as defined in the CLO transaction documents (CLO management agreement, indenture or other related

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[6] While the full impact of the final rule is still being assessed, we understand that banking entities believe that, if necessary, they likely will be able to obtain an opinion of counsel that the ownership interest indicia set forth in subsections (6)(i)(B)-(F) and subsection (6)(i)(G), except as it relates to subsection (6)(i)(A), will not apply to most CLO debt securities. However, they almost certainly will not be able to obtain a similar opinion of counsel in connection with subsection (6)(i)(A). Our request does not extend to any CLO debt security that would meet any of the indicia of ownership interest other than in subsection (6)(i)(A).

documents governing the issuance and management of the CLO), and to nominate or vote on or consent to a nominated replacement manager upon a manager's removal for cause or resignation, constitute "rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event" under section __.10(d)(6)(1)(A) of the Final Rule, whether or not an event of default or acceleration event exists under the CLO indenture, as long as the debt security does not meet any of the other indicia of "other similar interest" set forth in subsections (6)(i)(A) through (F) or subsection (6)(i)(G), except as it relates to subsection 6(i)(A) in the limited manner set forth above.

Alternative 2:

The Agencies confirm that the clause: "rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event" under section __.10(d)(6)(1)(A) of the Final Rule includes, whether or not an event of default or acceleration event exists under the CLO indenture, rights of a holder of debt securities of a CLO that is a covered fund to participate in the removal of a manager solely "for cause," as defined in the CLO transaction documents (CLO management agreement, indenture or other related documents governing the issuance and management of the CLO), and to nominate or vote on or consent to a nominated replacement manager upon a manager's removal for cause or resignation, as long as the debt security does not meet any of the other indicia of "other similar interest" set forth in subsections (6)(i)(A) through (F) or subsection (6)(i)(G), except as it relates to subsection 6(i)(A) in the limited manner set forth above.

Alternative 3:

The Agencies confirm that the clause: "rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event" under section __.10(d)(6)(1)(A) of the Final Rule includes, whether or not an event of default or acceleration event exists under the CLO indenture, rights of a holder of debt securities of a CLO that is a covered fund to participate in the removal of a manager solely "for cause," as defined in the CLO transaction documents (CLO management agreement, indenture or other related documents governing the issuance and management of the CLO), and to nominate or vote on or consent to a nominated replacement manager upon a manager's removal for cause or resignation, as long as:

(i) the debt security does not meet any of the other indicia of "other similar interest" set forth in subsections (6)(i)(A) through (F) or subsection (6)(i)(G), except as it relates to subsection 6(i)(A) in the limited manner set forth above; and

(ii) the CLO must be comprised predominantly of loans.

Once again, we are grateful for the staffs' time and consideration of this important issue. As we discussed in the January 9 Meetings, there is significant urgency to our request. Not only does the uncertainty as to treatment of CLO debt securities raise a number of complex and timesensitive accounting issues, but, absent a timely resolution, we are concerned about a substantial market disruption.

Please feel free to contact Elliot Ganz, LSTA's General Counsel, at (212) 880-3003 if you have any questions regarding this letter.

Sincerely,

R Bram Smith

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cc: The Honorable Mark Wetjen
Acting Chairman
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