



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 12-14
Interpretation
October 11, 2012
Division of Swap Dealers and Intermediary Oversight

American Securitization Forum
One World Financial Center, 30th Fl.
New York, NY 10281-0006

SIFMA
120 Broadway, 35th Fl.
New York, NY 10271

Re: Request for Exclusion from Commodity Pool Regulation for Securitization Vehicles

Ladies and Gentlemen:

This is in response to your correspondence, dated August 17, 2012, August 21, 2012, and October 5, 2012, to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), in which you requested an interpretation from the Division that certain funds are not commodity pools under Commission Regulation 4.10(d),¹ and Section 1a(10) of the Commodity Exchange Act (“CEA”),² or alternatively, a letter providing that the Division will not recommend enforcement action against the operators of certain funds that issue asset-backed securities (including mortgage-backed securities) for failure to register as commodity pool operators.

You have made several arguments as to why securitization vehicles should not be considered commodity pools. You state that such funds generally use swaps only to hedge interest rate or currency risk.³ You further state that such funds generally pay no initial margin and there is no leverage in the swap.⁴ You assert that securitization vehicles typically enter into swap transactions “at or about the time of the transaction’s closing and the entities generally do

¹ Commission rules referred to herein are found at 17 C.F.R. Ch.I (2011).

² 7 U.S.C. 1a(10).

³ Letter from SIFMA, at 3 (Aug. 21, 2012) (“SIFMA Ltr.”).

⁴ *Id.*

not enter into new swaps except as may be necessary to address counterparty downgrade or default.”⁵

You argue that when the Commission’s existing guidance of what activities result in classification of a fund as a commodity pool is viewed in conjunction with the recent inclusion of swaps within the definition of a “commodity interest,” it could result in securitization vehicles being captured within the Commission’s jurisdiction, which could impose significant burdens on the securitization industry that could have a chilling effect on the launch of new securitization vehicles.⁶

You argue that securitization vehicles do not satisfy the definition of commodity pool, and more specifically, that securitization vehicles do not meet the criteria articulated by the Ninth Circuit in *Lopez v. Dean Witter Reynolds Inc.*⁷ In particular, you state that most securitization vehicles do not have multiple equity participants, do not have pro rata allocations of accrued profits or losses because the issued interests are in the form of debt or debt-like interests with a stated interest rate or yield and principal balance and a specific maturity date, and do not have a purpose of trading in swaps or other commodity interests. You also assert that securitization vehicles are “capital markets financings of sales finance or other financial asset inventory” as opposed to an investment trust.⁸

You specifically request “no-action” relief or interpretative guidance for entities that are operated consistent with the Securities and Exchange Commission’s Regulation AB,⁹ the Securities and Exchange Commission’s rule 3a-7,¹⁰ or the requirements of a covered bond statute.¹¹ You also request relief for entities involved in collateralized debt obligations, collateralized loan obligations, and synthetic securitizations.¹² Additionally, you request blanket relief for securitization transactions that were initiated before the date of this letter or are otherwise in the process of being executed.¹³

In 1981, the Commission proposed and adopted the definition of “pool” in Commission Regulation 4.10(d), which provided that “pool” means “any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.”¹⁴ At that time there was no statutory definition of a commodity pool. The statutory definition of commodity pool, as it currently appears in Section 1a(10) of the CEA, is substantively identical to the Commission’s longstanding regulatory definition of the term “pool.”¹⁵

⁵*Id.*

⁶*Id.*

⁷ 805 F.2d 880 (9th Cir. 1986).

⁸ SIFMA Ltr. at 4.

⁹ 17 CFR 229.1100, *et seq.*

¹⁰ 17 CFR 270.3a-7.

¹¹ American Securitization Forum Letter, October 5, 2012, at 5 (“ASF II”).

¹² *Id.* at 7.

¹³ *Id.* at 3.

¹⁴ 46 FR 26004, 26014 (May 8, 1981).

¹⁵ *See*, 7 U.S.C. §1(a)(10), and 17 C.F.R. 4.10(d).

From the time of its adoption in 1981, the Commission has declined to constrain the phrase “operated for the purpose of trading” to the narrowest of possible interpretations. The reasons that the Commission articulated for rejecting a narrow understanding of the phrase were grounded in its dual concerns for customer and market protection. The Commission noted in the Preamble to the 1981 rule that commenters were concerned that the definition was overly broad.¹⁶ One commenter suggested a brightline percentage test as a function of commodity interests to other portfolio holdings to determine whether a collective investment scheme should be considered a pool. The Commission declined to set a specific percentage as a threshold over which an entity would be considered a commodity pool due to concerns that an entity which would not exceed the set trading level could still be marketed as a commodity pool to participants, who should still be afforded the protections under Part 4 of the Commission’s regulations.¹⁷

Several other commenters suggested that the definition should be narrowed to only those funds whose “principal purpose” was the trading of commodity interests. The Commission rejected that suggestion because it could “inappropriately exclude from the scope of the Part 4 rules certain persons who are, in fact, operating commodity pools.”¹⁸ Thus, the Commission recognized that there may be entities whose primary business focus may be outside the commodity interest sphere, yet may still have a significant exposure to those markets, which may implicate the Commission’s concerns regarding both customer and market protection. The rejection of the more narrow “principal purpose” language further indicated the Commission’s determination to expand the constrained meaning of the phrase “operated for the purpose of.” There is no evidence in the legislative record to indicate that when Congress adopted a statutory definition of “commodity pool,” that is substantively identical to the Commission’s longstanding regulatory definition of “pool,” it intended for the Commission to modify its understanding of the scope of phrase “operated for the purpose of.”

The determination to not to construe the phrase “operated for the purpose of” in the narrowest possible manner required that a comprehensive qualitative approach to determining a fund’s status as a pool was necessary. The Commission stated in the 1981 Preamble that “[d]epending on the facts of a particular case, an entity may or may not be a “pool” within the scope of § 4.10(d).”¹⁹ According to the Commission, this requires “an evaluation of all the facts relevant to the entity’s operation.”²⁰

¹⁶*Id.* at 26005.

¹⁷*Id.*

¹⁸*Id.* at 26006. The Commission’s conclusion that commodity pools are not limited to those funds whose primary purpose is trading commodity interests is consistent with the Dodd-Frank Act’s recent amendments to the CEA in Section 4m(3). Section 4m(3) was amended to exempt certain commodity trading advisors (“CTAs”) from registration provided that their business does not primarily consist of acting as a CTA, and that the CTA does not serve as a CTA to a commodity pool that is engaged primarily in trading commodity interests. 7 U.S.C. 6m(3). This statutory exemption for CTAs recognizes that there may be entities that are properly considered commodity pools that are not engaged primarily in trading commodity interests. Congress did not include a similar concept in the definition of commodity pool in CEA section 1a(10) or in the amended commodity pool operator definition in CEA section 1a(11).

¹⁹ *Id.*

²⁰ *Id.*

The Division believes that, consistent with the Commission's longstanding statements regarding the analysis of whether a fund is a pool, although the *Lopez* factors are useful, they are not dispositive and the failure of a fund to satisfy one or more of the factors does not mean that the fund is not a pool. The Division believes that it is required to evaluate the facts and circumstances presented in their entirety and determine whether a pooled investment vehicle possessing such characteristics should properly be considered to be a commodity pool. In attempting to make such an evaluation based on the characteristics you have presented, we tend to agree that certain entities that meet certain of the criteria you identify are likely not commodity pools, such as securitization vehicles that do not have multiple equity participants, do not make allocations of accrued profits or losses,²¹ and only issue interests in the form of debt or debt-like interests with a stated interest rate or yield and principal balance and a specific maturity date. Other sorts of financings or investments, however, based on the descriptions you have provided, do not preclude the issuer or, in the case of a covered bond, the related covered pool from being a commodity pool. Thus, your request for relief for entities operating to some extent under any covered bond statute, entities involved in collateralized debt obligations, entities involved in collateralized loan obligations, any insurance-related issuances, and any other synthetic securitizations is overly broad and does not provide any assurance that the related entities or a portion of their assets, operations, or activities would not properly be considered a commodity pool.

Nevertheless, based on an evaluation of the facts and circumstances presented regarding securitization vehicles and their issuance of asset-backed securities,²² the Division has determined that certain securitization vehicles should not be included within the definition of "commodity pool" and its operator should not be included within the definition of "commodity pool operator." The Division has determined that the criteria for exclusion include the following:

- The issuer of the asset-backed securities is operated consistent with the conditions set forth in Regulation AB,²³ or Rule 3a-7,²⁴ whether or not the issuer's security offerings are in fact regulated pursuant to either regulation,²⁵ such that the issuer, pool assets, and issued securities satisfy the requirements of either regulation;

²¹ Other than gains or losses resulting from permitted dispositions of defaulted financial assets.

²² When the Division refers to "asset-backed securities" it intends to include mortgage-backed securities within the term.

²³ 17 CFR 229.1100, *et seq.* (as of Apr. 2012).

²⁴ 17 CFR 270.3a-7 (as of Apr. 2012).

²⁵ For example, Regulation AB can be relied upon in connection with the determination of whether an issuer of asset-backed securities is excluded from the definition of commodity pool even in connection with private issuances and Rule 3a-7 may be relied upon in connection with the determination of whether an issuer of asset-backed securities is excluded from the definition of commodity pool even where the issuer is utilizing another exemption or exclusion from registration under the Investment Company Act of 1940, 15 U.S.C. §80a-1, *et seq.*

- The entity's activities are limited to passively owning or holding a pool of receivables or other financial assets,²⁶ which may be either fixed or revolving,²⁷ that by their terms convert to cash within a finite time period²⁸ plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to security holders;
- The entity's use of derivatives is limited to the uses of derivatives permitted under the terms of Regulation AB, which include credit enhancement and the use of derivatives such as interest rate and currency swap agreements to alter the payment characteristics of the cash flows from the issuing entity;
- The issuer makes payments to securities holders only from cash flow generated by its pool assets and other permitted rights and assets, and not from or otherwise based upon changes in the value of the entity's assets; and,
- The issuer is not permitted to acquire additional assets or dispose of assets for the primary purpose²⁹ of realizing gain or minimizing loss due to changes in market value of the vehicle's assets.

The Division believes that compliance with the aforementioned criteria results in the entity being substantively distinguishable from a fund that is properly considered a "commodity pool" under the definitions in Section 1a(10) of the CEA and Commission Regulation 4.10(b). Therefore, pursuant to Commission Regulation 140.99, the Division hereby interprets the definition of commodity pool under Section 1a(10) of the CEA and Commission Regulation 4.10(d) to not include entities that satisfy the criteria listed above.³⁰

As for securitization vehicles that cannot satisfy all the criteria stated above, the Division notes that we remain open to discussions with securitization sponsors to consider the facts and circumstances of their securitization structures with a view to determining

²⁶ The term "financial asset" as used in this interpretative letter does not include transactions whereby an entity obtains exposure to an asset that is not transferred or otherwise part of the asset pool. This is consistent with guidance provided by the Securities and Exchange Commission in its adopting release for Regulation AB. See 70 FR 1597, 1614 (Jan. 7, 2005).

²⁷ If the issuer is a "master trust," as that term is defined in Regulation AB, 17 CFR 229.1101(c)(3) (as of Apr. 2012), then the issuer must comply with the terms of Regulation AB and may be permitted to add additional assets to the pool that backs securities in connection with future issuances of asset-backed securities, which may be done in connection with maintaining a minimum pool balance in accordance with transaction agreements for master trusts with revolving periods or receivables or other financial assets that involve revolving accounts.

²⁸ Such would include the residual value realized on the disposition of leased assets to the extent consistent with the terms of Regulation AB.

²⁹ Nothing in this requirement should be construed to permit the use of derivatives beyond those circumstances set forth in the third bullet point above.

³⁰ The Division is not providing relief for entities that cannot satisfy the conditions set forth in this letter, although it is not stating that additional relief for other types of funds may not be available in the future. Such entities may be entitled to temporary no-action relief pursuant to the terms set forth in a letter issued by the Division concurrent with this one that provides relief to various classes of Commission registrants.

whether or not they might not be properly considered a commodity pool, or where not sufficiently assured, whether other relief might be appropriate under the circumstances, such as where a fund might be treated as an exempt pool.

This letter, and the positions taken herein, represent the view of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void.

Should you have any questions, please do not hesitate to contact Amanda Olear, Special Counsel, at 202-418-5283.

Very truly yours,

Gary Barnett

cc: Regina Thoele, Compliance
National Futures Association, Chicago