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Hon. Paul Ryan
Speaker
U.S. House of Representatives
H-232 The Capitol
Washington, DC 20515

Re: Support for H.R. 4166, the Expanding Proven Financing for American Employers Act

Dear Speaker Ryan:

The Structured Finance Committee (the “Committee”) of the New York City Bar Association (the “Association”) is pleased to submit the following comments on a bipartisan bill, H.R. 4166, that was introduced in the U.S. Congress in December 2015.¹

The Association is an organization of over 25,000 lawyers. Most of its members practice in the New York City area; however, Association membership spans nearly every state and 60 countries. The Committee focuses on a broad range of legal, accounting and regulatory issues of interest and concern to the structured finance industry. The Committee appreciates the opportunity to comment on the bill and stands ready to assist the House of Representatives and its staff if further clarification is required on any of the points raised in this letter.

The Expanding Proven Financing for American Employers Act (H.R. 4166) was introduced in the U.S. Congress on December 3, 2015 by Representatives Andy Barr (R-KY)

¹ The comments in this letter express solely the views of the Committee as a whole and do not necessarily reflect the views of any individual Member of the Committee. In addition, this letter does not represent the views of any of the law firms or companies with which the Members of the Committee are affiliated.

and David Scott (D-GA). The purpose of the bill is to provide tailored credit risk retention requirements to certain qualifying collateralized loan obligations. H.R. 4166 was referred to the House Committee on Financial Services (“FSC”) on the date of the bill’s introduction; on March 2, 2016, the FSC ordered the bill, as amended by the FSC (hereinafter, “H.R. 4166” or the “Bill”), to be “reported” for further consideration by the full House. The Bill, if enacted, will add a new Section 15G(e)(7) (captioned “Requirements for Qualified Collateral Loan Obligations”) to the U.S. Securities Exchange Act of 1934, as amended (the “1934 Act”), that specifies an alternate risk retention requirement for any collateralized loan obligation (“CLO”) if that CLO satisfies the definition of a “qualified collateralized loan obligation” (“QCLO”).

The Committee supports H.R. 4166 because the specifically tailored risk retention requirements provide a workable regime for CLOs that (as described in further detail below) is consistent with the substantive goals of section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Such an alternative regime will permit small and mid-sized companies, across countless sectors of the economy, to preserve their critically important access to the multi-billion-dollar pool of capital provided by CLOs.

H.R. 4166 PROVIDES MORE APPROPRIATE RISK RETENTION REQUIREMENTS FOR COLLATERAL MANAGERS OF CLOS THAT AVOID BEING UNDULY BURDENSOME

The Bill’s alternate risk retention requirements are appropriately customized to reflect several ways that collateral managers already retain economic incentives that are similar to those of investors in CLOs. While the Bill imposes new obligations on a collateral manager—directly and/or through one or more of its majority-owned affiliates (collectively, an “Eligible QCLO Retention Holder”)—to further the substantive purpose of the statute, the Bill does not demand a substantial modification to the operation of an already healthy marketplace.

Under the Bill as originally proposed to the FSC, the risk retention requirements for a QCLO may be met if an Eligible QCLO Retention Holder purchases and, during the applicable duration of risk retention specified by the final Credit Risk Retention rules that the Federal banking agencies issued in December of 2014² (“Final Rules”), holds (without hedging or otherwise transferring the credit risk) no less than 5% of the equity of such QCLO. However, during the FSC’s consideration of H.R. 4166, the FSC approved an amendment submitted by Representative Bill Foster (D-IL) (the “Foster Amendment”) that revised the form of the 5% retained interest contemplated by H.R. 4166, with the goal of aligning the interests of the Eligible QCLO Retention Holder with those of *all classes* of the QCLO securities. Accordingly, under the Foster Amendment formula, the Eligible QCLO Retention Holder, rather than retaining 5% of the QCLO equity only, must instead hold at least 3.5% of the QCLO equity, with the remaining 1.5% retention interest distributed among the QCLO debt classes. If either the original or amended retention formulation is passed into law, the alternate risk retention requirement would significantly reduce the current requirement for CLOs under the Final Rules, which mandates a retention interest of not less than 5% of *all of the securities* issued by the CLO (or the fair value thereof, as applicable).

² 79 F.R. 247 at 77602 *et. seq.*

H.R. 4166 REQUIRES EXPANSIVE PORTFOLIO AND CONCENTRATION SAFEGUARDS, AS WELL AS STRUCTURAL PROTECTIONS

The requirements for a CLO to constitute a QCLO are too expansive to detail in full within the confines of this comment letter. Prominent among them are a series of portfolio composition and concentration requirements, which include, *inter alia*, the following:

- 100%³ of the QCLO's assets must be comprised of senior secured loans and cash equivalents.
- None of the QCLOs assets may be asset-backed securities or derivatives (which limitation does not prohibit a QCLO from acquiring a loan participation or any interest related to or in a letter of credit, or entering into derivative transactions to hedge interest rate or currency rate mismatches).
- The QCLO may not purchase defaulted loans, margin stock, or equity-convertible securities.
- The QCLO may acquire only loans held or acquired by three or more investors or lenders unaffiliated with the collateral manager.
- Loans held by the QCLO may be only to borrowers the financial statements of which are subject to an annual audit from an independent, accredited accounting firm.
- No more than 60% of the QCLO's assets may be comprised of "covenant lite" loans.⁴
- No more than 3.5% of the assets of the QCLO may relate to any single borrower.
- No more than 15% of the assets of the QCLO may relate to any single industry.

Notably (and consistent with the common treatment of investment criteria in CLO indentures), in order to maintain its status as a QCLO, a CLO would need to comply, not only at its inception, but also at the time of the purchase of any asset during the lifespan of the QCLO, with the first, and the last three, of the foregoing portfolio requirements (or, if not in compliance with these requirements—due to changes in the properties, or the full or partial repayment of certain assets after they are purchased—to maintain or improve the level of compliance after giving effect to such purchase).

In addition, H.R.4166 specifies certain structural protections for QCLOs. These include requirements that (i) the QCLO's equity be at least 8% of the value of the QCLO's assets (presumably—although not explicitly—measured only at the time of issuance of the QCLO's

³ Note that H.R. 4166, as originally proposed to the FSC, specified that only 90% of the QCLO's assets must be senior secured loans and cash equivalents. That percentage was increased to 100% by the Foster Amendment.

⁴ Although "covenant lite" loans are not defined in the Bill, the term refers broadly to a category of loans that contain few or no financial covenants the failure of which would trigger a default under the governing loan documents.

securities), and (ii) the QCLO's governing documents specify over-collateralization and interest coverage tests, the failure of any of which triggers the mandatory application of available interest collections (and, if necessary, available principal collections) to repay the QCLO debt in order of seniority, until compliance with the applicable test is restored.

H.R. 4166 ALIGNS THE INTERESTS OF INVESTORS AND COLLATERAL MANAGERS

The Bill aligns collateral manager and investor interests by requiring that (a) the holders of the QCLO equity—*excluding* the equity held by Eligible QCLO Retention Holders—have the right to remove the collateral manager for cause, (b) the majority of the collateral manager's fees, including any incentive fee, be subordinated to payments then due in relation to the QCLOs debt securities, and (c) discretionary asset sales each year (excluding sales of defaulted or credit-deteriorated, credit-risk or credit-improved loans) not exceed 30% of the principal amount of the assets of the QCLO. Finally, the QCLO requirements include certain monthly reporting obligations, and requirements relating to regulatory oversight.

H.R. 4166 IS SUPPORTED BY STAKEHOLDERS IN THE REAL ECONOMY, AS WELL AS BY THE COMMITTEE

The U.S. Chamber of Commerce, which is the world's largest business federation, supports H.R. 4166 and has sent a comment letter showing its support.

The Committee likewise believes that the Bill represents an important step forward in refining risk retention requirements applicable to CLOs. In the Committee's view, the Bill reflects—particularly prior to the Foster Amendment—an approach that would align the risk retention requirements imposed by the Final Rules more closely with the stated goal of section 15G of the 1934 Act, as added by section 941 of the Dodd-Frank Act: namely, that the regulations require a securitizer to retain not less than 5% of “*the credit risk*” of a securitized asset. That mandate, along with the broader policy objectives of risk retention, are faithfully achieved by retention of 5% of the QCLO's equity, in which *substantially all of the credit risk of the QCLO is concentrated*. For that reason, we support the Bill and urge its passage by Congress.

The Committee appreciates the opportunity to comment on H.R. 4166. It will be glad to respond with further information at your request.

Respectfully submitted,



Patrick D. Dolan

Cc: Hon. Andy Barr
Hon. Kevin McCarthy
Hon. Nancy Pelosi
Hon. David Scott

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