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July 27, 2011

**Submitted via E-mail: [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)**

Office of the Comptroller of the Currency  
250 E Street, SW., Mail Stop 2-3  
Washington, DC 20219  
Docket Number OCC-2011-0002

**Submitted via E-mail: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)**

Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551  
Attn: Jennifer J. Johnson, Secretary  
Docket No. R-1411

**Submitted via E-mail: [Comments@FDIC.gov](mailto:Comments@FDIC.gov)**

Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429  
Attn.: Comments, Richard E. Feldman,  
Docket No. R-1411

**Submitted via E-mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)**

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
Attn.: Elizabeth M. Murphy, Secretary  
File Number S7-14-11

**Re: Credit Risk Retention**

Ladies and Gentlemen:

This letter responds to the request for comments made by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the

Federal Reserve System, and the Securities and Exchange Commission (collectively, the “Agencies”) in their joint notice of proposed rulemaking (the “Proposal”) entitled *Credit Risk Retention implementing Section 941(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, codified as Section 15G of the Securities Exchange Act of 1934.

While others have commented and are expected to comment on the anticipated effects the Proposal would have on the broader United States economy if adopted as proposed, we write to highlight a potential source of confusion concerning application of the rules to sponsors of collateralized loan obligation transactions (“CLOs”).

O’Melveny & Myers LLP is a global law firm that represents a range of financial institutions and other clients, including some who manage, invest in, or sponsor CLOs. We have represented participants in such vehicles for more than 20 years. The views expressed in this letter are our own and do not necessarily reflect the views of our clients.

#### Background

A CLO is a device through which senior secured corporate loans and other similar corporate debt instruments are acquired and carried. A CLO falls within the definition of asset-backed security (“ABS”), as such term is defined under the Proposal. The Proposal generally requires sponsors of ABS to retain not less than 5% of the credit risk of any asset that the sponsor transfers, sells, or conveys to a third party through the issuance of an ABS. The Proposal offers sponsors several options for satisfying this requirement, including by retaining an “eligible horizontal residual interest” in a CLO in an amount equal to at least 5% of the par value of all of the CLO’s notes. For example, if a CLO were to issue senior notes in an aggregate principal amount of \$200 million, mezzanine notes in an aggregate principal amount of \$80 million, and subordinated notes in an aggregate principal amount of \$20 million, the CLO sponsor could satisfy its risk retention obligation by holding \$15 million of the \$20 million of subordinated notes issued by the CLO.

The Proposal defines the term “sponsor” generally to include “a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity,” and provides that where there are multiple sponsors, only one of them is required to satisfy the risk retention obligation. Under the Proposal, the risk must be retained by one of the sponsors or an affiliate whose financial statements are consolidated with those of the sponsor. Footnote 42 of the Proposal goes on to state that in CLOs, “the CLO manager generally acts as the sponsor by selecting the commercial loans to be purchased by an agent bank for inclusion in the CLO collateral pool.”

We understand the purpose of footnote 42 of the Proposal to be to provide a non-exclusive example of one participant in a CLO that may satisfy the definition of “sponsor” for purposes of the risk retention requirement. The wording of the footnote could, however, lead to confusion if interpreted to preclude the possibility of any other participant in the CLO that satisfies the definition of “sponsor” from satisfying the risk retention requirement. In particular, for transactions in which the CLO manager does not transfer any assets to the CLO, interpreting

footnote 42 to preclude other CLO participants, including the CLO initiator that *does* transfer assets to the CLO, from being deemed a “sponsor” could frustrate the intent of the proposed rule.

Examples from the marketplace may be constructive in illustrating the concern. Commercial banks have commonly, with the assistance of an investment bank, transferred pools of loans from their balance sheets to a CLO and had the CLO engage a third-party manager to perform basic reinvestment activities with respect to the securitized assets in accordance with pre-agreed upon parameters and procedures. Moreover, in some of these “balance sheet” transactions, the CLO acquires a static pool of loans from the sponsoring commercial bank and no reinvestment is permitted, leaving the CLO manager with only a perfunctory role involving basic monitoring and compliance activities for the CLO assets. In all of these transactions, the commercial banks initiating the CLOs would better satisfy the requirements of a “sponsor” under the Proposal than would the CLO managers, which act in these CLOs as mere service providers.

Still other CLOs are initiated by well-capitalized entities that are not banks. These entities may not themselves be investment advisers but rather have external advisers that also serve as managers of the CLOs initiated by the entities. Many externally managed business development companies (“BDCs”) use CLOs to fund the financing of small to midsize U.S. enterprises. While each of these CLOs is organized and initiated by a BDC, it is the BDC’s external manager (or its affiliate) that acts as the CLO collateral manager, not the BDC. Similarly, NYSE-listed KKR Financial Holdings LLC (“KFN”) is an externally managed specialty finance company that sponsors CLOs by seeding them through transfers of some assets from its own balance sheet. KFN’s CLOs are managed by a wholly-owned subsidiary of KFN’s external SEC-registered investment adviser. KFN, the transferor of assets to each of its CLOs, has historically acquired and retained most of the notes of the lowest tranches issued by each CLO that have a value well in excess of 5% of the par value of the notes issued by the CLO. Sponsorship of the CLOs is consistent with many BDCs’ and KFN’s strategies of assisting in financing corporate borrowers. It is such BDCs and KFN, and not the CLO managers, who best satisfy the definition of “sponsor” under the Proposal.

Misconstruing the concept in footnote 42 to preclude CLO participants other than the CLO manager from being deemed a sponsor capable of satisfying the 5% risk retention requirement could suggest a need for some well-capitalized CLO initiators that have external advisers to restructure their internal operations to comply with the requirement, rather than meet the requirement by having the CLO initiator and transferor of assets retain the requisite credit risk-- a solution that would otherwise be consistent with the express wording of and policy behind the Proposal. Indeed, the stated purpose of the Proposal is to “ensure the quality of the assets underlying a securitization transaction, and thereby [to help] align the interests of the securitizer with the interests of investors.”<sup>1</sup> As the definition of “sponsor” included in the Proposal suggests, the transferor of the assets is in the best position to assess the credit quality of the assets.

<sup>1</sup> See p. 14 of the Proposal.

Recommended Clarification

To alleviate any potential confusion about the non-exclusive nature of the example provided in footnote 42 of the Proposal, the concept could be rephrased along the following lines:

“For example, in the context of collateralized loan obligations (CLOs), the sponsor, which may include the CLO manager or another participant, generally is a person who organizes and initiates the CLO transaction by selling or transferring, either directly or indirectly, including through an affiliate, commercial loans to the CLO issuer.”

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Thank you very much for your consideration of the clarification proposed in this letter. If you have any questions or wish to discuss further any of the matters described herein, please contact Deborah M. Festa directly, at (213) 430-6323 or by e-mail at [dfesta@omm.com](mailto:dfesta@omm.com).

Respectfully Submitted,

*O'Melveny & Myers LLP*