

CFTC Further Clarifies Commodity Pool Treatment for Certain Securitizations and Provides Additional No-Action Relief for Others

On December 7, 2012, the Division of Swap Dealer and Intermediary Oversight (Division) of the Commodity Futures Trading Commission (CFTC) issued interpretation and no-action letter [No. 12-45](#),¹ “Further Exclusions from Commodity Pool Regulation for Certain Securitization Vehicles; No-Action Relief for Certain Securitization Vehicles Formed Prior to October 12, 2012” (the CFTC Second Securitization Letter). The CFTC Second Securitization Letter does three things: it provides interpretive clarification that some securitization entities are not “commodity pools”; it provides conditional no-action relief for certain legacy securitization entities; and it provides time-limited no-action relief until March 31, 2013 for non-exempt securitization entities to allow for more time for further dialogue with CFTC Staff.

Further Clarification and Interpretation

The CFTC Second Securitization Letter begins by affirming the relief provided by the Division in [CFTC Interpretation Letter No. 12-14](#)² (the CFTC First Securitization Interpretation Letter, which we discussed in our related prior [Legal Update](#)³). It then discusses some additional types of securitization entities that the Division has determined generally should be excluded from the definition of “commodity pool,” even though such entities may not meet the operating or trading limitations contained in Regulation AB under the Securities Exchange Act of 1934, as

amended (Regulation AB), and Rule 3a-7 under the Investment Company Act of 1940, as amended (Rule 3a-7), as required under the CFTC First Securitization Interpretation Letter. These securitization entities would properly be excluded if (i) they otherwise meet the requirements that the use of swaps is no greater than contemplated by Regulation AB or Rule 3a-7, (ii) the swaps used by such entities are not used in any way to create an investment exposure and (iii) the criterion relating to the ownership of financial assets under the CFTC First Securitization Interpretation Letter continues to be satisfied. In the Division’s view, investments in such an entity are essentially in the financial assets held by the entity and not in the swaps, much like investments in traditional securitization vehicles that satisfy Regulation AB or Rule 3a-7.

Clarifications With Respect to Certain Securitization Vehicles

Specifically, the Division cites standard asset-backed commercial paper (ABCP) conduits, traditional collateralized debt obligation (CDO) and covered bond transactions as examples of such securitization entities.

In cases where exposures to synthetic assets consisting of swaps are designed to create, or have the effect of creating, investment exposure (i.e., that may increase investment returns and

distributions rather than serving as credit enhancement as contemplated by Item 1114⁴ of Regulation AB or a permitted form of hedging under Regulation AB), such vehicles may be a commodity pool; however, the Division notes that, depending on additional facts, the operator of a CDO or other securitization entity with a small portion of its holdings in synthetic assets may be exempt under CFTC Regulation 4.13(a)(3).

Securitization Entities To Which the Safe Harbor Does Not Apply

The CFTC Second Securitization Letter also discusses additional securitization entities that, in the Division's view, are distinguishable and are not similarly exempt. These entities include repackaging vehicles that either (i) issue credit- or equity-linked securities and hold high-quality financial assets, but sell credit protection through a swap, through which the related investors obtain their investment exposure or (ii) use swaps to extend the investment maturity on an underlying bond. In these cases, the Division's view is that investors are obtaining a significant component of their investment upside or downside from the related swaps.

Is There a Broader Principle?

The CFTC, in effect, is perhaps endorsing a broader principle: that a securitization entity would not be treated as a commodity pool if the swaps do not create an "investment exposure." An investment appears to be treated as an "investment exposure" if its return would be variable depending on the variability of the payment requirements under the swaps. This principle would appear to exempt from the definition of "commodity pool" any typical securitization entity that issues only securities that have a stated return and for which the swaps are relatively precise hedges of interest rate and currency risks.

No-Action Relief

The CFTC Second Securitization Letter includes both no-action and time-limited no-action relief for operators of securitization vehicles.

First, the Division states that no enforcement action will be taken for failure to register as a commodity pool operator (CPO), if the following criteria are and remain satisfied:

- The issuer issued fixed income securities before October 12, 2012 that are backed by, and structured to be paid from, payments on or proceeds received in respect of, and whose creditworthiness primarily depends upon, cash or synthetic assets owned by the issuer;
- The issuer has not and will not issue new securities on or after October 12, 2012; and
- The issuer shall, promptly upon request of the Commission or any division or office thereof, and in any event within 5 business days of such request, provide to such requestor an electronic copy of the following:
 - the most recent disclosure document used in connection with the offering of the related securities;
 - all amendments to the principal documents since issue;
 - the most recent distribution statement to investors; and
 - if the issuer's securities were offered relying on Rule 144A under the Securities Act of 1933, a copy of the information that would be provided to prospective investors to satisfy Rule 144A(d)(4); *provided*, that, if the issuer does not provide the information required under the CFTC Second Securitization Letter, it must demonstrate that it cannot obtain the required documents through reasonable commercial efforts.

As a result, unexcused failure to provide such required documentation would result in the related securitization entity becoming ineligible

to rely on the relief granted in the CFTC Second Securitization Letter.

Second, the CFTC Second Securitization Letter also includes time-limited no-action relief until March 31, 2013, for operators of securitization entities that are not entitled to the relief under the CFTC First Securitization Interpretation Letter, or otherwise under the CFTC Second Securitization Letter, because they failed to register as CPOs. The relief allows for continuing dialogue between the CFTC and the securitization industry.

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Endnotes

- 1 Available at <http://cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-45.pdf>.
- 2 Available at <http://cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-14.pdf>.
- 3 Available at <http://www.mayerbrown.com/CFTC-Clarifies-Commodity-Pool-Treatment-for-Certain->

Securitized-Provides-Time-Limited-No-Action-Relief-for-Others-10-19-2012/.

- 4 The Division noted that where the use of swaps is commercially unreasonable as credit support with respect to a securitization, it may conclude that a commodity pool exists. By way of example, the Division discussed the use of a swap by an issuer with an affiliate/sponsor where the swap counterparty credit support for the interest and principal was sufficient to allow the floating rate bonds rated “CCC” to obtain “AA” pricing. Such vehicle would be a commodity pool, in the Division’s view, because the swap was a significant aspect of the investment.

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