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September 1, 2016

Katherine Hsu
Chief, Office of Structured Finance
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Ms. Hsu:

On behalf of our client, Sancus Capital Management LP, and its affiliates, ("Sancus Capital") we respectfully request that the staff (the "Staff") of the Securities and Exchange Commission (the "Commission") confirm your concurrence with our view that, based on the facts and circumstances described in this letter, a proposed "applicable margin reset" with respect to notes issued pursuant to a collateralized loan obligation transaction would not constitute an "offer and sale of asset-backed securities by an issuing entity."

I. Background

Section 15G of the Securities Exchange Act ("Section 15G")[1] requires a "securitizer" of an asset-backed securitization ("ABS") to retain at least 5% of the credit risk of the assets collateralizing the ABS.[2] In October 2014, pursuant to Section 15G, the Commission, along with the Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") (collectively the "Agencies") adopted final rules (the "Final Rule") implementing this credit risk requirement.

The Final Rule requires that the sponsor of each "securitization transaction" occuring after the effective date[3] (the "Effective Date") retain at least 5% of the credit risk of the transaction (the "Retention Interest").[4] The sponsor is the entity that "organizes and initiates"[5] a

[1] Section 941 of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act added section 15G to the Securities Exchange Act of 1934.

[2] *See* Securities Exchange Act of 1934 § 15G, 15 U.S.C. § 78o-11.

[3] The Effective Date for securitization transactions (other than residential mortgage backed securitizations) is two years after the Final Rule was published in the Federal Register, which occurs on December 24, 2016.

[4] *See* Credit Risk Retention; 79 Fed. Reg. 77,602, 77,742 (Subpart B, § __.3) (December 24, 2014).

securitization transaction whereas a securitization transaction is defined as "a transaction involving the offer and sale of asset-backed securities by an issuing entity,"[6] relying on the definition of "offer and sale" from the Securities Act of 1933.[7]

Our client, Sancus Capital, directly and through its affiliates, invests in rated senior and unrated subordinated asset-backed securities (collectively, "CLO Securities") issued in collateralized loan obligation transactions ("CLOs").

Typically, senior CLO Securities bear interest at a fixed rate or at a fixed margin over Libor. As the issuer of CLO Securities ("Issuer") collects interest and principal proceeds from its assets, it distributes those proceeds to the holders of its CLO Securities or reinvests them in new assets through separate interest and principal waterfalls. On each payment date, the interest waterfall provides for the sequential payment of interest accrued on the CLO Securities using available interest proceeds, subject to diversion to the early amortization of senior classes or to the purchase of additional assets if certain covenants are not satisfied. Principal proceeds are initially reinvested in new assets, and then, following the termination of a reinvestment period, are applied to the sequential redemption of CLO Securities in their order of seniority.

In a typical CLO transaction, the Issuer is capitalized by only a nominal amount of equity interests, which are owned by a Cayman Islands charitable trust. The true economic equity in the transaction is provided by the most subordinated CLO Securities (the "Residual Interests") which do not have a stated interest coupon but instead receive variable returns based on the residual performance of the CLO's assets after payments due on the senior CLO Securities (the "Excess Return"). As a result, the holders of Residual Interests are often referred to as being in the "first loss" position on the CLO: any reduction in the portfolio return, whether from principal losses or from lower portfolio yields, is borne first by the Residual Interests through a reduction in Excess Return. Some principal and interest coverage covenants further provide that interest proceeds that would otherwise be distributed to the Residual Interests be diverted to pay down principal on the more senior classes. For this reason, investors in Residual Interests are acutely sensitive to principal losses on the underlying assets, as well as to the tightening of asset spreads.[8]

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[5] *Id.* at 77,742 (Subpart A, § __.2).

[6] *Id.* at 77,741 (Subpart A, § __.2).

[7] *See* Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3).

[8] Mezzanine CLO Securities, which receive principal and interest payments after the senior CLO securities but prior to the Residual Interests, share many of the formal features of senior CLO securities, including bearing interest at a fixed rate or at a fixed margin over Libor. However, as with Residual Interests, interest proceeds that would otherwise be payable on mezzanine CLO Securities may be diverted to pay down

The risk of a reduction of Excess Return is especially high due to the fact that leveraged loans can typically reprice or prepay almost at any time at the option of the borrower. Accordingly, periods of general credit spread tightening are correlated with waves of loan repricings and refinancings that can adversely impact Residual Interests. As a result, most, if not all, CLO indentures contain structural features that allow the Issuer, typically at the instruction of the holders of the Residual Interests, to reduce the interest paid on one or more senior tranches of CLO Securities to then-current market rates ("Re-Pricing"). This Re-Pricing feature is valuable to investors in Residual Interests such as our client, because it enables them to protect their returns by mirroring the loan prepayment option with the option to reset the margin rates paid on the senior CLO Securities. In addition, it allows CLOs to maintain competitive returns and proper interest coverage on their mezzanine securities over the life of the transaction.

Without a re-pricing feature, the return attrition in Residual Interests caused by tightening asset spreads could leave subordinated noteholders with no other option than to trigger a general redemption of the CLO, liquidating the underlying CLO portfolio and redeeming all CLO Securities. Alternatively, the return attrition in Residual Interests and the lowering of interest coverage ratios may, in an environment of tightening interest spreads, lead CLO managers to seek out higher-yielding investments in the form of cov-lite,[9] second-lien[10] or middle-market loans,[11]

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principal on more senior classes if certain coverage tests are not met, making mezzanine CLO securities sensitive to tightening asset spreads as well.

[9] "Cov-lite" loans are loans that contain limited, if any, financial covenants. Generally, "cov-lite loans" either do not require the borrower thereunder to maintain debt service or other financial ratios or do not contain common restrictions on the ability of the borrower to change significantly its operations or to enter into other significant transactions that could affect its ability to repay such loans. Ownership of "cov-lite loans" may expose the CLOs to different risks, including with respect to liquidity, price volatility and ability to restructure loans, than is the case with loans that have such requirements and restrictions. In addition, in the current economic environment, the market prices of "cov-lite loans" may be depressed.

[10] Second-lien loans are subordinated in right of payment and ranked junior to one or more other loans made to a borrower. If the underlying borrower experiences financial difficulty, holders of its more senior debt obligations will be entitled to exercise any remedies and receive payments in priority to the loan held by the CLO.

[11] "Middle-market" loans are loans that are made to smaller borrowers and in smaller principal amounts (typically in an aggregate principal amount of up to $200-250 million) than the broadly-syndicated loans that make up the bulk of the CLO market. Such loans involve a number of particular risks that may not exist in the case of large public companies, including: (i) these companies may have limited financial resources and limited access to additional financing, which may increase the risk of their defaulting on their obligations, leaving creditors dependent on any guarantees or collateral they may have obtained; (ii) these companies frequently have shorter operating histories, narrower product lines and smaller market shares than larger businesses, which render them more vulnerable to competitors' actions and market conditions,

thereby contributing to lower investment and underwriting standards and to increased risk within CLO portfolios.

Each Issuer contracts with an investment manager ("Manager") to select assets to be purchased by the Issuer throughout the life of the CLO. As explained in the Supplementary Information accompanying the Final Rule, "the agencies believe that the risk retention rules apply to CLOs because CLO Managers clearly fall within the statutory definition of 'securitizer' set forth in Exchange Act section 15G."[12] Accordingly, our client expects that the Manager, with respect to any CLO in which our client invests, will be considered a sponsor of any CLO the Manager manages, and as such the Manager would be charged with holding the Retention Interest in connection with any "offer and sale" of ABS interests by the Issuer after the Effective Date.

While CLOs that close prior to the Effective Date are "grandfathered" from risk retention compliance, new offers and sales of CLO Securities, including securitization transactions in respect of CLOs that originally closed prior to the Effective Date, will be required to comply with the retention provisions of the Final Rule. Accordingly, if the Commission takes the position that a Re-Pricing is an "offer and sale of asset-backed securities by an issuing entity," previously-grandfathered transactions that undergo a Re-Pricing after the Effective Date would be required to come into compliance with the risk retention provisions.

In light of the possibility that a Re-Pricing would cause a CLO initially issued prior to the Effective Date to become subject to the risk retention provisions of the Final Rule, our client has developed an applicable margin reset ("AMR") mechanism substantially modeled after the widely employed auction rate mechanism found in auction rate securities ("ARS"). Based on previous Commission relief and various court interpretation, it is our opinion that the AMR mechanism constructed as described below does not consititute a new "offer and sale of asset-backed securities by an issuing entity" within the meaning of the Final Rule, and thus would not trigger retention requirements if employed after the Effective Date.

While the obligation to hold risk retention pursuant to the Final Rule falls on the Manager of a CLO, the consequences of not being able to effect a Re-Pricing are borne by the holders of

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as well as general economic downturns; (iii) there may not be as much information publicly available about these companies as would be available for public companies, and such information may not be of the same quality; and (iv) these companies are more likely to depend on the management talents and efforts of a small group of persons, and as a result, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on these companies' ability to meet their obligations.

[12] Credit Risk Retention; 79 Fed. Reg. 77,602, 77,650.

mezzanine and subordinated CLO Securities.[13] Therefore, our client is requesting that the Staff confirm its concurrence with our opinion that a reset of CLO liabilities through an AMR procedure does not constitute a new "offer and sale of asset-backed securities by an issuing entity," as without such confirmation CLO Securities subject to AMR procedures would be unavailable. Alternatively, given the limited number of Managers capable of complying with the Final Rule prior to the Effective Date, between now and the Effective Date our client may have to invest in CLOs which do not comply with the Final Rule and thus will not be able to refinance or re-price after the Effective Date, thereby exposing our client to potential losses in case of a general spread tightening occurring after the Effective Date.

II. Applicable Margin Reset

Having some sort of mechanic to allow interest rates to reset on the notes issued by a CLO is critical to the economics of a CLO. The underlying assets of a CLO are a pool of commercial loans, each of which is subject to periodic interest rate resets and call features. If a sufficient number of the underlying commercial loans either see their interest rates reduced as a result of a periodic interest rate reset, or are called and replaced by new commercial loans bearing interest at lower rates, the interest proceeds available to the CLO to pay interest to the holders of CLO Securities will be reduced. Without the ability of the CLO to modify the yield on its existing liabilities to better reflect current yields in credit markets, it may become impossible for the CLO to properly pay its debt as it becomes due or to distribute excess income to the subordinated Securities, which increases the odds of substantial CLO portfolio unwinds. Therefore, given the uncertainty surrounding the status of Re-Pricing mechanics employed after the Effective Date, CLO market participants are currently searching for ways to ensure their continued grandfathered status after the Effective Date while maintaining the ability to reprice a CLO in case the interest rates on the underlying collateral become misaligned with CLO liabilities.

Because of past Staff relief granted to ARS transactions, our client has developed a mechanism whereby interest rates payable to the senior CLO Securities are periodically reset pursuant to an auction mechanism. Our client (or members of our client's firm) intends to establish a newly-formed affiliate to act as "auction service provider" (in such capacity, the "Auction Service Provider") by providing a platform on which broker-dealers could submit bids to purchase CLO Securities following each auction, depending on the interest rate determined

[13] Notably, the holders of mezzanine CLO Securities do not have the right to trigger a CLO redemption, meaning that, if spreads on the underlying assets were to tighten to the point that interest payable on the mezzanine CLO Securities was diverted to the holders of senior CLO Securities, the mezzanine investors would be unable to mitigate their losses other than through selling their notes, likely at a loss.

pursuant to the auction, and our client would use its position as a purchaser of subordinated CLO Securities to negotiate with the Manager and underwriter of new CLOs to include the auction mechanism in the documentation for CLOs that close after the date the Final Rule was adopted. As discussed more fully below, the auction mechanism requires no Issuer, noteholder or Residual Interest involvment and, because it will be fully outlined in the initial offering documents and indenture, it will necessitate no amendments to the indenture or CLO Securities at the time of auction.

Unlike a typical CLO Re-Pricing, which occurs at the behest of the holders of the Residual Interests or the Manager, the proposed AMR procedure would serve to reset interest rates through a reverse Dutch auction occurring at predetermined intervals after the CLO closing (each, an "AMR Date"), up to a specified maximum number of such AMR dates. The first AMR Date would be scheduled to occur on a specified date after the end of the non-call period, and subsequent AMR Dates could follow at certain specified intervals thereafter. For example, an AMR could take place on certain specified payment dates or anniversaries of the closing date. Ultimately we would not anticipate the AMR procedures being applied to any class of CLO Securities more than two or three times over the life of a CLO.

The occurrence of an AMR Date could also be subject to certain objective conditions precedent, including standard conditions such as the absence of an event of default under the CLO indenture, economic conditions evidenced by publicly observable economic or market indicators,[14] the Trustee having received an opinion of counsel to the effect that the AMR will not cause certain adverse tax consequences,[15] or the Settlement Agent (as defined below) having received confirmation from at least three broker-dealers of their intent to submit bids in the AMR, each of which conditions will be set forth in the initial offering documents for the CLO Securities. None of the Issuer, the Manager, the holders of any CLO Securities (including the Residual Interests), or any other party, would have any discretion to call for or cause an AMR Date to occur, and as long as the conditions precedent to an AMR Date set forth in the offering

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[14] By way of example, these economic or market indicators could include indices of leveraged loan interest rates such as the Par Weighted Coupon of the S&P U.S. Issued High Yield Corporate Bond Index, or broader measures of bank lending rates such as the Wall Street Journal prime rate, each meeting certain predefined thresholds.

[15] For this reason, and because mezzanine CLO Securities are typically originally sold with original-issue discount and trade at a discount to par while (as explained below) CLO Securities subject to AMR are redeemed and then re-sold at par, it is expected that only senior CLO Securities – those rated 'A' or above – will be subject to AMR.

documents are satisfied, no such party would have any discretion to cancel the occurrence of an AMR Date.[16]

At the time of closing, all AMR procedures and each proposed AMR Date, as well as the conditions precedent to the occurrence of an AMR Date, will be clearly outlined in the offering documents and the indenture, and the Issuer will retain the Auction Service Provider to conduct the auction procedure confidentially between the auction participants, as well as a settlement agent ("Settlement Agent") to solicit broker-dealers from a pre-approved list to participate in the auction and to facilitate settlement of trades resulting from the AMR procedure.

The Auction Service Provider will be independent from the Issuer, Manager, trustee and placement agents in the CLO. While affiliates of the Auction Service Provider (including Sancus Capital, but not the Auction Service Provider itself) may acquire CLO Securities (including Residual Interests), the ownership of such CLO Securities is not in our view material to the analysis set forth herein due to the limited nature and duties of the Auction Service Provider. Specifically, the role of the Auction Service Provider will be purely mechanical and without any discretionary functions (i.e., merely assembling confidential orders and calculating the winning bid margin as outlined below). Moreover, the Auction Service Provider will be required to keep all bids and calculations confidential (including without any disclosure to its affiliated entities) except to the extent of any required notices to the Trustee and the Settlement Agent as part of its role as Auction Service provider, meaning our client will not have any informational advantages with respect to the bids submitted through the Auction Service Provider's platform. The Settlement Agent may be one of the placement agents in the CLO, but will be independent from the Issuer and the Manager.

Access to the Auction Service Provider's platform would only be granted to settlement agents designated with respect to CLO transactions and to other auction participants selected by settlement agents; for any AMR procedure held in relation to a specific CLO, the list of broker-dealers allowed to participate in the auction would be limited to the settlement agents listed under the Auction Service Provider's platform, and any other auction participants designated by the Settlement Agent for that transaction, with the expectation that this would substantially

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[16] While the conditions precedent will be objectively observable and verifiably either true or false, we anticipate, given current market practice, that parties like CLO trustees will not want to make these determinations of their own accord, and that therefore a certification by the Issuer may be required for the trustee to permit the AMR to proceed. Given the objective nature of the conditions precedent, the lack of discretion in the Issuer certifying as to their satisfaction, and the fact that Issuers are typically managed by professional directors without a direct financial stake in the returns generated by the CLO, we do not consider this extremely limited involvement by the Issuer material to consideration of whether the AMR constitutes an offer and sale "by an issuing entity."

encompass the universe of banks and broker-dealers most active in the CLO market. For any given auction, broker-dealers listed on the platform could be excluded (i) from that auction only, by the Settlement Agent in charge of that auction, if the Settlement Agent has reason to believe that such broker-dealer would not be able to settle its orders and would thereby expose the Settlement Agent to unacceptable counterparty risk, or (ii) from any third-party auction, by the Auction Service Provider, using objective criteria aimed at identifying broker-dealers who repeatedly fail to bid auctions after having confirmed their intention to participate to the related settlement agent.[17] Broker-dealers will not be affiliated with, and would not receive any compensation from, the Issuer or the Manager, but would be paid directly by the investors buying and selling CLO Securities pursuant to the AMR procedures as with any other sale between third parties facilitated by a broker-dealer.

Prior to an AMR Date, the trustee will provide notice to the Settlement Agent and the holders of CLO Securities of each outstanding class subject to the AMR procedure (each such class, an "AMR Class"). The notice will specify the AMR Date, a copy of the auction procedures initially included in the offering documents and indenture, and the transfer price, which will be substantially equal to par plus accrued interest, if any (together, the "Transfer Price"). Upon receiving notice from the trustee, the Settlement Agent will solicit the pre-approved broker-dealers to participate in the AMR by submitting bids on behalf of their clients. If at least three approved broker-dealers have not logged onto the Auction Service Provider's AMR platform to indicate their intent to participate in an AMR on or prior to a cutoff date, the Auction Service Provider will notify the Settlement Agent and the Trustee and the AMR will be cancelled (and rescheduled for the next succeeding payment date).

Existing holders of CLO Securities and new third-party buyers may direct their participating broker-dealer to submit to the Auction Service Provider a confidential bid (a "Bid"), committing to purchase, for the applicable Transfer Price, up to a given principal balance of CLO Securities of a particular AMR Class on the applicable AMR Date, but only if the rate determined through the auction is not lower than a specified minimum applicable margin specified in the bid. Bids submitted during the auction may not specify a rate higher than a specified maximum (typically the applicable margin above three month LIBOR in effect prior to the AMR Date, less a specified amount set forth in the offering documents (as an illustrative example, perhaps 0.20%)).

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[17] For example, a broker-dealer may be excluded if it has given positive indications of its intention to bid in at least three AMRs across various transaction in the past six months but failed to submit bids in any of them, or if it has given positive indications of its intention to bid in at least five AMRs but failed to submit bids in more than half of them.

In order to ensure that a retention holder affiliated with the sponsor or originator ("Retention Holder") that must hold at least a minimum fraction of certain classes of CLO Securities in order to satisfy applicable regulatory requirements[18] is able to satisfy this obligation, a Retention Holder (and only a Retention Holder) will also be able to submit a retention order (a "Retention Order") committing to retain up to a given principal balance of CLO Securities of a particular AMR Class on the applicable AMR Date, irrespective of the rate determined through the auction. CLO Securities subject to Retention Orders will not be included in the AMR procedures.[19] Bids and Retention Orders are collectively referred to as "Orders."

Broker-dealers could submit Bids on their own behalf as well as on behalf of third-party investors, and in the event that a third-party buyer fails to deliver funds to settle its purchase of CLO Securities, its related broker-dealer may choose to purchase those CLO Securities for its own account (or, in the alternative, the Settlement Agent may purchase those CLO Securities directly), and then seek to sell those CLO Securities to another buyer after the completion of the AMR procedures. The Retention Holder would not be permitted to submit Orders other than its Retention Order, and other than any such Retention Orders submitted by the Retention Holder, neither the Issuer, the Manager, nor other person affiliated with the Issuer or Manager would be eligible to submit Orders as part of the AMR procedures, and therefore no such affiliated person would be able to influence the outcome of the AMR procedures.

All Orders must be submitted to the Auction Service Provider through a broker-dealer at least six business days prior to the AMR Date (the 6th business day prior being the "AMR Determination Date"). On the AMR Determination Date, the Auction Service Provider will assemble all Orders submitted and, for each AMR Class, determine the amount of notes not subject to a Retention Order and therefore available to purchase pursuant to the AMR procedure. The Auction Service Provider will apply Bids for such AMR Class with the lowest specified minimum applicable margin to each available note, with Bids for higher minimum applicable margins only subsequently accepted, until all notes of such class are subject to Bids or Retention

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[18] As the AMR procedures will initially be included into transactions that are not subject to the Final Rule as of their respective closing dates, we expect that this requirement would initially only pertain to European risk retention requirements, and not any retention requirement under the Final Rule. However, in the event that the CLO market found the AMR procedures to be a useful mechanism for inclusion in CLOs closing after the Effective Date, the Retention Holder concept could apply to a sponsor holding the Retention Interest required by the Final Rule as well.

[19] As described below, CLO Securities subject to Retention Orders will not be included in the calculation of the Clearing Rate and will not be subject to the mandatory call on the AMR Date as described below, but would nevertheless bear interest at the applicable margin determined for CLO Securities of the relevant Class from and after the AMR Date.

Orders. The lowest applicable margin at which there are sufficient Bids and Retention Orders specifying margins not higher than such margin to account for all of the notes in such class is the "Clearing Rate" for such class. Bids lower than the Clearing Rate will be accepted, Bids higher than the Clearing Rate will be rejected, and Bids at the Clearing Rate will be allocated *pro rata* among winning bidders, as all available notes are sold.

If there are sufficient Bids to establish a Clearing Rate for any AMR Class not higher than the specified maximum margin, the Clearing Rate will become the applicable margin applied to all notes in the AMR Class (whether or not subject to the auction) until the next AMR Date, if any. Once the new margin has been determined, the Auction Service Provider will provide notice of the Clearing Rate and winning bids for each AMR Class to the Settlement Agent, which will inform each existing holder of CLO Securities and each broker-dealer participating in the AMR.

On the AMR Date, for each AMR Class for which a Clearing Rate has been successfully established, the Settlement Agent will call the CLO Securities of such class using the mandatory call mechanism of the applicable securities depositary, and pay to each existing holder the Transfer Price of its notes subject to the call. The Settlement Agent will then re-sell the CLO Securities (now bearing an applicable margin equal to the Clearing Rate) on the same day to any bidder whose Bid was accepted in the auction, again for the Transfer Price. None of the sale proceeds will accrue for the ultimate benefit of the Issuer or the Settlement Agent; the end result after all of the transfers on the AMR Date will be a transfer of CLO Securities from the existing holders to the winning bidders, and a transfer of the Transfer Price from the winning bidders to the existing holders.

If there are not enough Bids to purchase all available notes in a particular AMR Class, the AMR procedure "fails," the current holders of notes in such AMR Class will continue to hold their CLO Securities at the applicable margin that existed just prior to the AMR process, and a new AMR Date (and corresponding AMR Determination Date) will be scheduled for the next succeeding payment date, to be repeated on each succeeding payment date until a successful auction is held. In addition, notes subject to Retention Orders will not be subject to tender and repurchase, but will continue to be held by the Retention Holder (and bear interest at the rate determined pursuant to the AMR from and after the AMR Date).

For all CLOs electing treatment under the AMR procedures, the offering circular for such CLOs will include a prominent statement (e.g., on the cover of the offering document) as to whether the Manager (or sponsor) is subject to risk retention requirements with respect to the CLO, and if it is, the manner in which it intends to comply with the requirements. The offering circular for the CLO will also contain a section entitled "Applicable Margin Reset Procedures" setting forth all of the applicable conditions and criteria for an AMR, and other information relevant to an investor contemplating investing in CLO Securities of an AMR Class, including:

- the initial schedule of AMR Dates, and the procedure for designating a new AMR Date if a scheduled AMR Date does not occur or an AMR fails;

- conditions necessary for an AMR Date to occur, including the minimum number of participating broker-dealers to permit an AMR to occur;

- the mechanics of the bidding process, including how to submit a Bid, how the Clearing Rate will be determined, and how Orders will be deemed accepted or rejected;

- the calculations defining the maximum margin permitted to be set forth in any Bid;

- the identity of the initial Auction Service Provider and Settlement Agent;

- a statement to the effect that reliance on the interpretive letter contemplated hereby does not preclude the availability of any applicable private rights of actions for any violation of the federal securities laws; and

- a statement that the purpose of AMR is not to provide liquidity, but rather to permit the margin on CLO Securities in each AMR Class to be adjusted to reflect changes in interest on the CLO's assets and/or to reflect current market pricing.

Both the Auction Service Provider and the Settlement Agent may be paid a fee for their services by the Issuer, irrespective of the success or failure of any application of the AMR procedure or the margin determined. In either case, expenses incurred by the Auction Service Provider and the Settlement Agent would be reimbursed by the Issuer as administrative expenses pursuant to the terms of the priority of payments in the CLO indenture. In the event that the AMR procedures fail and a Clearing Rate cannot be determined, the expenses of the Auction Service Provider and the Settlement Agent would be reimbursed along with other administrative expenses on the next quarterly payment date. In the event that the AMR procedures succeed and a Clearing Rate is determined, the expenses of the Auction Service Provider and the Settlement Agent would again be payable by the Issuer on subsequent payment dates, but with the amount payable on any payment date capped so as not to exceed the difference between the amount of interest that would have been due on the CLO Securities if the AMR had not taken place (and hence the CLO Securities still bore their original, higher rate of interest) and the amount of interest actually due on the CLO Securities on that payment date.

III. Previous Staff No-Action Letters and Other Guidance

The AMR procedures discussed above have been designed so as to fit squarely within previous Staff guidance and substantially modeled after auction procedures widely found in ARS transactions. ARS are issued as long term nominal maturity bonds with interest rate auctions occurring at predetermined short term intervals, usually every 7, 28 or 35 days. On each auction date, both existing holders and potential investors of ARS enter into the bidding process through the same mechanisms described in the AMR procedure. The auction agent determines the Clearing Rate at which all available ARS are sold and this Clearing Rate becomes the applicable interest rate until the next auction date.

The aim of issuers and investors in issuing and purchasing ARS differs from the aim of Issuers and investors in CLO Securities interested in issuing and purchasing AMR notes. ARS have typically been employed as a means of ensuring added liquidity for the security holders, but as explained above, AMR procedures would be incorporated into CLO offering documents and indentures to ensure that interest rate margins on CLO liabilities are able to properly trace prevailing market rates. Rather than the 7, 28 or 35 day intervals between auctions typically found in ARS transactions, AMR would only be employed on specific predetermined dates occurring after a non-call period.[20] Because it will be clearly disclosed in the offering circular that the purpose of AMR is not to provide liquidity, investors should not perceive CLO Securities subject to AMR as equivalent to a short-term investment; thus, there is no expectation that CLO Securities with AMR provisions will suffer widespread failures as previously seen in ARS.

Issuers of ARS have received Staff no-action guidance indicating that the resetting of interest rates via a Dutch auction does not constitute an "offer and sale" of securities under the Securities Act.[21] In *Lehman Brothers Kuhn Loeb Incorporated* (available 4/20/83),[22] the Staff considered whether preferred stock having its interest rate reset every 28 days at an auction would constitute a "continuous distribution of securities" (such that a new prospectus would have to be

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[20] The "non-call period" for a CLO typically comprises the period from the closing date to the second anniversary of the closing date, and guaranties the holders of the rated CLO Securities that their investment will remain outstanding within this period. Following the end of the non-call period, the holders of the Residual Interests have the right to trigger a redemption (or a re-pricing) of the rated CLO Securities. Two to three years after the end of the non-call period, the "reinvestment period" ends, meaning that the Manager may no longer cause the Issuer to buy and sell the corporate loans that back the CLO other than in certain very limited circumstances, and the asset pool becomes static.

[21] In addition to the no-action support discussed below, courts have exhibited similar treatment to periodic interest rate resets; *see generally* Sanderson v. Roethenmund, 682 F. Supp. 205 (S.D.N.Y. 1988).

[22] *See Lehman Brothers Kuhn Loeb Incorporated*, SEC No-Action Letter (Apr. 20, 1983).

distributed to purchasers at each auction).[23] The preferred stock issuer argued that the "purchases and sales in the auction process should be considered market transactions in a security whose distribution has previously been completed."[24] The Staff granted no-action relief, concluding that such a mechanic would not constitute an offer and sale of the security and thus would not require the continuous filing of registration statements.[25]

Similarly, in *City Capital Funding, Inc.* (available 10/11/84),[26] the Staff considered whether money market preferred shares having its dividend rate periodically reset through an auction process was a continuous distribution. Noting that the Staff has provided no-action relief to issuers using a similar auction mechanic, the issuer argued that the dividend rate reset was a secondary market transaction rather than a continuous distribution by the issuer.[27] The Staff concurred with the issuer, stating that a new registration statement or post-effective amendment would not have to be filed each time the dividend rate on the shares was reset through an auction.[28]

Outside of the context of ARS, the Staff has provided no-action relief for issuers of securities with interest rate reset mechanisms clearly built into the offering documents and indenture. In *Xerox Credit Corporation* (available 5/12/83),[29] the Staff considered whether predetermined annual interest rate adjustments tracking changes in the effective interest rate on one-year U.S. Treasury obligations were "new securities" which required registration under the Securities Act of 1933. The issuer argued that the interest rate adjustment is "accomplished in the manner contemplated and expressly provided for at the time the security was issued."[30] The Staff concurred, stating that the annual reset mechanism did not necessitate filing a new registration statement.[31]

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[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *See City Capital Funding, Inc.*, SEC No-Action Letter (Nov. 12, 1984).

[27] *Id.*

[28] *Id.*

[29] *See Xerox Credit Corporation*, SEC No-Action Letter (May 12, 1983).

[30] *Id; see also Continental Telephone Company*, SEC No-Action Letter (June 17, 1983).

[31] *Id.*

Courts have also addressed the question of whether certain changes to the terms of a security, including a reset of interest rates, constitutes a new purchase and sale of a security. In *Sanderson v. Roethenmund*, the plaintiffs purchased international certificates of deposit ("ICDs") which, upon their maturity, were rolled over into other ICDs issued and sold by the same issuing entity.[32] They brought claims under Section 12(a)(2) of the Securities Act several years after their initial investment, which they claimed were not time-barred because "each rollover was a separate sale of a security which commenced the running of a new three year limitation period."[33] The court noted that the Second Circuit had held previously stated that "[b]efore changes in the rights of a security holder can qualify as the purchase of a new security . . . there must be such significant change in the nature of the investment or in the investment risks as to amount to a new investment."[34] The court held that a rollover of ICDs did not amount to a new purchase, because "each rollover represented merely a periodic interest rate and maturity date adjustment to a new security" which "was something contemplated by the Sandersons when they made their initial purchases."[35]

The Staff have more recently considered auction structures similar to the AMR procedures in *Eaton Vance Management*.[36] Eaton Vance Management sought to market "liquidity protected preferred shares ("LPP"), a new type of preferred stock."[37] The LPP were subject to weekly dividend resets in which "broker-dealers acting as remarketing agents" would "set dividend rates on the LPP based upon canvassing of the potential market buyers of shares," with the result being "the lowest possible rate at which all the LPP would be either held or bought after matching up sell, bid and buy orders."[38] Bids of potential dividend rates on the LPP were subject to a capped "Boundary Rate" based on a spread above LIBOR or a percentage of LIBOR at the time of the dividend reset.

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[32] 682 F. Supp. 205 (S.D.N.Y. 1998). The "investment decision doctrine" is used by courts to determine whether there was a continuous distribution of securities rather than a "one-shot deal." *See* Goodman v. Epstein, 582F.2d 388 (7th Cir. 1978), *cert denied,* 440 U.S. 939 (1979); s*ee also* Hill v. Equitable Bank, Nat'l Ass'n, 599 F. Supp. 1062, 1972 (D. Del. 1984).

[33] *Id.* at 208-09.

[34] *Id.* at 209, quoting *Abrahamson v. Fleschner*, 568 F.2d 862, 858 (2d Cir. 1997), *cert. denied*, 436 U.S. 905 (1978).

[35] *Id.* at 209.

[36] *Eaton Vance Management*, SEC No-Action Letter (June 12, 2008).

[37] *Id.*

[38] *Id.*

In analyzing whether periodic adjustments to interest rates on, or transactions involving the repurchase and re-marketing of, securities previously issued pursuant to a registration statement, constitute a continuous or delayed offering by the original registrant under the Securities Act of 1933, the Staff has explained that:

> Plans of financing can involve periodic adjustments of interest or dividend rates, rollovers of securities, and plans to buy back and re-market securities, sometimes coupled with "puts" or guarantees (which themselves are securities). Filings involving such plans require an analysis of Section 5 and Rule 415 issues with respect to all securities involved in the offerings. Even after the original offering of the securities has terminated, the registrant may still be engaged in a continuous or delayed offering with respect to the future periodic issuance or modification of securities. These subsequent transactions may involve primary offerings of the issuer's securities to the extent the issuer pays a remarketing or auction agent or otherwise is involved in subsequent sales such as in the remarketings or auctions.[39]

Two months later, the Staff specifically outlined the analysis required in "identify[ing] whether a purported secondary offering is really a primary offering, i.e., the selling shareholders are actually underwriters selling on behalf of an issuer" in the context of Rule 415 under the Securities Act. In the Securities Act Rules Compliance and Disclosure Interpretations Question 612.09 ("CDI 612.09"), the Staff outlined a multi-part factual test for whether an offering should be considered as a primary or secondary one, writing:

> The question of whether an offering styled a secondary one is really on behalf of the issuer is a difficult factual one, not merely a question of who receives the proceeds. Consideration should be given to how long the selling shareholders have held the shares, the circumstances under which they received them, their relationship to the issuer, the amount of shares involved, whether the sellers are in the business of underwriting securities, and finally, whether under all the circumstances it appears that the seller is acting as a conduit for the issuer.

IV. Discussion

As discussed above, Section 15G requires risk retention compliance in connection with any "securitization transaction" occurring after the Effective Date. A securitization transaction is

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[39] Securities Act Sections Compliance and Disclosure Interpretations Question 239.14 ("CDI 239.14").

a "transaction involving the offer and sale of asset-backed securities *by an issuing entity.*"[40] In the CLO context, therefore, risk retention compliance is only required in connection with an "offer and sale" of CLO Securities by the Issuer.

(a) *The AMR procedures involve secondary market transactions between investors.*

The AMR procedures were modeled on the ARS procedures previously granted relief by the Staff. Accordingly, application of the AMR procedures should be interepreted in a manner consistent therewith, i.e., as involving secondary market transactions between investors rather than an "offer and sale" of CLO Securities by the Issuer.

As the Staff indicated in the *Lehman Brothers Kuhn Loeb* and *City Capital Funding* no-action letters, periodic interest rate resets through a Dutch auction, conducted by an independent auction agent under procedures clearly outlined in the indenture, are secondary transactions rather than a new distribution of securities by the Issuer. In the absence of a new distribution, an issuer is not deemed to have engaged in an "offer and sale" of securities as defined under the Securities Act of 1933.[41] The AMR procedures substantially follow the mechanics the Staff approved in *Lehman Brothers Kuhn Loeb* and *City Capital Funding*. Similar to the process in *Lehman Brothers Kuhn Loeb*, broker-dealers will canvas investors to determine whether they desire to hold the CLO Securities and at what margin, and investors will submit their bids through broker-dealers. In this case an independent Auction Service Provider, filling the role of the Transfer Agent in *Lehman Brothers Kuhn Loeb*, will determine the margin for each AMR Class without any interference or influence from the Issuer or Manager, being the lowest bid that, in combination with all other lower bids, would clear the market of the entire principal amount of CLO Securities of each AMR Class. After the Clearing Rate is determined, it will become the applicable margin on the CLO Securities until the next application of the AMR procedures.

Similar to the LPP discussed in *Eaton Vance Management*, bids on the notes of each AMR Class will be subject to a maximum permissible rate, the formula of which will be fully disclosed in the CLO offering circular. This maximum rate narrows the possible range of outcomes for each application of the AMR procedures, which both gives initial investors in the CLO Securities additional certainty as to the margins payable on the CLO Securities over the life

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[40] Credit Risk Retention, 79 Fed. Reg. at 77,741 (Subpart A, § __.2) (emphasis added).

[41] As the *Lehman Brothers Kuhn Loeb* and *City Capital Funding* no-action letters make clear, the issuer is not required to file a new registration statement or post-effective amendment following each auction. This would not be the case had the Staff found the issuer was engaged in the "offer and sale" of new securities, pursuant to the registration requirements of Securities Act of 1933 § 5, 15 U.S.C. § 77e(a).

of the deal, and further limits the investment decision to be made by investors at the time of each AMR.

Furthermore, addressing the concerns in *Xerox Credit Corp.*, the specifics of the AMR procedure will be fully disclosed in the CLO offering documents and the indenture at the time of closing. No amendment will be necessary as the auction will be conducted pursuant to procedures contemplated and expressly provided for at the time the CLO Securities are issued. As the applicant in *Xerox Credit Corp.* wrote, "[t]he interest rate adjustment is a change in one term of the security, accomplished in the manner contemplated and expressly provided for at the time the security was issued."

Finally, the CLO Securities subject to the AMR procedures are subject to even fewer changes than the ICDs in *Sanderson*, in that only their interest rate will be adjusted, and not their maturity date, and unlike the ICDs in *Sanderson*, no new CLO Securities will be issued at the time of an AMR: rather, the notes of each AMR Class will be tendered to the Settlement Agent, who will immediately re-sell them to the winning bidders, without obtaining a new CUSIP, re-registering the notes with the relevant securities depositary, or canceling the existing CLO Securities.

(b) *The AMR procedures do not constitute a primary offering.*

The Staff explained in CDI 239.14 that financings involving "periodic adjustments of interest or dividend rates, rollovers of securities, and plans to buy back and re-market securities . . . require an analysis of Section 5 and Rule 415 issues with respect to all securities involved in the offerings," and "these subsequent transactions may involve primary offerings of the issuer's securities to the extent the issuer pays a remarketing or auction agent or otherwise is involved in subsequent sales such as in the remarketings or auctions." We do not believe that payments by the Issuer to the Auction Service Provider and the Settlement Agent in connection with the AMR procedures would cause the AMR procedures to constitute a primary offering, based on the prior no-action guidance issued by the Staff and discussed above, as well as a review of the criteria outlined by the Staff in the context of Rule 415 in CDI 612.09. Specifically, we note that the indicia of a primary offering (i.e., an offer and sale "*by an issuing entity*") outlined in CDI 612.09 are absent in the context of the AMR procedures.

The criteria identified in CDI 612.09 are described below. We consider these criteria from the perspective of the current holders of notes of each AMR Class who tender their CLO Securities to the Settlement Agent as the "selling" party. While these notes are tendered to the Settlement Agent and then sold by the Settlement Agent to the winning bidder, the Settlement Agent takes no exposure to the notes between the time they are tendered to it and the time it sells them on, and is selling notes for precisely the same price as it purchased them, without any

commission, holdback or economic interest other than its ongoing fee and right to expense reimbursement. Accordingly, the Settlement Agent through the use of its electronic portal is merely acting as a facilitator for the buying and selling of notes, rather than as a party that is buying or selling or taking principal risk for its own account.

- *Identity of the party receiving the proceeds of the sale of CLO Securities.*[42]

The selling noteholders, rather than the Issuer, will receive the proceeds of the sale of CLO Securities in each AMR Class.

- *How long the selling noteholders have held the CLO Securities.*

Other than as a result of any trading directly between investors in the secondary market, the initial noteholders will have held their CLO Securities for at least the duration of the non-call period prior to the first application of the AMR procedures, while any subsequent noteholders will hold their CLO Securities until the next AMR Date, a period that may be as short as several months, but is expected to last for a year or more; in any case, the noteholders will have acquired the CLO Securities as a long-term investment and not with a view to distribution on behalf of the Issuer.

- *The circumstances under which the selling noteholders received the CLO Securities.*

To the extent the selling noteholders are the initial noteholders, they will have acquired their CLO Securities from the underwriter or placement agent of the CLO in arm's-length transactions on the CLO closing date. Otherwise, the selling noteholders will have acquired their CLO Securities either from the Settlement Agent at par on an AMR Date, or from another noteholder in the secondary market between AMR Dates. In each case, the offering circular for the CLO will require that any purchaser or transferee of CLO Securities held through a securities depositary (including the CLO Securities of each AMR Class) have represented and agreed that it is acquiring its interest in such CLO Securities for its own account for investment and not with a view to the resale, distribution or other disposition thereof in violation of the Securities Act. Accordingly, the AMR procedures will not be a means for a selling noteholder to distribute CLO Securities on behalf of the Issuer.

- *The relationship of the selling noteholders to the Issuer.*

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[42] In CDI 612.09, the Staff wrote that the consideration of whether an offering was a primary or secondary offering was "not *merely* a question of who receives the proceeds" (emphasis added).

Both the selling noteholders and bidding investors in the AMR will have arm's-length relationships with the Issuer and will be required to submit bids through broker-dealers designed to result in a robust bidding process for the CLO Securities.

- *The amount of CLO Securities involved.*

The full outstanding amount of each AMR Class will be subject to tender and purchase on each successful application of the AMR Procedures, other than any CLO Securities held by the Retention Holder and subject to a Retention Order.

- *Whether the sellers are in the business of underwriting securities.*

The selling noteholders will be the current holders of the CLO Securities, and as a result will have previously represented at the time of their purchase of CLO Securities that they were acquiring their interest in such CLO Securities for their own account for investment and not with a view to the resale, distribution or other disposition thereof in violation of the Securities Act. Thus, the selling noteholders will not be underwriters of CLO Securities.

- *Whether under all the circumstances it appears that the seller is acting as a conduit for the Issuer.*

Selling noteholders in an AMR process are clearly not acting as a conduit for the Issuer. Rather, the AMR procedures involve a secondary-market sale from existing noteholders to new noteholders. This noteholder transaction is conducted without the Issuer's involvement or receipt of any sale proceeds, and in a manner fully disclosed in the offering circular for the CLO.

(c) *The application of the AMR procedures is consistent with the policy goals of the Final Rule.*

As the Agencies noted in the Supplementary Information accompanying the Final Rule, asset-backed securitization involves "the transfer of . . . assets—in exchange for new capital—to other market participants," which could lead to a "moral hazard problem of loan originators or securitization sponsors incurring risks in the underwriting or securitization process for which they did not bear the consequence."[43] Notably, the AMR procedures do not involve any transfer of assets by the Issuer in exchange for additional capital; rather, the AMR is solely a secondary

[43] Credit Risk Retention, 79 Fed. Reg. at 77,705.

market transaction between noteholders that serves to reset the applicable margin to market clearing rates. No additional proceeds are made available to the Issuer as a result of such process. As a result, the AMR procedures are fully consistent with the policy goals underpinning the Final Rule.

V. Request for Relief

For the forgoing reasons, we respectfully request the Staff to confirm your concurrence with our view that, based on the facts and circumstances described in this letter, application of the AMR procedures would not constitute an "offer and sale of asset-backed securities by an issuing entity" within the meaning of the Final Rule.

* * * * *

We appreciate your assistance in this matter. Please do not hesistate to call John Timperio of Dechert LLP at (704) 339-3180 if you have any questions regarding the relief requested herein. If the Staff does not concur with Sancus Capital's position, Sancus Capital requests an opportunity to confer with the Staff concerning the applicable terms of the AMR procedures prior to the issuance of a response.

Sincerely,

John Timperio

John M. Timperio

JMT