Clients&FriendsMemo

SEC Adopts a Rule Prohibiting Conflicts of Interest in Certain Securitizations

December 5, 2023

On November 27, 2023, the Securities and Exchange Commission (the "**Commission**") adopted Rule 192 under the Securities Act of 1933 (the "**Securities Act**"), a rule that is designed to prohibit "material conflicts of interest" in certain securitizations.[1] Rule 192 implements Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"),[2] which was codified as Section 27B ("**Section 27B**")[3] of the Securities Act. Subject to certain exceptions, Section 27B prohibits certain participants in asset-backed securities ("**ABS**")[4] securitization transactions from engaging in transactions within a designated time period that would involve or result in any "material conflict of interest." Section 27B directed the Commission to issue rules implementing this prohibition no later than 270 days after the enactment of Dodd-Frank (*i.e.,* within 270 days of July 21, 2010).[5]

After originally proposing Rule 127B in September of 2011,[6] in response to the Section 27B mandate, but taking no further action on that proposed rule for nearly 12 years, the Commission proposed Rule 192 on January 25, 2023 (the "**Re-Proposal**")[7] to supersede proposed Rule 127B.

---

1 *See Prohibition against Conflicts of Interest in Certain Securitizations*, SEC Release No. 33-11254; File No. s7-01-23; (Nov. 27, 2023) (the "**Adopting Release**"), available at https://www.sec.gov/files/rules/final/2023/33-11254.pdf.

2 Pub. L. 111-203, 124 Stat. 1376 (2010).

3 15 U.S.C. 77z-2a.

4 Proposed Rule 192(c) defines "**ABS**" to mean an asset-backed security as defined in Section 3(a)(79) of the Securities Exchange Act of 1934 (the "**Exchange Act**"), as well as synthetic asset-backed securities and hybrid cash and synthetic asset-backed securities.

5 15 U.S.C. 77z-2a(b).

6 *See Prohibition against Conflicts of Interest in Certain Securitizations*, SEC Release No. 34-65355; File No. s7-38-11; (Sept. 19, 2011), 76 Fed. Reg. 60320 (Sept. 28, 2011) (the "**2011 Release")**, available at http://www.sec.gov/rules/proposed/2011/34-65355fr.pdf.

7 *See Prohibition against Conflicts of Interest in Certain Securitizations*, SEC Release No. 33-11151; File No. s7-01-23; (Jan. 25, 2023), 88 Fed. Reg. 9678 (Feb. 14, 2023) (the "**Re-Proposal**"), available at https://www.govinfo.gov/content/pkg/FR-2023-02-14/pdf/2023-02003.pdf.

While proposed Rule 127B largely tracked the text of Section 27B, the Re-Proposal asserted that Rule 192 is designed to "provide greater clarity regarding the scope of prohibited and permitted conduct."[8]

Rule 192 will become effective 60 days after its publication in the Federal Register; and compliance with Rule 192 will be required with respect to any ABS "the first closing of the sale of which" occurs 18 months after such publication date. The text of Rule 192 is set forth in Appendix A hereto.

BRIEF OVERVIEW

1. SCOPE and PROHIBITION

Rule 192 prohibits:

- an underwriter, placement agent, initial purchaser or sponsor of an ABS, as well as certain affiliates or subsidiaries of such an entity (collectively, "**Securitization Participants**");
- for a period commencing on the date on which a person "has reached an agreement that such person will become a Securitization Participant with respect to an ABS" and ending on the date that is one year after the date of the first closing of the sale of such ABS;
- from directly or indirectly engaging in any transaction that would involve or result in a "material conflict of interest" between the securitization participant and an investor in such ABS (*i.e.*, a "**Conflicted Transaction**").

2. EXCEPTED ACTIVITIES

As provided in Section 27B, the following three categories of activities are excluded from the prohibition in Rule 192:

- risk-mitigating hedging transactions designed to reduce specific, identifiable risks to a Securitization Participant in connection with, and related to, positions, contracts or other holdings of the Securitization Participant;
- purchases or sales made pursuant to commitments of Securitization Participants to provide liquidity for the ABS; and
- purchases or sales made pursuant to bona fide market-making in the ABS, the underlying assets of the ABS or financial instruments that reference the ABS.

---

[8] Re-Proposal, *supra* note 7, at 9679.

3. KEY DIFFERENCES from PROPOSED RULE 192

Rule 192 largely retains the contours of the rule as proposed in the Re-Proposal. However, it narrows the sweep of proposed Rule 192 in several key respects:

- narrowing the affiliates and subsidiaries that would be captured by the Securitization Participant definition to those that act "in coordination with" a Securitization Participant or receive or have access to pre-closing information regarding an ABS, without incorporating a formal, prescriptive "information barrier" exclusion;
- allowing the initial distribution of an ABS to fall within the risk-mitigating hedging exception, thereby permitting synthetic ABS that perform a risk-mitigating function to be issued;
- including a "safe harbor" for ABS issued by non-US persons and offered and sold in compliance with Regulation S under the Securities Act;
- removing the "start-date" reference to having "taken substantial steps" to reach an agreement to become a Securitization Participant, but still leaving some ambiguity as to the "start-date";
- clarifying that a person acting "**solely** pursuant to [its] contractual rights as a holder of a long position" in the applicable ABS is not a "sponsor" and therefore not included in the definition of Securitization Participant;
- removing the proposed exclusion from "sponsor" status for Fannie Mae and Freddie Mac while they remain in the conservatorship, but making clear that the synthetic credit risk transfer transactions in which they engage are not prohibited, even if they exit conservatorship;
- removing from the "sponsor" definition persons that have the **non-contractual** ability to direct the structure, design or assembly of an ABS; and
- clarifying that the term "sponsor" does not include a person that is solely responsible for "ongoing administration" of an ABS, including servicers, but noting that the status of special servicers is subject to a "facts and circumstances" analysis.

BACKGROUND

Section 27B was enacted to prohibit underwriters, sponsors and others who assemble and sell ABS from profiting from the securities' failure.[9] The Adopting Release characterizes this objective as prohibiting "transactions that effectively represent a "bet" against the performance of an ABS…."[10] Although the Re-Proposal acknowledged that the securitization markets have

[9] Congressional Record, S5899 (July 15, 2010) (statement of Sen. Carl Levin).

[10] Adopting Release, *supra* note 1, at 9

undergone various changes since Section 27B was enacted and that the Commission does "not have data on the [current] extent of" the conduct that gave rise to that provision,[11] the contours of Rule 192 as adopted, remain very similar to those of the proposed rule (except as noted above). In that regard, Commissioner Peirce – the lone dissenting Commissioner – expressed the view that although the rule is an improvement over the Re-Proposal, it nevertheless contains "lingering ambiguities" and continues to be characterized by "over-breadth."[12] She expressed concern as to whether the rule successfully "stops the types of conflicted transactions that plagued financial crisis era securitizations without placing undue burdens on ordinary course transactions."[13]

KEY COMPONENTS OF THE PROHIBITION

Consistent with Section 27B, Rule 192 applies (unless an exception is available) when a transaction: (1) involves an asset-backed security; (2) is effected by a covered person (*i.e.*, a Securitization Participant); (3) is deemed to involve a "conflict of interest" that is "material"; and (4) is effected during a covered timeframe. Rule 192 attempts to bring clarity with respect to each of those concepts.

1. COVERED PERSONS

Rule 192(c) includes specific definitions for the terms underwriter, placement agent, initial purchaser and sponsor; and it defines the terms "affiliate" and "subsidiary" by reference to the definitions in Rule 405 under the Securities Act.

"Underwriter," "Placement Agent" and "Initial Purchaser" Definitions

The terms "underwriter" and "placement agent" are unchanged from those in the Re-Proposal. Rule 192 identically defines those terms as a person who has agreed with an issuer or selling security holder to: (1) purchase securities from the issuer or selling security holder for distribution; (2) engage in a distribution for or on behalf of the issuer or selling security holder; or (3) manage or supervise a distribution for or on behalf of such issuer or selling security holder. The term "distribution" (which also is unchanged from the Re-Proposal) is, in turn, defined to mean: (1) "an offering of securities, whether or not registered under the Securities Act, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods"; and (2) an offering of securities made pursuant to an effective Securities Act registration statement. The Adopting Release notes that the focus on "special selling efforts and selling methods" is designed

[11] Re-Proposal, *supra* note 7, at 9679.

[12] Commissioner Hester M. Peirce, Statement on Adoption of Rule Prohibiting Conflicts of Interest in Certain Securitizations (Nov. 27, 2023).

[13] *Id.*

to distinguish an ABS offering from secondary trading and that indicia of those efforts and methods include greater than normal sales compensation, delivering a sales document and conducting road shows.[14]

The term "initial purchaser" is separately defined in Rule 192(c), to capture a person that has agreed with an issuer to purchase securities from the issuer for resale to other purchasers in transactions that are not required to be registered under the Securities Act in reliance upon Rule 144A under the Securities Act or because they do not involve any public offering. That term also is unchanged from the proposed rule.

The Adopting Release notes that the foregoing definitions are based on the function a person has agreed to perform, rather than the person's title,[15] and that "no factual determination" as to whether that person had direct involvement in the structure or design of the ABS is required.[16] The Adopting Release expresses the view that a person that has an agreement with the issuer to perform the enumerated functions "would likely be privy to information about the ABS or underlying assets, giving them the opportunity to influence the structure of the relevant ABS and engage in a bet against it."[17] The Adopting Release clarifies, however, that selling group members that do not have a direct relationship with the issuer are not underwriters, placement agents or initial purchasers for purposes of Rule 192.[18]

"Sponsor" Definition

With respect to the term "sponsor," subparagraph (i) of the Rule 192(c) definition essentially incorporates the Regulation AB definition of that term, defining a "sponsor" as: "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."

However, subparagraphs (ii)(A) and (ii)(B) of the definition significantly expand upon the Regulation AB definition by including "any person 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 or referenced by the asset-backed security," other than "a person who acts solely pursuant to such person's contractual rights as a holder of a long position in the asset-backed

---

[14] Adopting Release, *supra* note 1, at 35 and footnote 137.

[15] *Id.* at 35 and 39.

[16] *Id.* at 37.

[17] *Id.*

[18] *Id.* at 36.

security."[19] The Adopting Release expresses the view that the scope of the definition "is necessary to capture the relevant securitization participants that would have the incentive and ability to engage in conflicted transactions as a result of their ability to structure, design, or assemble an ABS or its underlying or referenced asset pool."[20] However, the release explains that a person can be a contractual rights sponsor even if it does not actually exercise that right because it would have access to information regarding the ABS prior to their sale "and would therefore have the opportunity to use that information to engage in a conflicted transaction."[21]

The newly-added express exclusion for persons who act "solely pursuant to" their contractual rights as holders of long positions will be helpful for ABS investors, such as "B-piece buyers" in CMBS issuances. However, the inclusion of the word "solely" makes the availability of this carve-out subject to a facts and circumstances analysis, including with respect to any other roles the investor may have in the transaction (*e.g.*, acting as special servicer) and any affiliation it may have with the special servicer or another transaction participant.[22]

In another potentially helpful change, the Commission eliminated from the definition of "sponsor" a person that has the **non-contractual** ability to influence the asset selection process. This deletion was made partly to ensure that ABS investors would not be deemed to be "sponsors" merely because they engage in an iterative negotiation process with deal participants.[23]

Persons that perform "**only** administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, or assembly, or ongoing administration" of an ABS are excluded from the Rule 192(c) sponsor definition. The "ongoing administration" concept is a newly-added clarification and encompasses servicers.[24] However, the Adopting Release indicates that the status of a special servicer should be determined on a "facts and circumstances" basis.[25] The Adopting Release notes that "the ability to determine whether (and when) to negotiate a work-out of a loan, take possession of the property collateralizing the loan, and purchase the loan out of the securitization at a discount" may not be consistent with the types of administrative or ministerial functions eligible for the "ongoing administration" exclusion.[26] Of course, this fails to take into

---

[19] Text of proposed Rule 192*, infra, Appendix A* at § 230.192(c) (emphasis added).

[20] Adopting Release, *supra* note 1, at 58–59.

[21] *Id.* at 58.

[22] *Id.* at 51–52.

[23] *Id.* at 51.

[24] *Id.* at 60–62.

[25] *Id.* at 62.

[26] *Id.*

account the fact that transactions without a special servicer require the servicer to undertake activities to address troubled assets.

Certain Persons Included in and Excluded from the Sponsor Definition

The Adopting Release notes that sponsors could include, among others, collateral managers for collateralized loan obligations ("**CLOs**") and municipal advisors.[27]

Although Commissioner Peirce commented, in the context of the Re-Proposal, that "municipal entities are unlikely to engage in conflicted transactions" and therefore suggested that consideration should be given to exempting those entities from the prohibition altogether and other commenters echoed this view,[28] the rule, as adopted, does not exclude municipal issuers from the "sponsor" definition.[29]

Rule 192(c) excludes from the definition of "sponsor" "the United States or an agency of the United States with respect to any ABS that is fully insured or fully guaranteed as to the timely payment of principal and interest by the United States."[30] However, any other Securitization Participants involved in such an ABS transaction. Such transactions, such as ABS guaranteed by the Government National Mortgage Association (*i.e.*, "**Ginnie Mae**"), would be subject to Rule 192, including Ginnie Mae issuers.[31]

The Re-Proposal had contained an exclusion from the "sponsor" definition for Fannie Mae and Freddie Mac with respect to securities that are fully insured or fully guaranteed by them as to the timely payment of principal or interest, but only for so long as they are operating under the conservatorship or receivership of the Federal Housing Finance Agency. However, this exclusion was not included in Rule 192, as adopted.[32]

The Adopting Release emphasizes that warehouse financing is "a routine activity to finance the purchase of assets by a securitization participant in furtherance of the issuance of an ABS" and that "a lender's right to determine which assets it is or is not willing to finance pursuant to its

---

[27] *Id.* at 39 and 55.

[28] *See* Commissioner Hester M. Peirce, Statement on Proposed Rule Prohibiting Conflicts of Interest in Certain Securitizations (Jan. 25, 2023) (noting that, in the event a municipal entity elects to establish compliance procedures as a defense against an enforcement investigation, it would incur "unnecessary costs").

[29] Adopting Release, *supra* note 1, at 18. The Adopting Release notes that, even if municipal issuers might be subject to constraints that limit their ability to engage in conflicted transactions, underwriters and other Securitization Participants are not subject to those constraints.

[30] *Id.* at 11 and 38.

[31] *Id.* at 65.

[32] *Id.* at 68.

underwriting standards, does not meet the definition of "sponsor.""[33] However, as is the case with any entity, affiliation with a Securitization Participant could potentially create Securitization Participant status.[34] The Adopting Release also indicates that third-party asset sellers do not become "sponsors" purely by virtue of originating and selling assets to the ABS sponsor.[35]

"Affiliate" and "Subsidiary" Definitions; No Explicit Use of Information Barriers

The Re-Proposal defined the terms "affiliate" and "subsidiary" solely by reference to Rule 405 under the Securities Act, which would have caused those terms to sweep very broadly.[36] However, in response to commenter concerns, the rule now limits those terms to affiliates and subsidiaries, as each defined in Rule 405, that: (1) act "in coordination with" an underwriter, placement agent, initial purchaser, or sponsor; or (2) have access to or receive information about the relevant ABS or the asset pool underlying the relevant ABS prior to the first closing of the sale of the relevant ABS.

Although the rule, as adopted, does not explicitly incorporate the use of information barriers, due to concerns that a prescriptive information barrier exception could be either too permissive for some market participants or too difficult for other participants to satisfy,[37] the Adopting Release does note that information barriers can be central to assuring that an affiliate or subsidiary is not acting in coordination with a Securitization Participant and does not have access to or receive information about the applicable ABS or asset pool.[38] The Adopting Release also discusses the criteria that can be used to identify the requisite "separateness."[39]

Therefore, Securitization Participants will be required to conduct factual assessments of their corporate structures to identify the affiliates and subsidiaries that could be deemed to be a Securitization Participant and, if necessary, implement measures to avoid that status or measures to

---

[33] *Id.* at 56–57.

[34] *Id.* at 57.

[35] *Id.* at 63–64.

[36] Under Rule 405, an "affiliate" of a specified person is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified. A "subsidiary" of a specified person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. "Control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. *See* 17 C.F.R. 230.405.

[37] Adopting Release, *supra* note 1, at 74.

[38] *Id.* at 77.

[39] *Id.* at 76–77. The Adopting Release notes that those include: (1) information barriers, including written procedures to prevent the flow of information between relevant entities, and physical separation of personnel; (2) separate trading accounts; (3) the absence of officer and employee interlocks; (4) involvement in unrelated businesses; or (5) the absence of trading authority or trade pre-approval authority on the part of any personnel with oversight or managerial responsibility.

assure compliance with Rule 192. In the case of Securitization Participants that are part of a large corporate family, this could be a time-consuming and difficult process.

2. COVERED ABS TRANSACTIONS

As required by Section 27B, Rule 192(c) applies to any asset-backed security, as that term is defined in Section 3(a)(79) of the Exchange Act, as well as to any synthetic ABS. Unlike proposed Rule 127B, Rule 192(c) also applies to any hybrid cash and synthetic ABS.[40] The Adopting Release highlights the fact that the definition includes both ABS sold in registered and exempt offerings, making clear that both types of offerings could result in potential conflicts of interest.[41]

Synthetic CLOs and Other Synthetic ABS

Although the Re-Proposal could have been read to prohibit the issuance of synthetic balance sheet CLOs for risk management purposes, the Adopting Release makes clear that these transactions are not prohibited so long as they satisfy the risk-mitigating hedging exception described below.[42]

Although many commenters requested that the term "synthetic ABS" be defined and certain commenters offered proposed definitions,[43] the rule, as adopted, does not do this. However, the Adopting Release notes that the Commission generally views a synthetic ABS "as a fixed income or other security issued by a special purpose entity that allows the holder … to receive payments that depend primarily on the performance of a reference self-liquidating financial asset or a reference pool of self-liquidating financial assets."[44]

Transactions Not Included

Although the Re-Proposal requested comment regarding whether a catch-all provision should be added to the ABS definition to cover any product that functions as the equivalent of a cash ABS, synthetic ABS or a hybrid cash and synthetic ABS,[45] the rule, as adopted, does not do this. Rather,

---

[40] *See Id.* at 15; Re-Proposal, *supra* note 7, at 9681 (noting that, given that the prohibition in Section 27B applies to both Exchange Act ABS and synthetic ABS, "it would be inconsistent for the rule not to apply to a hybrid ABS that has characteristics of both cash ABS and synthetic ABS.").

[41] Adopting Release, *supra* note 1, at 20–21.

[42] *Id.* at 225.

[43] *Id.* at 14–15.

[44] *Id.* at 24.

[45] Re-Proposal, *supra* note 7, at 9682.

the Adopting Release attempts to clarify that products that arguably could have been captured by this sort of broad catch-all are **not** subject to the rule.

In particular, the Adopting Release makes clear that mortgage insurance linked notes are not ABS, nor are corporate debt securities, even if they transfer risk regarding specific assets.[46] The release also confirms that equity-linked or commodity-linked products are not ABS because they do not involve self-liquidating financial assets and that security-based swaps are not ABS because they are financial contracts between two counterparties that do not involve the issuance of a security from a special purpose entity.[47]

Exclusion for Foreign Securitizations

Unlike the proposed rule, Rule 192 includes an exclusion for securitizations effected by non-US issuers (as defined by reference to Regulation S under the Securities Act) and offered and sold in compliance with Regulation S.[48] The Adopting Release notes that this exclusion is intended to parallel the exclusion under Rule 15Ga-2(e).[49] However, the Adopting Release notes that, if there are ABS sales in the United States, the provisions of Rule 192 apply.[50]

3. COVERED TIMEFRAME

Section 27B applies to parties who engage in a prohibited transaction "**at any time** for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security[.]"[51] It does not include a specified commencement date, but clearly encompasses prohibited transactions occurring before the issuance of the relevant ABS.

Rule 192(a)(1) also applies to pre-issuance prohibited transactions and employs the same "end-date" as does Section 27B. However, it attempts to provide more clarity as to the specific commencement date. In that regard, it applies to Securitization Participants that engage in a Conflicted Transaction "for a period commencing on the date on which a person has reached 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[.]" The Adopting Release indicates that, for purposes of the rule,

---

46 Adopting Release, *supra* note 1, at 21–22 and 24–25.

47 *Id.* at 25.

48 *See* Section (e) of Rule 192.

49 Adopting Release, *supra* note 1, at 29.

50 *Id.* at 27.

51 *See* 2011 Release, *supra* note 6, at 60320 (emphasis added).

"agreement" refers to "an agreement in principle (including oral agreements and facts and circumstances constituting an agreement) as to the material terms of the arrangement by which such person will become a securitization participant."[52] The release thus notes that "whether there has been an agreement to become a securitization participant will depend on the facts and circumstances of the securitization transaction and the parties involved."[53]

In the interests of providing greater start-date clarity, the Commission eliminated the proposed inclusion of having "taken substantial steps to reach an agreement" to become a Securitization Participant.[54] The Re-Proposal sought comment regarding whether a **specific** date should be designated as the start-date; however, no such date is included.[55]

The Adopting Release expresses the view that the commencement point is designed to capture "the point at which a person may be incentivized and/or could act on an incentive to engage in the misconduct that Section 27B is designed to prevent."[56]

4. COVERED "CONFLICT OF INTEREST" TRANSACTIONS

Rule 192(a)(2) attempts to address the scope of the activities prohibited by the rule by providing that "engaging in any transaction would involve or result in a material conflict of interest . . . if such transaction is a [Conflicted Transaction]." This prohibition must be read in conjunction with the "directly or indirectly" standard contained in Rule 192(a)(1). The term Conflicted Transaction is defined in Rule 192(a)(3) to encompass three categories of transactions IF "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 [applicable ABS]." Thus, an activity falling within one of those three categories will only be a Conflicted Transaction if the foregoing "materiality test" is met.

Those three categories of activity are:

(1) Short Sales

Pursuant to Rule 192(a)(3), the first category of potentially prohibited activity are short sales of the relevant ABS. The Adopting Release explains that a Securitization Participant that sells an ABS it does not own (or that it would borrow to make delivery) would be

---

[52] Adopting Release, *supra* note 1, at 83.

[53] *Id.*

[54] *Id.* at 79.

[55] *Id.*

[56] *Id.*

making a bet against the ABS.[57] It is immaterial whether the Securitization Participant makes a profit on a short-sale of the ABS; the act of selling short would be sufficient.[58]

(2) Credit Default Swaps

The second category of potentially prohibited activity is the purchase of a credit default swap or other credit derivative pursuant to which a Securitization Participant would be entitled to receive payments upon the occurrence of specified credit events in respect of the relevant asset-backed security. The Adopting Release notes that it is irrelevant whether the credit derivative is in the form of a credit default swap or other credit derivative product "because the focus is on the economic substance of the credit derivative as a bet against the relevant ABS[.]"[59]

(3) "Economically Equivalent" Transactions

In the Re-Proposal, Rule 192(a)(3)(iii) included a broad, catch-all category of potentially prohibited activity that would have encompassed the purchase or sale of any financial instrument or entry into a transaction through which the Securitization Participant would benefit from the "actual, anticipated or potential: (1) adverse performance of the asset pool supporting or referenced by the relevant [ABS]; (2) loss of principal, monetary default, or early amortization event on the relevant [ABS]; or (3) decline in market value of the relevant [ABS]." However, the Commission replaced this broad, amorphous language with "the purchase or sale of any financial instrument (other than the relevant ABS) or the entry into a transaction that is substantially the economic equivalent of a [short sale or credit default swap]". For the avoidance of doubt, transactions that only hedge **general** interest rate or currency exchange risk are expressly carved out.[60] If a transaction falls within this prong, the Securitization Participant need not ultimately profit from it in order for it to be prohibited.[61]

The narrower language of Rule 192(a)(3)(iii) should make it easier to identify Conflicted Transactions, but could nevertheless generate debate as to whether a transaction is "substantially the economic equivalent" of a short sale or credit derivative. When parties are making this assessment, they should refer to the language of the Adopting Release clarifying that this prong is

---

[57] *Id.* at 92.

[58] *Id.*

[59] Re-Proposal, *supra* note 7, at 9694.

[60] Adopting Release, *supra* note 1, at 106. By contrast, transactions that relate to the idiosyncratic performance of the particular ABS would not fall within this carve-out.

[61] *Id.* at 116.

intended to apply to transactions that are "direct bets against an ABS… regardless of their form" and is intended to "remove the incentive for [Securitization Participants] to place their own interests ahead of those of ABS investors."[62] The Adopting Release makes clear that this prong could encompass transactions that relate to "a pool of assets with characteristics that replicate the idiosyncratic credit performance of the asset pool supporting the relevant ABS"; the prong is not limited to transactions that specifically reference the applicable ABS or asset pool.[63]

The Adopting Release emphasizes that "ordinary course" pre-securitization and issuance activities – such as the provision of warehouse financing and the transfer of assets into the securitization vehicle – are not Conflicted Transactions.[64] However, the Adopting Release notes that synthetic ABS can be Conflicted Transactions unless they satisfy the conditions to the risk-mitigating hedging exception.[65] The Adopting Release also notes that transactions involving a "sizeable" portion of the assets in a pool could be Conflicted Transactions.[66]

5. MATERIALITY

As noted in subsection 4 above, a transaction would only be a Conflicted Transaction if the transaction is deemed to be "material"; *i.e.*, if "there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision[.]" Rule 192 thus incorporates the "reasonable investor" standard of materiality utilized by some courts as a touchstone for "materiality" in the context of "insider trading" decisions.[67]

The Adopting Release emphasizes that this standard does not allow Securitization Participants to avoid subjecting certain transactions to the prohibitions of proposed Rule 192 through the use of disclosures.[68] The Adopting Release asserts that, while adequate disclosures could reduce the likelihood that an investor would invest in an ABS that is affected by a conflict of interest, disclosures would not entirely eliminate the incentive for Securitization Participants to enter into conflicted transactions.[69]

---

[62] *Id.* at 97.

[63] *Id.* at 100.

[64] *Id.* at 106.

[65] *Id.* at 111 and 126.

[66] *Id.* at 103.

[67] *Id.* at 118. The "reasonable investor" standard of materiality was articulated in Basic v. Levinson, 485 U.S. 224, 231–32 (1988).

[68] *Id.* at 119.

[69] *Id.* at 120.

Similarly, the Adopting Release notes that the use of a "reasonable investor" standard should not be interpreted to imply that an otherwise prohibited transaction would be permissible if the investor selects or approves of the assets underlying the ABS.[70] The Adopting Release notes that, even if an investor were given adequate information regarding the pool of assets and consents to that asset pool, a Securitization Participant could nonetheless "structure the ABS . . . in a way that would position the securitization participant to benefit from the adverse performance of" the underlying assets.[71]

Although certain commenters recommended that the rule be limited to ABS transactions that are intentionally designed to fail, the Commission did not adopt that approach. The Adopting Release notes that "narrowing the scope in this way could reduce the effectiveness of the rule to prophylactically prevent these types of material conflicts of interest with investors" and "frustrate the statutory mandate of Section 27B."[72]

6. ANTI-EVASION

Rule 192(d) provides that "[i]f a securitization participant engages in a transaction or a series of related transactions that, although in technical compliance with [the exceptions to the Rule's prohibition], is part of a plan or scheme to evade [that prohibition], the transaction will be deemed to violate" that prohibition. This approach represents a change from the Re-Proposal, which contained a somewhat broader and vaguer "anti-circumvention" provision.[73]

EXCEPTIONS TO PROHIBITION

Consistent with Section 27B, Rule 192(b) contains exceptions to the Rule 192 prohibition for risk-mitigating hedging activities, liquidity commitments and bona fide market-making. Rule 192(b) provides specific guidance as to the contours of those exceptions and imposes certain conditions to satisfying the risk-mitigating hedging exception and the bona fide market-making exception.

1. RISK-MITIGATING HEDGING ACTIVITIES

Section 27B(c) describes "risk-mitigating hedging activities" as "activities in connection with positions or holdings arising out of the underwriting, placement, initial purchase, or sponsorship of an [ABS], provided that such activities are designed to reduce the **specific risks** to the [relevant securitization participant] associated with positions or holdings arising out of" the applicable

[70] *Id.*

[71] *Id.* at 121.

[72] *Id.* at 16.

[73] *Id.* at 169.

activities.[74] Rule 192(b) follows the footprint of Section 27B, but makes clear that those positions can be hedged on an individual or aggregated basis and can include the origination or acquisition of assets that the Securitization Participant securitizes.

In a major change from the Re-Proposal, the Commission removed language that would have precluded the initial distribution of an asset-backed security (such as a synthetic ABS) from falling within the risk-mitigating hedging activity exception. Accordingly, synthetic ABS can be issued so long as the conditions of that exception are satisfied.[75] In another key change from the Re-Proposal, the activities falling within this exception would not be limited to activities "arising out of [a Securitization Participant's] securitization activities." The Adopting Release indicates that this change was made to "not unnecessarily restrict the ability of an affiliate or subsidiary of a securitization participant to hedge exposures that it may originate, retain, acquire, or finance in connection with the ordinary course of its business but that may be unrelated to the securitization activities of" the Securitization Participant.[76] This change also was responsive to commenter concerns that the risk-mitigating hedging exception should not be limited to exposures arising out of Securitization Participant's securitization activities.[77]

The Adopting Release indicates that a primary purpose of the definition is to allow a Securitization Participant to hedge retained ABS positions (to the extent not inconsistent with the SEC's risk retention rule) and to hedge exposures arising out of the assets that are originated or acquired by the Securitization Participant in connection with warehousing assets.[78] In an effort to distinguish permitted risk-mitigating hedging activity from Conflicted Transactions, Rule 192(b)(1) permits risk-mitigating hedging activities only if each of the following conditions is satisfied:

(1) Significant Mitigation of Specific, Identifiable Risks

When the hedging activity is commenced and at the time of any adjustments, the 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 a Securitization Participant.[79]

---

[74] 15 U.S.C. 77z-2a(c) (emphasis added).

[75] *Id.* at 125.

[76] *Id.* at 127–28.

[77] *Id.* at 128.

[78] *Id.* at 124.

[79] Text of Rule 192, *infra* Appendix A, at § 230.192(b)(1)(ii)(A) (emphasis added).

(2) Ongoing Recalibration

The activity is subject, as appropriate, to **ongoing recalibration** by the Securitization Participant to ensure the activity satisfies the requirements of the risk-mitigating exception and "does not facilitate or create an opportunity to **materially** benefit from a conflicted transaction other than through risk reduction." The insertion of "materially" reflects a change from the Re-Proposal.

(3) Compliance Program

The Securitization Participant establishes, maintains and enforces an internal compliance program that is reasonably designed to ensure compliance with the risk-mitigating hedging exception, including reasonably designed procedures that provide for the specific hedging activity to be "identified, documented, and monitored."

The Adopting Release emphasizes that a Securitization Participant cannot "overhedge" its risks in a way that would result in a net short exposure to the relevant ABS or otherwise constitute "speculative activity."[80] The Re-Proposal noted that, although hedging may occur on an aggregate basis, the requirement that the risks must be "specific" and "identifiable" means that a Securitization Participant would be unable to rely upon the risk-mitigating hedging exception if it were to enter into a CDS referencing a retained ABS, but designed to hedge "generalized risks that it believes to exist based on non-position specific modeling or other considerations."[81] The Adopting Release notes that whether a risk is "specific and identifiable" involves a "facts and circumstances" analysis.[82]

The Adopting Release asserts that a risk-mitigating hedge need not have "an exact negative correlation" with the exposure being hedged.[83] Although the Re-Proposal requested comment as to whether a certification requirement should be required if exact negative correlation cannot be achieved[84] and as to overall compliance with the conditions of the proposed rule,[85] Rule 192 does not impose any certification requirements.[86]

---

[80] Adopting Release, *supra* note 1, at 133.

[81] Re-Proposal, *supra* note 7, at 9701.

[82] Adopting Release, *supra* note 1, at 132 and 138.

[83] *Id.* at 137.

[84] *Re-Proposal, supra* note 7, at 9703.

[85] *Id.* at 9703–04.

[86] Adopting Release, *supra* note 1, at 144.

The Adopting Release also makes clear that hedging transactions that involve an index that includes a class of the ABS and that is permitted under Regulation RR would be permitted under Rule 192.[87]

The Re-Proposal also requested comment as to whether the proposed rule should specify the exact frequency as to which a Securitization Participant should be required to "recalibrate" its hedge[88] and as to whether a Securitization Participant that is in compliance with similar Volcker Rule conditions should presumptively be deemed to be in compliance with the risk-mitigating hedging exception in proposed Rule 192.[89] However, neither of those approaches was adopted.

Thus, although Rule 192(b)(1) brings some clarity to the contours of the risk-mitigating hedging exception, complying with this paragraph will still involve a fair amount of uncertainty and a potentially significant compliance burden. For example, identifying the contours of "specific" and "identifiable" risk – as opposed to "generalized risks . . . based on non-position specific modeling" – could prove to be a challenge.

2. LIQUIDITY COMMITMENTS

Consistent with Section 27B, the second Rule 192(b) exception is for purchases or sales of ABS made pursuant to and consistent with commitments of a Securitization Participant to provide liquidity for the ABS. Rule 192(b)(2) essentially tracks the language of Section 27B. The Re-Proposal noted that, as is the case under Section 27B, a liquidity "commitment" need not take the form of a contractual obligation.[90] The Adopting Release clarifies that "to the extent that the purchases and sales of [Fannie Mae and Freddie Mac] ABS in a dollar roll transaction are consistent with a commitment …to provide liquidity for the relevant ABS, then such dollar roll transaction will be eligible for the liquidity commitment exception."[91]

3. BONA FIDE MARKET-MAKING

The third exception to the Rule 192(a) prohibition permits certain bona fide market-making in ABS. Specifically, Rule 192(b)(3) permits bona fide market-making activities – including market-making related hedging – conducted in accordance with five conditions. This exception applies to market-making with respect to the applicable ABS, the assets underlying those ABS and financial instruments, such as CDS, that reference those ABS or assets or with respect to which the Rule

[87] *Id.* at 104, footnote 386.

[88] Re-Proposal, *supra* note 7, at 9701.

[89] *Id.* at 9703.

[90] *Id.* at 9704.

[91] Adopting Release, *supra* note 1, at 146.

192 prohibition otherwise applies (collectively, the "**Relevant Instruments**").[92] Consistent with the proposed rule, the initial issuance of an ABS does not qualify as bona fide market-making activity. The Adopting Release notes that "[t]his means that a securitization participant is not able to rely on the … exception for bona fide market-making… for primary market activities, such as issuing a new synthetic ABS."[93]

The Adopting Release emphasizes that the bona fide market-making activity exception does not include a requirement to analyze the applicability of the exception on a trade-by-trade basis.[94] Rather, the Adopting Release indicates that the rule is "focused on the overall market-making related activities of a securitization participant," with a condition that those activities are "related to satisfying the reasonably expected near term demand of the securitization participant's customers."[95] It also notes that hedging the risk of a price decline of market-making related ABS positions qualifies for the bona fide market-making exception; that activity does not need to separately rely on the risk-mitigating hedging exception.[96]

Pursuant to Rule 192(b)(3) the five conditions that need to be satisfied – which draw from the concept of market-making in both the Volcker Rule and the Exchange Act – are as follows:

(1) Conduct Evidencing Market-Maker Role

The first condition requires that the Securitization Participant "routinely stands ready to purchase and sell one or more types" of the Relevant Instruments and be "willing and available to quote, purchase and sell, or otherwise enter into long and short positions in [the Relevant 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 Instruments. The Adopting Release notes that Rule 192(b)(3) employs a "routinely stands ready" standard, as opposed to a stricter standard, to avoid causing a chilling effect on a Securitization Participant's ability to act as a market-maker in a less liquid market.[97] The Adopting Release acknowledges, in this regard, that market-makers in illiquid markets "likely do not trade continuously, but trade only intermittently or at the request of customers."[98] However, the Adopting Release notes that, in order to satisfy this

[92] *Id.* at 150–51.

[93] *Id.* at 151 and 153.

[94] *Id.* at 155.

[95] *Id.*

[96] *Id.* at 156.

[97] *Id.* at 158.

[98] *Id.*

condition, the Securitization Participant needs to have "an established pattern of providing price quotations on either side of the market and a pattern of trading with customers on each side of the market."[99] It further notes that the Securitization Participant "needs to be willing to facilitate customer needs in both upward and downward moving markets."[100] The Adopting Release indicates, as well, that the Securitization Participant must be willing to quote and trade in sizes requested by market participants, as this would evidence the Securitization Participant's willingness to provide intermediation services.[101]

(2) Nexus to Near-Term Client Demand

Pursuant to Rule 192(b)(3), the Securitization Participant's activities also need to be "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 Instruments. This condition is identical to that of the Volcker Rule. The Adopting Release indicates that this condition is designed to distinguish activity conducted for the purpose of building inventory in less liquid instruments from activity conducted to bet against the relevant ABS.[102] The Adopting Release notes that determining whether this condition has been satisfied requires a facts and circumstances analysis.[103]

(3) Non-Incentivizing Compensation

Pursuant to Rule 192(b)(3), the compensation arrangements for persons performing the activity need to be designed to not reward or incentivize Conflicted Transactions. The Adopting Release notes that a compensation arrangement that is designed to reward "speculation in, and appreciation of, the market value of market-making positions" would not be consistent with the bona fide market-making exception.[104]

(4) Registration/Licensing

Pursuant to Rule 192(b)(3), the Securitization Participant needs to be licensed or registered, under applicable law and self-regulatory organization ("**SRO**") rules, to engage

---

[99] *Id.*

[100] *Id.*

[101] *Id.* at 159.

[102] *Id.*

[103] *Id.* at 160.

[104] *Id.* at 160–61.

in the activity described in the bona fide market-making definition, **if** such registration is otherwise required. The Adopting Release clarifies that a person that is exempt from registration or excluded from regulation under applicable law and SRO rules would not be in non-compliance with this condition.[105]

(5) Compliance Program

The fifth condition of Rule 192(b)(3) is that the Securitization Participant needs to establish, maintain and enforce an internal compliance program that is reasonably designed to ensure the Securitization Participant's compliance with the requirements of the bona fide market-making exception. Rule 192(b)(3) requires that the compliance program contain "reasonably designed written policies and procedures that demonstrate a process for prompt mitigation of the risks" of the Securitization Participant's market-making positions and holdings. The Adopting Release notes that a reasonably designed compliance program should identify the processes by which the Securitization Participant identifies the Relevant Instruments with respect to which the participant may make a market and the processes by which the participant would determine the reasonably expected near term demand for those instruments.[106] With respect to the need for processes relating to "prompt mitigation," the Adopting Release cites "aged positions" as an example of the positions that might require mitigation actions.[107]

Although the Re-Proposal sought comment as to whether compliance with the equivalent Volcker Rule conditions presumptively evidence compliance with the bona fide market-making exception,[108] the rule, as adopted, does not include this presumption. Although the Re-Proposal also sought comment as to whether the rule should include a certification requirement, no such requirement was included.[109]

As is the case with the risk-mitigating hedging exception, Rule 192(b)(3) brings some clarity to the bona fide market-making exception. However, efforts to comply with this exception would still create a significant amount of uncertainty, as well as a substantial compliance burden.

* * *

[105] *Id.* at 161.

[106] *Id.* at 165–66.

[107] *Id.* at 166.

[108] Re-Proposal, *supra* note 7, at 9703.

[109] *Id.*

If you have any questions, please feel free to contact Michael Gambro or Maurine Bartlett or any of your other Cadwalader contacts.

Maurine Bartlett	+1 212 504 6218	maurine.bartlett@cwt.com
Michael S. Gambro	+1 212 504 6825	michael.gambro@cwt.com

APPENDIX A – TEXT OF RULE 192

§ 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 such person has reached 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 that is substantially the economic equivalent of a transaction described in paragraph (a)(3)(i) or (a)(3)(ii) of this section, other than, for the avoidance of doubt, any transaction that only hedges general interest rate or currency exchange risk.

(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, including those arising out of its securitization activities, such as the origination or acquisition of assets that it securitizes.

(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 materially 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 or with respect to which the prohibition in paragraph (a)(1) of this section otherwise applies, 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, if required, 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 a synthetic asset-backed security and a hybrid cash and synthetic asset-backed security.

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 if the affiliate or subsidiary:

(A) Acts in coordination with a person described in paragraph (i) of this definition; or

(B) Has access to or receives information about the relevant asset-backed security or the asset pool underlying or referenced by the relevant asset-backed security prior to the first closing of the sale of the relevant asset-backed security.

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 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 or referenced by the asset-backed security, other than a person who acts solely pursuant to such person's contractual rights as a holder of a long position in the asset-backed security.

(iii) Notwithstanding paragraph (ii) of this definition, a person that performs only administrative, legal, due diligence, custodial, or ministerial acts related to the structure, design, assembly, or ongoing administration of an asset-backed security or the composition of the pool of assets underlying or referenced by the asset-backed security will not be a sponsor for purposes of this rule.

(iv) Notwithstanding paragraphs (i) and (ii) of this definition, 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.

(d) *Anti-evasion.* If a securitization participant engages in a transaction or a series of related transactions that, although in technical compliance with paragraph (b) of this section, is part of a plan or scheme to evade the prohibition in paragraph (a)(1) of this section, that transaction or series of related transactions will be deemed to violate paragraph (a)(1) of this section.

(e) *Safe harbor for certain foreign transactions.* The prohibition in paragraph (a)(1) of this section shall not apply to any asset-backed security for which all of the following conditions are met:

(1) The asset-backed security (as defined in this section) is not issued by a U.S. person (as defined in 17 CFR 230.902(k)); and

(2) The offer and sale of the asset-backed security (as defined by this section) is in compliance with 17 CFR 230.901 through 905 (Regulation S). By the Commission.