CENTER FOR CAPITAL MARKETS COMPETITIVENESS

PRIVATE EQUITY GROWTH CAPITAL COUNCIL

October 28, 2013

Mr. Robert deV. Frierson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Mr. Robert Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

Legislative & Regulatory Activities
Division
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Regulations Division
Office of the General Counsel
Department of Housing and Urban
Development
451 7th Street, SW
Washington, DC 20410

**Re: Joint Proposed Rule on Credit Risk Retention OCC RIN 1557-AD40; FRB RIN 7100-AD70; FDIC RIN 3064-AD74; SEC RIN 3235-AK96; FHFA RIN 2590-AA43l HUD RIN 2501-AD53**

Dear Mr. deV. Frierson, Mr. Pollard, Mr. Feldman, Ms. Murphy and To Whom It May Concern:

Our organizations represent all sectors of the economy and speak on behalf of businesses that employ tens of millions of workers domestically and internationally. Our members need access to a variety of different forms of capital to provide the resources for operations, expansion and job creation. We support strong risk management practices and the appropriate level of controls needed to insure responsible and sustainable business lending. As such, we appreciate the opportunity to provide comment on the Joint Proposed Rule on Credit Risk Retention ("Proposed Rule") issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve (Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), the Federal Housing Finance Agency ("FHFA"), and the Department of Housing and Urban Development ("HUD") (also collectively known as "the Agencies").

While we agree that unreasonable risk-taking should be mitigated to the extent possible, we firmly believe that reasonable risk-taking is a necessary ingredient for the free enterprise system to work. We have serious concerns that the Proposed Rule will adversely restrict an important form of financing for businesses, Collateralized Loan Obligations ("CLOs"), which were not a cause of the 2007-2008 financial crisis. If the Proposed Rule were to be adopted, businesses would have fewer funding options, higher borrowing costs and reduced credit availability. Accordingly, we respectfully request that the risk retention rules exempt CLOs, or in the alternative that the rules be tailored in such a manner that CLOs will continue to be an efficient form of financing available to businesses.

As you know, section 941(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requires the Agencies to prescribe rules that require securitizers to retain an economic interest in a material portion of the credit risk of the underlying securitized assets. We support the goals of section 941(b) of improving the alignment of interests among borrowers, issuers, and investors within the securitization chain. Credit risk retention is one mechanism that could help align such interests, but it is a policy approach that comes with inherent costs. We would suggest that in the case of CLOs the costs of risk retention far outweigh the benefits.

Fully functioning credit markets are necessary for economic growth and job creation. We have specific concerns with certain aspects of the Proposed Rule and their potential impact on the American consumer, American businesses and the American economy. An appropriate resolution of these issues can assist in restoring credit flows to the market place and maintain the balance between effective regulation of the market place and appropriate risk taking.

Securitization has become a vital component of our system of finance over the past two decades and now provides a critical source of funding alongside more traditional balance sheet lending. It is important to note that not all securitized products are the same—there are different classes of underlying assets, different structures and contrasting credit risk profiles. Uniform application of the rules to different products would heighten the risk that the rules could adversely affect credit availability. Therefore, it is important that the Agencies adopt rules that are closely tailored to the characteristics, risks, and benefits associated with each asset class.

Simply put, a one size fits all approach will make it difficult for the Agencies to effectively regulate the marketplace, while hampering the ability of businesses and investors to appropriately use the right securitization products.

For all American businesses, access to capital and the ability to borrow at reasonable rates is critical to growth and success. CLOs are a vital funding mechanism and source of credit, especially for companies that cannot access the corporate bond market. According to a report conducted by the Federal Reserve, the FDIC, and the OCC, in 2010 there were approximately $250 billion in syndicated commercial loans made to U.S. companies through CLOs.[1] This constitutes 25% of all term loans outstanding in the United States. A broad swath of corporate America participates in this market, including companies from the health care, energy, retail, entertainment, and telecommunications sectors, to name just a few.

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[1] "Credit Quality of the Shared National Credit Portfolio Improved in 2010," *Shared National Credit Review* (Sept. 28, 2010), available at http://www.federalreserve.gov/newsevents/press/bcreg/20100928a.htm

CLOs are not originate-to-distribute securitizations and do not need risk retention rules. Furthermore, CLO managers are not sponsors of the transactions and should not be subject to risk retention rules. CLO managers already have "skin in the game" by virtue of a number of unique characteristics embedded within the CLO structure, including the fact that managers receive a majority of their fees only after investors get paid. Notwithstanding the aligned interests between managers and investors, the Proposed Rule requires that CLOs provide that the "sponsor" must retain 5% of the fair value of a new CLO. This would mean more onerous requirements for CLOs than for other asset classes, as the proposed "5% of fair value of the CLO" retention requirement exceeds the requirement applicable to other asset classes that the securitizer retain "not less than 5% of the credit risk of the assets." Under the Proposed Rule the CLO sponsor may not receive cash flows on the equity slice until the CLO notes begin to amortize and then only on a pro rata basis. This payment structure is inconsistent with how CLO cash flows work because the notes issued by the CLO do not amortize until the end of the reinvestment period, which may be years into the future. This restriction on cash flows would render the economics of such an arrangement unworkable.

Furthermore, the proposed alternative arranger option described in the Proposed Rule for CLOs is unworkable. The Proposed Rule requires that loan arrangers can satisfy risk retention via a "CLO-eligible" loan tranche. The loan arranger would have to retain 5% of the loan tranche purchased by CLOs for the life of the loan (or until default) which is contrary to prudent risk management principles. The loan arranger must take an initial allocation of at least 20% of the entire credit facility. The Proposed Rule would therefore require loan arrangers to hold significantly increased amounts of loans on their books, which would require those banks to have increase regulatory capital requirements and would impair their ability to engage in prudential risk management.

The CLO market performed largely as expected during the financial crisis. Unlike structured products based on subprime mortgages, many of which experienced considerable losses in recent years, investment grade CLO tranches experienced very few aggregate losses.[2] In the past 16 years combined, CLOs have experienced a cumulative *impairment* rate of approximately 1.5%, and the actual *loss* rate was even lower, which is well in line with investor expectations. The Fed acknowledged a low default rate for CLO collateral in its Report to Congress on Risk Retention in October 2010, citing the aligned incentive mechanisms inherent in CLO structures.[3] This fact should be considered as the Agencies work to finalize the Proposed Rule.

Businesses that rely upon the CLO market are essential components of the American economy. The CLO market enables these companies to create and preserve millions of American jobs. This is an obvious source of capital that simply cannot be impaired. Given the critical role that CLOs play as a source of funding for American businesses, it is essential that the Agencies modify the Proposed Rule so that CLOs are not subject to overly broad credit retention requirements.

While we believe CLOs should be exempt, if the Agencies do not exempt CLOs then the Agencies should tailor the proposed rule in such a manner to allow CLOs to continue to be an efficient form of capital formation for businesses.

In conclusion, we urge the Agencies to strike the appropriate balance between enhancing regulatory oversight and ensuring vibrant and liquid credit markets where borrowers can access loans at affordable rates. As currently drafted, the proposed rules would have adverse consequences upon the CLO market and the businesses that use CLOs to access almost $300 billion in capital. By constraining the ability of businesses to access the financing provided by CLOs, borrowing costs will increase, risk will be transferred to less stable financing vehicles and economic growth and job creation will suffer.

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[2] In fact, most CLO debt downgraded during the crisis has been subsequently upgraded with most originally rated AAA tranches still rated at least Aa- or better, even under new stronger requirements from the Agencies. CLO mezzanine debt, originally rated below investment grade, will not take any losses and CLO equity outperformed original pre-crisis expectations.

[3] *See* Board of Governors of the Federal Reserve, Report to Congress on Risk Retention, October 2010.

Accordingly, we respectfully request that these concerns be taken into account and that the Agencies exempt CLOs from the risk retention rules, or construct the rules so that businesses will be able to use CLOs as an appropriate financing mechanism to grow and create jobs. A failure to do so will create harmful and long-term unintended adverse impacts to our businesses, capital markets and economy.

Sincerely,

David Hirschmann
President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

Steve Judge
President and CEO
Private Equity Growth Capital
Council