

§ 230.192 Conflicts of interest relating to certain securitizations.

(a) *Unlawful activity.*

(1) *Prohibition.* A securitization participant shall not, for a period commencing on the date on which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an asset-backed security and ending on the date that is one year after the date of the first closing of the sale of such asset-backed security, directly or indirectly engage in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such asset-backed security.

(2) *Material conflict of interest.* For purposes of this section, engaging in any transaction would involve or result in a material conflict of interest between a securitization participant for an asset-backed security and an investor in such asset-backed security if such a transaction is a conflicted transaction.

(3) *Conflicted transaction.* For purposes of this section, a conflicted transaction means any of the following transactions with respect to which there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the asset-backed security:

- (i) A short sale of the relevant asset-backed security;
- (ii) The purchase of a credit default swap or other credit derivative pursuant to which the securitization participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant asset-backed security; or
- (iii) The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction through which the securitization participant would benefit from the actual, anticipated or potential:
 - (A) Adverse performance of the asset pool supporting or referenced by the relevant asset-backed security;
 - (B) Loss of principal, monetary default, or early amortization event on the relevant asset-backed security; or
 - (C) Decline in the market value of the relevant asset-backed security.

(b) *Excepted activity.* The following activities are not prohibited by paragraph (a) of this section:

- (1) *Risk-mitigating hedging activities.*

- (i) *Permitted risk-mitigating hedging activities.* Risk-mitigating hedging activities of a securitization participant conducted in accordance with this paragraph (b)(1) in connection with and related to individual or aggregated positions, contracts, or other holdings of the securitization participant arising out of its securitization activities, including the origination or acquisition of assets that it securitizes, except that the initial distribution of an asset-backed security is not risk-mitigating hedging activity for purposes of paragraph (b)(1) of this section.
 - (ii) *Conditions.* Risk-mitigating hedging activities are permitted under paragraph (b)(1) of this section only if:
 - (A) At the inception of the hedging activity and at the time of any adjustments to the hedging activity, the risk-mitigating hedging activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the securitization participant, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;
 - (B) The risk-mitigating hedging activity is subject, as appropriate, to ongoing recalibration by the securitization participant to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1) of this section and does not facilitate or create an opportunity to benefit from a conflicted transaction other than through risk-reduction; and
 - (C) The securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements set out in paragraph (b)(1) of this section, including reasonably designed written policies and procedures regarding the risk-mitigating hedging activities that provide for the specific risk and risk-mitigating hedging activity to be identified, documented, and monitored.
- (2) *Liquidity commitments.* Purchases or sales of the asset-backed security made pursuant to, and consistent with, commitments of the securitization participant to provide liquidity for the asset-backed security.
- (3) *Bona fide market-making activities.*
 - (i) *Permitted bona fide market-making activities.* Bona fide market-making activities, including market-making related hedging, of the securitization participant conducted in accordance with this paragraph (b)(3) in connection with and related to asset-backed securities with respect to which

the prohibition in paragraph (a)(1) of this section applies, the assets underlying such asset-backed securities, or financial instruments that reference such asset-backed securities or underlying assets, except that the initial distribution of an asset-backed security is not bona fide market-making activity for purposes of paragraph (b)(3) of this section.

(ii) *Conditions.* Bona fide market-making activities are permitted under paragraph (b)(3) of this section only if:

- (A) The securitization participant routinely stands ready to purchase and sell one or more types of the financial instruments described in paragraph (b)(3)(i) of this section as a part of its market-making related activities in such financial instruments, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;
- (B) The securitization participant's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments described in paragraph (b)(3)(i) of this section;
- (C) The compensation arrangements of persons performing the foregoing activity are designed not to reward or incentivize conflicted transactions;
- (D) The securitization participant is licensed or registered to engage in the activity described in paragraph (b)(3) of this section in accordance with applicable law and self-regulatory organization rules; and
- (E) The securitization participant has established, and implements, maintains, and enforces, an internal compliance program that is reasonably designed to ensure the securitization participant's compliance with the requirements of paragraph (b)(3) of this section, including reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks of its market-making positions and holdings.

(c) *Definitions.* For purposes of this section:

Asset-backed security has the same meaning as in section 3(a)(79) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(79)), and also includes synthetic asset-backed securities and hybrid cash and synthetic asset-backed securities.

Distribution means:

- (i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or
- (ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

Initial purchaser means a person who has agreed with an issuer to purchase a security from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon 17 CFR 230.144A or that are otherwise not required to be registered because they do not involve any public offering.

Placement agent and underwriter each mean a person who has agreed with an issuer or selling security holder to:

- (i) Purchase securities from the issuer or selling security holder for distribution;
- (ii) Engage in a distribution for or on behalf of such issuer or selling security holder; or
- (iii) Manage or supervise a distribution for or on behalf of such issuer or selling security holder.

Securitization participant means:

- (i) An underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security; or
- (ii) Any affiliate (as defined in 17 CFR 230.405) or subsidiary (as defined in 17 CFR 230.405) of a person described in paragraph (i) of this definition.

Sponsor means:

- (i) Any 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 entity that issues the asset-backed security; or
- (ii) Any person:
 - (A) with a contractual right to direct or cause the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security; or
 - (B) that directs or causes the direction of the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security.

- (C) Notwithstanding paragraphs (ii)(A) and (ii)(B) of this definition, a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly of an asset-backed security or the composition of the pool of assets underlying the asset-backed security will not be a sponsor for purposes of this rule.
- (iii) Notwithstanding paragraphs (i) and (ii) of this definition:
 - (A) The United States or an agency of the United States will not be a sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States.
 - (B) The Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617) with capital support from the United States; or any limited-life regulated entity succeeding to the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that the entity is operating with capital support from the United States; will not be a sponsor for purposes of this rule with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by such entity.
- (d) ***Anti-circumvention.*** If a securitization participant engages in a transaction that circumvents the prohibition in paragraph (a)(1) of this section, the transaction will be deemed to violate paragraph (a)(1) of this section.