



Federal Deposit Insurance Corporation

3501 Fairfax Drive, Arlington, VA 22226-3500

Legal Division

December 2, 2011

TO: Executive Secretary

FROM: Phillip E. Sloan, Counsel
Legal Division

SUBJECT: Meeting with The Loan Syndications and Trading Association (“LSTA”) and
Crescent Capital Group

Please include this memorandum in the public file on the Notice of Proposed Rulemaking relating to Credit Risk Retention (RIN 3064-AD74), 76 Fed. Reg. 24090 (the “NPR”).

On November 21, 2011 FDIC staff (George Alexander, Kathy Russo and Phil Sloan) met in person with representatives of the LSTA (Meredith Coffey and Elliot Ganz) and Thomas Vartanian and Cynthia Williams of Dechert LLP, counsel to LSTA. Bram Smith and Tess Felfe of LSTA and Matthew Miller of Crescent Capital Group joined the meeting by teleconference.

The discussion addressed the proposal by the LSTA to exempt open market collateralized loan obligation transactions from the risk retention requirements set forth in the NPR.

In addition to distributing its August 1, 2011 comment letter on the NPR, which is available on the FDIC’s website, the LSTA distributed the attached document containing draft regulation text.

Insert a new § ____.23 and redesignate proposed § ____.23 as § ____.24:

§ ____.23 *Exemption for Certain Open Market Collateralized Loan Obligations.*

(a) *General.* The risk retention requirements in subpart B of this part shall not apply to a CLO, its manager, its investors or any other person or entity involved in such CLO so long as such CLO operates in accordance with the provisions of paragraph (c) of this section.

(b) *Definitions.* The following definitions apply for purposes of this section.

(1) *balance sheet CLO* means a CLO whose assets consist predominantly of loans originated and transferred to the CLO by one or more of its affiliates other than in (i) open market transactions or (ii) in transactions permitted in paragraph (c)(3)(ii) or (iii) of this section, and the assets and liabilities of such CLO are, immediately after issuance of its ABS interests¹ in a securitization transaction, included under generally accepted accounting principles in the consolidated balance sheet of one or more of its affiliates.

(2) *CLO* means a special purpose entity that (i) issues debt and equity interests and (ii) whose assets consist predominantly of loans and temporary investments.

(3) *commercial borrower* means an obligor under a corporate credit obligation (including a loan).

(4) *corporate credit obligation* means an obligation of a borrower (i) organized as a corporation, partnership, limited liability company, statutory trust or similar entity, (ii) that is engaged in one or more business activities and (iii) is not an ABS interest.

¹ The term “ABS interest” is defined in proposed § ____.2 as follows:

ABS interest:

(1) Includes any type of interest or obligation issued by an issuing entity, whether or not in certificated form, including a security, obligation, beneficial interest or residual interest, payments on which are primarily dependent on the cash flows of the collateral owned or held by the issuing entity; and

(2) Does not include common or preferred stock, limited liability interests, partnership interests, trust certificates, or similar interests that:

(i) Are issued primarily to evidence ownership of the issuing entity; and

(ii) The payments, if any, on which are not primarily dependent on the cash flows of the collateral held by the issuing entity.

(5) *government obligations* means direct obligations of, and obligations fully guaranteed as to full and timely payment by, the United States (or by any agency thereof to the extent such obligations are backed by the full faith and credit of the United States).

(6) *hedge transactions* means interest rate swaps, currency swaps, timing swaps, basis swaps, caps, floors and collars and similar transactions for the purpose of hedging related exposures and not for the purpose of obtaining exposure to a corporate credit obligation .

(7) *highest required investment category* means, with respect to ratings assigned by any nationally recognized statistical rating organization, (i) for long-term instruments, the highest rating then assigned thereby to the long-term debt of the United States of America or (ii) for short-term instruments, the highest short-term rating then assigned thereby to the short-term debt of the United States of America.

(8) *initial loan syndication transaction* means a transaction in which a loan is syndicated to a group of lenders.

(9) *loan* means any obligation of a commercial borrower for the payment or repayment of borrowed money (including, without limitation, loans and deposits and reimbursement obligations arising from drawings pursuant to letters of credit and other similar instruments) that is documented by a term loan agreement, revolving loan agreement or other similar credit agreement.

(10) *manager* means an entity that manages a CLO, which entity is registered as an investment adviser under the Investment Advisers Act of 1940, as amended, or is an affiliate of such a registered investment adviser and itself is managed by such registered investment adviser.

(11) *open market CLO* means a CLO (i) whose assets consist predominantly of senior, secured syndicated loans acquired by such CLO directly from the sellers thereof in open market transactions or as otherwise permitted in paragraph (c)(3)(ii) or (iii) of this section and of temporary investments, (ii) that is managed by a manager, and (iii) that is not a balance sheet CLO. An open market CLO may obtain credit from a third party to finance the acquisition of its assets in open market transactions or as otherwise permitted in paragraph (c)(3)(ii) or (iii) of this section prior to the issuance of its ABS interests in a securitization transaction.

(12) *open market transaction* means (i) either an initial loan syndication transaction or a secondary market transaction in which a seller offers senior, secured syndicated loans to prospective purchasers in the loan market on market terms on an arm's length basis, which prospective purchasers include, but are not limited to, entities that are not affiliated with the seller, or (ii) a reverse inquiry from a prospective purchaser of a senior, secured syndicated loan through a dealer in the loan market to purchase a senior, secured syndicated loan to be sourced by the dealer in the loan market.

(13) *person* means any individual, corporation, estate, partnership, business or statutory trust, limited liability company, sole proprietorship, joint venture, association, joint stock company, trust (including any beneficiary thereof), unincorporated organization or government or any agency or political subdivision thereof or other entity.

(14) *secondary market transaction* means a purchase of a senior, secured syndicated loan not in connection with an initial loan syndication transaction but in the secondary market.

(15) *senior, secured syndicated loan* means a loan made to a commercial borrower that:

- (i) is not subordinate in right of payment to any other obligation for borrowed money of the commercial borrower,
- (ii) is secured by a valid first priority security interest or lien in or on specified collateral securing the commercial borrower's obligations under the loan, and
- (iii) the value of the collateral subject to such first priority security interest or lien, together with other attributes of the obligor (including, without limitation, its general financial condition, ability to generate cash flow available for debt service and other demands for that cash flow), is adequate (in the commercially reasonable judgment of the manager exercised at the time of investment) to repay the loan in accordance with its terms and to repay all other indebtedness of equal seniority secured by such first priority security interest or lien in or on the same collateral.

(16) *temporary investments* means investments held by an open market CLO prior to investing or reinvesting in senior, secured syndicated loans and other corporate credit obligations and/or making payments it owes on its debt and equity interests which may be in the form of:

- (i) United States dollars;
- (ii) direct obligations of, and obligations fully guaranteed as to full and timely payment by, the United States (or by any agency thereof to the extent such obligations are backed by the full faith and credit of the United States);
- (iii) demand deposits, time deposits or certificates of deposit of depository institutions or trust companies incorporated under the laws of the United States or any state thereof and subject to supervision and examination by federal or state banking or depository institution authorities; *provided* that at the time of the CLO's investment or contractual commitment to invest therein, the

commercial paper, if any, and short-term unsecured debt obligations (other than such obligation whose rating is based on the credit of a person other than such institution or trust company) of such depository institution or trust company shall have a credit rating in the highest required investment category;

(iv) corporate, non-extendable commercial paper having, at the time of the CLO's investment or contractual commitment to invest therein, a rating in the highest required investment category;

(v) demand deposits, time deposits or certificates of deposit that are fully insured by the FDIC and either have a rating on their certificates of deposit or short-term deposits in the highest required investment category;

(vi) notes that are payable on demand or bankers' acceptances issued by any depository institution or trust company referred to in paragraph (b)(14)(iii) of this section;

(vii) investments in money market funds or other regulated investment companies having, at the time of the CLO's investment or contractual commitment to invest therein, a rating of the highest required investment category;

(viii) time deposits (having maturities of not more than 90 days) by an entity the commercial paper of which has, at the time of the CLO's investment or contractual commitment to invest therein, a rating of the highest required investment category;

(ix) repurchase obligations with respect to any security that is a direct obligation of, or fully guaranteed by, the United States or any agency or instrumentality thereof the obligations of which are backed by the full faith and credit of the United States, in either case entered into with a depository institution or trust company (acting as principal) described in paragraph (b)(16)(iii) of this section with a rating of the highest required investment category; or

(x) other investments with a maturity one year or less with a rating of the highest required investment category.

(17) *workout interests* means equity interests and corporate credit obligations obtained as a result of a workout, restructuring, bankruptcy, or similar transaction or proceeding in connection with an asset held by an open market CLO.

(c) *Requirements for an Exempt Open Market CLO.*

(1) *In general.* In order to qualify for the exemption in paragraph (a) of this section, a CLO must be an open market CLO that operates in accordance with the provisions of this paragraph (c).

(2) *Investment limitations.*

(i) An open market CLO's assets shall be comprised solely of senior, secured syndicated loans, other corporate credit obligations, temporary investments, government obligations used to credit enhance ABS interests issued by an open market CLO, hedge transactions and workout interests.

(ii) An open market CLO shall operate in accordance with transaction documents that require it to hold at least 90 percent of the aggregate outstanding principal amount of its assets in senior, secured syndicated loans and temporary investments (all such assets to be valued at par, and excluding from such calculation government obligations used to credit enhance ABS interests issued by an open market CLO, hedge transactions and workout interests); provided, that if at any time it is not in compliance with this requirement, an open market CLO may not purchase any assets other than senior, secured syndicated loans, temporary investments, government obligations used to credit enhance ABS interests issued by an open market CLO and hedge transactions.

(iii) An open market CLO may not invest in ABS interests or in derivatives, provided that this shall not prohibit an open market CLO from acquiring loan participations or any interest in or relating to a letter of credit or entering into hedge transactions.

(3) *Requirements for purchases.* Purchases of senior, secured syndicated loans by an open market CLO may only be made (i) in open market transactions, (ii) from an open market CLO that operates in accordance with the provisions of paragraph (c) of this section, or (iii) from a CLO in existence as of the effective date of this section that is not a balance sheet CLO.

(4) *Compensation of Open Market CLO Managers.* The compensation of the manager of an open market CLO must satisfy the following requirements:

(i) The manager may not receive any management fee or gain on sale from an open market CLO at the time of the issuance of its ABS interests in a securitization transaction; and

(ii) The manager's compensation must be tied to the performance of an open market CLO so that at least 60 percent of the manager's potential compensation is subordinated in right of payment to the timely payment of interest accrued and owing on secured debt instruments issued by an open market CLO.