October 30, 2013

By Electronic Submission

Office of the Comptroller of the Currency
250 E Street, S.W.
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Washington, D.C. 20219

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Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
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Washington, D.C. 20549-1090

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500

Re: **Notice of Proposed Rulemaking, Credit Risk Retention**
SEC (Release No. 34-64148; File No. S7-14-11); FDIC (RIN 3064-AD74); OCC (Docket No. OCC-2011-0002); FRB (Docket No. 2011-1411); FHFA (RIN 2590-AA43); HUD (RIN 2501-AD53)

Ladies and Gentlemen:

Eaton Vance Corp. (NYSE: EV), based in Boston, is one of the oldest investment management firms in the United States, with a history dating back to 1924. Eaton Vance and its affiliates managed $273.1 billion in assets as of September 30, 2013, offering individuals and institutions a broad array of investment strategies and wealth management solutions. Eaton Vance Corp. conducts its investment management activities primarily through two subsidiaries, Eaton Vance Management and Boston Management and Research (collectively referred to herein as Eaton Vance), which provide investment advisory and/or administration services to various Eaton Vance clients including registered investment companies, privately offered funds and CLOs. Eaton Vance employs over 30 personnel in its bank loan department, including 5 portfolio managers, 2 traders and 13 research analysts. Eaton Vance has been managing registered investment companies that invest primarily in bank loans continuously since 1998 and CLOs since 2000. Eaton Vance currently manages approximately $42.2 billion in loan assets on behalf of clients.

Eaton Vance is pleased to submit these comments in response to the joint Further Notice of Proposed Rulemaking, 78 Fed. Reg. 57928 (Sept. 20, 2013; originally released Aug. 28, 2013) ("FNPRM"), concerning risk retention and the implementation of Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

I. Overview.

Eaton Vance is a sophisticated investor and invests in various securities on behalf of clients, including securities issued by CLOs. We submit these comments to address how the agencies' proposed regulations would adversely affect investors by severely curtailing the formation of CLOs, how features of CLOs already protect investors through extensive and adequate incentives that align CLO managers' interests with those of CLO investors, and how, if regulation is deemed necessary, other alternatives would protect investors without causing extensive harm to CLOs, credit markets, and competition.

In particular, Eaton Vance is concerned that the regulations proposed by the agencies would significantly and adversely affect the formation and continued operation of CLOs, together with the scope of investment opportunities they offer to investors. Open Market CLOs present none of the risks to investors presented by the originate-to-distribute model that Section 941 was designed to address, and a range of incentives ensure that their managers act consistently with investors' interests. CLO performance during the recent financial crisis confirms the robustness of these incentives and investor protections, as does the subsequent resurgence of the CLO market that demonstrates investors' confidence that their interests are fully protected. For these reasons, additional regulation requiring CLO managers to retain more credit risk would produce no benefits and would substantially harm competition and the public. This result would be especially unfortunate because various alternatives are available to the agencies that would better advance the public interest.

II. Our Experience with CLO Securities and the Investor Protections Afforded by Open Market CLOs.

As noted above, Eaton Vance and affiliates manage over $270 billion in assets, including over $42.2 billion in in loan assets on behalf of clients. Unlike many of our competitors in the loan market, CLOs represent approximately $2 billion of the $42.2 billion assets under management and are therefore not the driver of our bank loan investment platform. However, we have acted as both a manager of CLO funds (9 CLO mandates) as well as an investor in the various debt tranches of other CLOs (over 40 individual investments ranging from Single-A to double-B credit quality). We look at the CLO product as an important part of the overall leveraged loan market as well as an attractive product for potential investment by many of our institutional clients.

While CLOs did experience some severe market-price volatility during the 2008 financial crisis like many other securitized products, actual credit losses in CLOs that Eaton Vance managed or invested in on behalf of clients were minimal and generally within modeled expectations for the product/client portfolio. Equity returns on CLOs we managed during the last credit cycle have exceeded initial investor expectations while debt investors have remained well covered by collateral quality and asset coverage metrics. CLOs in which we have invested have also proven to withstand credit stress and remain as performing assets across a number of our portfolios. Based on our experiences as an active participant in the CLO market over two credit cycles, we believe that the CLO structure provides a viable investment option for institutional and/or accredited individual investors. Furthermore, we believe that the CLO structure provides a viable source of global capital to U.S. companies that employ U.S. citizens.

Eaton Vance's market role and experience provides us with a clear understanding of the current CLO market, CLOs' performance during and since the recent financial crisis, and the likely adverse effects of the proposed regulations.

III. The Proposed Rules Would Adversely Affect Us, Other CLO Investors, Investors in Related Products, and Open Market CLO Managers.

Our experience as an investor in the CLO market leaves us with no doubt that the proposed rules would significantly and adversely affect the formation and scope of future CLOs, and thus would severely curtail CLOs' offerings to investors.

The requirement that Open Market CLO managers retain five percent of the face value of the CLO's assets – in addition to the significant credit risks already assumed through the CLO managers' compensation structure – would drastically reduce CLO formation. Many CLO managers are too small to secure or devote funds of that magnitude for positions that cannot be disposed or hedged – no matter what the competing business opportunities or demands. For other CLO managers that might have the financial capacity to hold such a significant position, doing so would require a restructuring of current business models and anticipated returns – making a once viable business much less profitable, requiring that managers instead devote those funds to other, more productive uses.

Our market assessment is that the proposed rules would cause a dramatic decrease in the size and functioning of the CLO market as a whole. We participated in a survey of CLO managers the results of which indicated that the decrease in CLO offerings is anticipated to be in the order of 75 percent.[1] We generally agree with that assessment, and are concerned that it may well be too optimistic. We are also aware of the broad range of comments and record evidence that establish that the proposed rules would adversely affect the formation and continued operation of the CLO market.[2] As a general matter, we agree with the factors identified in those

[1] *See* LSTA Letter Comment, July 29, 2013 at 3–6.

[2] *See* LSTA Letter Comment, Aug. 1, 2011 at 14–17; LSTA Letter Comment, Apr. 1, 2013 at 14–16; LSTA Letter Comment, July 29, 2013 at 3–9; SIFMA Letter Comment, June 10, 2011 at 70; American Securitization Forum Letter Comment, June 10, 2011 at 137; JP Morgan Chase & Co. Letter Comment, July 14, 2011 at 50; Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 32; Bank of America, Letter Comment, Aug. 1, 2011 at 29-30; Wells Fargo Letter Comment, July 28, 2011 at 29; White & Case Letter Comment, June 10, 2011 at 2.

comments and assess that those factors will contribute to the magnitude of the decrease in CLO formation identified in the LSTA survey. Indeed, the agencies themselves anticipate these adverse effects on CLOs and competition.[3]

Our experience also indicates that this resulting decrease in the formation and scope of CLOs would have negative implications for our clients that invest in CLOs, other CLO investors, and investors in products that compete with CLO securities. CLO offerings are an important part of the market that benefits investors. CLO securities are an attractive, transparent mechanism for securing yield and exposure to an important credit sector. They permit that exposure while providing a range of protections, modes of investment, and related services to investors. CLOs also compete with other, similar investment offerings, putting downward pressure on those competitors' margins and prices – while increasing the range of investor protections and service features that competitors must offer.

CLOs are long-only investment vehicles that provide real financing to predominantly U.S. companies. Just as the traditional mortgage securitization (and not the aggressive sub-prime derivations) reduced borrowing costs for the average homeowner, the CLO structure has reduced the cost of capital for many U.S. corporations. In a time of relatively stagnant economic growth, any actions that would restrict capital or increase the cost of capital substantially could have harmful effects on the still-fragile U.S. recovery.

IV. Additional Regulation of Open Market CLOs Is Inappropriate and Unnecessary.

A. Commercial and Regulatory Factors Already Align the Interests of Open Market CLO Managers and CLO Investors.

The proposed credit risk retention rules fail to account for the significant factors that already ensure that Open Market CLO managers select and manage CLO assets prudently and in investors' interests. Open Market CLOs do not employ the "originate-to-distribute" model of securitization that contributed to the financial crisis and prompted Congress to enact Section 941. The nature of Open Market CLOs, and their role in the loan market and in the provision of securities to investors, ensures that they operate independently and that managers' interests are aligned with CLO investors' interests. This alignment of interests, and related lack of any need for risk retention regulation to further align those interests, arises from the following characteristics of Open Market CLOs.

First, Open Market CLO managers act independently of loan originators and exercise independent judgment in selecting among loans originated by unaffiliated entities. They are free from potential conflicts and disincentives related to the originate-to-distribute model and attract investors based in large measure on this independence and the resulting quality of asset selection. This provides a strong incentive for continued selection of higher-quality assets.

[3] *See* 78 Fed. Reg. 57962.

Second, CLO managers bear significant risk through their deferred, contingent compensation structure that has been shaped and ratified by the market. CLO managers receive their primary sources of compensation only if they deliver for their investors: they are compensated principally as the most subordinated CLO investors secure their returns, and a large component of their compensation is received only after the CLO has performed well over most of its life for all classes of investors, including those whose securities are most at risk. CLO managers' compensation structure places a premium on careful selection and management of assets, aligning their interests with investors' interests. Indeed, investors and the competitive process have shaped and ratified the compensation structure. In this fundamental sense, CLO managers already have skin in the game – and creating that interest, which already exists for CLOs, is the entire point of the proposed regulations. The agencies have recognized and acknowledged this alignment of investor and manager interests created by the compensation structure.[4]

Third, almost all Open Market CLO managers (including Eaton Vance) are registered investment advisors, with associated fiduciary duties – and potential liabilities – to their investors. This status triggers a separate and quite effective regulatory and supervisory regime that also provides incentives for careful selection and management of assets.

Fourth, the assets selected by Open Market CLO managers have been evaluated through multiple layers of underwriting and market decisions. These include the loan arrangers' decisions in underwriting the loans, the market's evaluation in pricing and syndicating the loans, and the CLO manager's decisions in selecting the loans for the CLO to purchase. Often, the assessments reflected in secondary market pricing also contribute to the selection of high-quality assets.

Fifth, CLO managers actively manage their loan portfolios for much of the life of a CLO. This active role is unlike that for many other ABSs, and further protects investors. CLO managers can limit losses and secure additional gains based on the additional performance information provided for the particular loans and by the secondary market. In this management role, the CLO manager exercises independent judgment and has every incentive to act only in the best interest of CLO investors.

Finally, CLO managers select – and CLO investors demand – commercial loans with features that protect investors. Prominently, CLO managers select senior secured loans. This often ensures complete or substantial recovery and loss protection even in the event of default, and is an important reason why CLOs protected investors so well during the recent financial crisis.

B. CLO Performance Confirms the Adequacy of Existing Incentives and Investor Protections.

The historically strong performance of CLOs demonstrates the concrete and practical results of these unique features of CLOs. Despite the massive financial crisis that resulted in

[4] *See* 78 Fed. Reg. 57963.

widespread losses among other asset classes, CLOs performed well. Although CLOs experienced ratings downgrades, the vast majority of CLO notes that were originally rated AAA retained ratings of AA or higher during the crisis.[5] And most significantly, CLOs experienced *de minimis* events of default and even lower rates of financial loss.[6] The Board of Governors of the Federal Reserve has acknowledged the low default rate among CLOs during the financial crisis, which it attributed in part to the incentive alignment mechanisms inherent to CLOs.[7]

We are aware of numerous comments submitted in this rulemaking that confirm the strong performance of CLOs during the financial crisis.[8] Our experience as direct participants in the industry accords with these views. We believe that this record of performance demonstrates that the existing safeguards and incentive alignments in the CLO industry more than adequately meet the goals of Section 941.

In particular, the ongoing investor demand for CLO securities reflects a market judgment, by the most informed and interested parties, that Open Market CLOs are structured in a manner that protects and advances investor interests while offering a valuable investment opportunity. CLOs were one of the first types of ABS to experience revived demand following the 2008 financial crisis, and demand for CLOs has been quite strong during the past few years. Based on our actual investment experience in the CLO market, we believe that CLOs issued prior to the financial crisis ("1.0 CLOs") were designed with sufficient structural features to protect all investors. In addition to the broader market statistics referenced above, the fact that all 1.0 CLOs in which we invested and most 1.0 CLOs that we have followed have performed as initially designed strengthens our positive view of CLOs. Post-crisis CLO issuance ("2.0 CLOs") have been further structural enhancements (e.g. greater debt subordination, higher credit quality requirements, reduction in non-loan assets, etc.) that we believe should make all debt tranches able to withstand even greater credit stress while maintaining credit quality. Thus, we intend to continue to invest in this market on behalf of our clients. This resurgence in investment indicates that the investor community has examined CLO performance during an extremely stressful financial period and has concluded that CLOs offered, and continue to offer, robust protections for investor interests. Lastly, Eaton Vance currently manages one 2.0 CLO and intends to pursue active management of future CLO transactions, which further demonstrates our belief in the stability of the CLO structure.

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[5] *See* LSTA Letter Comment, August 1, 2011 at 7.

[6] *Id*.

[7] *See* Board of Governors of the Federal Reserve, Report to Congress on Risk Retention 62, Oct. 2010.

[8] *See* LSTA Letter Comment, Aug. 1, 2011 at 7; LSTA Letter Comment, April 1, 2013 at 19; LSTA Letter Comment, July 29, 2013 at 2 and Appendix A; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 90-93; American Securitization Forum Letter Comment, June 10, 2011 at 134-135; SIFMA Letter Comment, June 10, 2011 at 69; Morgan Stanley Letter Comment, July 27, 2011 at 18; Bank of America Letter Comment, Aug. 1, 2011 at 23; Wells Fargo Letter Comment, July 28, 2011 at 29; The Center for Capital Markets Competitiveness of the United States Chamber of Commerce Letter Comment, Aug. 1, 2011 at 4; Cong. Himes and other Members of Congress Letter Comment, July 29, 2011 at 2.

C. In Light of These Incentives and Performance History, Additional Regulation Would Provide No Public Interest Benefits.

Because existing commercial and regulatory incentives align the interests of CLO managers and CLO investors, additional risk retention requirements would not redress any market failure or further align those interests. Because Open Market CLO managers select assets independently of loan originators, and do not operate as part of an "originate-to-distribute" model, the operations of Open Market CLOs present none of the risks to investors that Section 941 was designed to address. As set out above, the recent performance of CLOs and investor demand for CLO securities confirms that no additional risk retention requirements are needed.

We agree with other commenters that have analyzed the language and purpose of Section 941 and have shown that Congress did not intend to impose risk retention requirements on Open Market CLO managers.[9] Presumably, Congress did not intend to do so precisely because Open Market CLOs present none of the problems Section 941 was designed to fix. Because Open Market CLO managers facilitate the CLOs' purchase of assets, they do not directly or indirectly sell or transfer assets to the CLO – and are thus not within the scope of the statutory definition of "sponsor" as the agencies incorrectly assert.[10]

We also agree with commenters that, in light of the high costs and absence of benefits arising from imposing credit risk retention requirements on Open Market CLO managers, the agencies should exercise their statutory powers to exempt those managers from the credit risk retention requirements – assuming that those requirements even apply.[11] If the agencies believe that certain types of CLOs pose a risk to investors, or that further restrictions on which CLO managers can qualify for an exemption are appropriate, a commercially sensible set of "ring-fencing" qualifications has been proposed in the comments.[12]

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[9] *See, e.g.*, LSTA Letter Comment, Aug. 1, 2011 at 7–14; LSTA Letter Comment, Apr. 1, 2013 at 17–19; LSTA Letter Comment, July 29, 2013 at 9–10; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 93–95; SIFMA Letter Comment, June 10, 2011 at 68–69; American Securitization Forum, June 10, 2011 at 135–136; JP Morgan Chase & Co. Letter Comment, July 14, 2011 at 53–60; The Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 31–32; Morgan Stanley Letter Comment, July 27, 2011 at 21; Bank of America Letter Comment, Aug. 1, 2011 at 23–30; Wells Fargo Letter Comment, July 28, 2011 at 26–29; White & Case Letter Comment, June 20, 2011 at 1–7; Cong. Himes and other Members of Congress Letter Comment, July 29, 2011 at 1–2.

[10] *Compare* 78 Fed. Reg. 57962.

[11] *See, e.g.*, LSTA Letter Comment, Aug. 1, 2011 at 17–19; LSTA Letter Comment, Mar. 9, 2012; LSTA Letter Comment, Apr. 1, 2013 at 23; American Bar Association Business Law Section Letter Comment, July 20, 2011 at 93–95; SIFMA Letter Comment, June 10, 2011 at 71–72; American Securitization Forum, June 10, 2011 at 138–139; The Financial Services Roundtable Letter Comment, Aug. 1, 2011 at 33; Bank of America Letter Comment, Aug. 1, 2011 at 30; Wells Fargo Letter Comment, July 28, 2011 at 29; Loan Market Association Letter Comment, Aug. 1, 2011 at 2.

[12] *See* LSTA Letter Comment, Mar. 9, 2012 at Appendix A.

Eaton Vance appreciates the agencies' consideration of these comments and would be pleased to provide additional information or assessments that might assist the agencies' decision-making. Please feel free to contact Michael Kinahan in the event you have questions regarding these observations and conclusions.

Sincerely,

/s/ Scott H. Page
Scott H. Page
Vice President and
Director of Bank Loans