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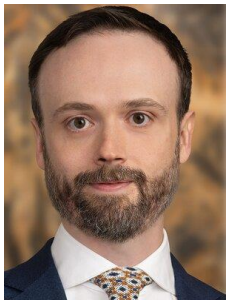
Parsing The SEC's No-Action Letter On Rule 192 Compliance

By **Brandon Figg** (June 4, 2025, 4:26 PM EDT)


Brandon Figg

On May 16, the staff of the U.S. Securities and Exchange Commission's Division of Corporation Finance sent a no-action letter to the Securities Industry and Financial Markets Association related to Rule 192, the securitization conflicts of interest rule.

According to the no-action letter, the staff will not recommend:

- Enforcement action with respect to certain conflicted transactions entered into by the employees of an underwriter, placement agent, initial purchaser or sponsor that act in a capacity unrelated to the structuring and issuance of the relevant asset-backed security; or

- The selection of the assets supporting the relevant asset-backed security — if, subject to certain conditions, those nondeal team employees are sufficiently separate from the individuals involved in structuring and selling the relevant asset-backed security.[1]

This will effectively allow securitization participants, such as arrangers with multiple trading desks, to utilize internal information barriers between employees within the same legal entity to avoid running afoul of the broad catchall provision set forth in Prong (iii) of the definition of a "conflicted transaction" in Rule 192.

Background

On Nov. 27, 2023, the commission implemented Section 621 of the Dodd-Frank Act by adopting Rule 192.

The rule prohibits a securitization participant with respect to an asset-backed security from engaging, directly or indirectly, in any conflicted transaction for a period commencing on the date on which such person has reached an agreement to become a securitization participant with respect to such 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.[2]

The commission defined a "conflicted transaction" in paragraph (a)(3) of the final rule as:

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.[3]

Prong (iii) of the definition effectively functions as a catchall to capture transactions that are, in economic substance, bets against the relevant asset-backed security or the asset pool supporting or referenced by the relevant asset-backed security even if they are not documented in the same form as a short sale or credit derivative.

While Rule 192 does include exceptions for the risk-mitigating hedging activities and bona fide market-making activities of a securitization participant that result in conflicted transactions, the availability of such exceptions is conditioned upon, among other requirements, the securitization participant implementing a compliance program that can adequately identify and monitor such transactions.

Unfortunately, for larger securitization participants such as arrangers with multiple trading desks, the unclear boundaries of Prong (iii) discussed below have frustrated their efforts to build out systems to track such transactions across their various business lines.

For example, in the adopting release for Rule 192,[4] the commission stated that Prong (iii) could capture both transactions that are entered into with respect to:

- A sizable portion of the asset pool supporting or referenced by the relevant asset-backed security; and
- A pool of assets with characteristics that replicate the idiosyncratic credit performance of the asset pool supporting the relevant asset-backed security.[5]

However, the adopting release did not include any specific guidance regarding:

- What would constitute a sizable portion of the asset pool supporting or referenced by the relevant asset-backed security;[6] or
- The characteristics of an asset pool that would cause such pool to have "characteristics that replicate the idiosyncratic credit performance of the asset pool" that supports or is referenced by the relevant asset-backed security.

Moreover, the adopting release did not include any intent or knowledge requirement or provide an exclusion for transactions that are disclosed to investors and/or with respect to which prior investor

consent has been obtained.

The result is that, under Rule 192 as adopted, securitization participants must necessarily engage in a facts-and-circumstances review of each transaction, or group of transactions, that could potentially be a conflicted transaction under Prong (iii). This has proven to be intractably difficult to implement for certain market participants at scale.

No-Action Letter

Made by the Securities Industry and Financial Markets Association, the Structured Finance Association, the Loan Syndications and Trading Association, the CRE Finance Council and the Bank Policy Institute, the request for no-action relief stated that the "the potential permutations [of Prong (iii)] are limitless and it is therefore impossible to develop a system that looks across the number and breadths of all trading desks."

In response, the Division of Corporate Finance announced that it will not recommend enforcement action to the commission with respect to a Prong (iii) transaction entered into by a nondeal team employee if the following conditions are satisfied:

a. The Securitization Participant has written policies and procedures in place reasonably designed to:

i. Prevent the coordination of ABS [asset backed security] Deal Teams with Non-Deal Team Employees in connection with the relevant ABS; and

ii. Prevent access to, and receipt of, Restricted ABS Information by Non-Deal Team Employees from ABS Deal Teams; and

b. The Non-Deal Team Employees did not engage in such coordination with ABS Deal Teams and there was no access to, or receipt of, Restricted ABS Information by Non-Deal Team Employees from ABS Deal Teams; and

c. Even if such individuals were in technical compliance with parts (a) and (b) above, they were not part of a plan or scheme to evade the prohibition in Rule 192(a)(1).

These conditions mirror, in substance, those set forth in the adopting release regarding the application of the rule's prohibition to an affiliate or subsidiary of a securitization participant that is a separate legal entity.

Specifically, the adopting release provided that any affiliate or subsidiary of a securitization participant is also a securitization participant for purposes of Rule 192 if it (1) acts in coordination with the securitization participant, or (2) 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 date of the first closing of the sale of the relevant asset-backed security.[8]

The commission stated that the intent of this approach was to "capture the range of affiliates and subsidiaries with the opportunity and incentive to engage in conflicted transactions without frustrating market participants' ability to meet their obligations under other Federal- and State-level laws that require the use of information barriers or other such firewalls."[9]

While the final rule did not include an information barrier-based exception in the rule text, the preamble

to the adopting release did include a nonexhaustive list of the types of barriers or other indicia of separateness that could be used by a securitization participant to demonstrate lack of coordination and access to information, including the following:

- Effective information barriers between the securitization participant and the relevant affiliate or subsidiary — including written policies and procedures designed to prevent the flow of information between the relevant entities, internal controls, physical separation of personnel, etc;
- Maintenance of separate trading accounts for the securitization participant and the relevant affiliate and subsidiary;
- Lack of common officers or employees, other than clerical, ministerial, or support personnel, between the securitization participant and the relevant affiliate or subsidiary;
- The relevant affiliate being engaged in an unrelated business and no communication occurring between the securitization participant and the relevant affiliate; and
- To the extent that personnel have oversight or managerial responsibility over accounts of both the securitization participant and the relevant affiliate or subsidiary, such persons do not have authority to (and do not) execute trading in individual securities in the accounts or the authority to, and do not, preapprove trading decisions for the accounts.[10]

The commission stated that any such mechanisms must effectively prevent the affiliate or subsidiary from acting in coordination with the named securitization participant or from accessing or receiving information about the relevant asset-backed security or the asset pool underlying or referenced by the relevant asset-backed security.[11]

Therefore, whether an affiliate or subsidiary acts in coordination with a securitization participant or has access to, or receives, information about an asset-backed security or its underlying asset pool prior to the closing date will ultimately depend on the facts and circumstances.

In a footnote to the no-action letter, the division referenced this discussion in the adopting release and the statement in the adopting release that "[a] securitization participant generally should consider the structure of its organization and the ways in which information is shared to assess what mechanisms should be employed to comply with Rule 192."[12]

As such, we expect that, for purposes of the no-action relief, the same indicia of separateness, as applied to employees within the same legal entity, would be relevant for determining whether the asset-backed security deal team on one trading desk is sufficiently separate from the nondeal team employees on a different trading desk.

Key Takeaways and Next Step

For securitization participants, such as broker-dealers, with existing information barriers between trading desks that have been established to comply with other federal- and state-level laws,[13] the no-action letter is welcome relief that should be readily adaptable to their existing policies and procedures.

For securitization participants that do not already have existing policies and procedures establishing information barriers in place that would satisfy the conditions set forth in the no-action letter, we would expect that those entities will need to weigh the cost of implementing such policies and procedures and/or updating their existing policies and procedures against their likelihood to engage in conflicted transactions.

For example, if such a securitization participant only engages in interest rate hedging — and does not engage in any credit-based hedging — then it may decide that implementing information barriers for this purpose would not be worth the additional cost and operational complexity. This may particularly be the case for relatively smaller securitization participants with fewer employees and lines of business.

However, if such a securitization participant does routinely engage in credit-based hedging, then it may want to explore ways to implement information barriers for this purpose that are most appropriately tailored to its business while achieving compliance with the rule.

As a reminder, compliance with Rule 192 is required for asset-backed security transactions that close on or after June 9. However, the prohibition time frame begins when a securitization participant reaches an agreement in principle as to the material terms of its role in the transaction.

Therefore, the prohibition already applies to asset-backed security transactions that are currently in process but will close on or after June 9.

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[1] SIFMA et al., SEC Staff No-Action Letter (May 16, 2025). https://www.sec.gov/rules-regulations/no-action-interpretive-exemptive-letters/division-corporation-finance-no-action/sifma-051625.

[2] 17 CFR 230.192.

[3] 17 CFR 230.192(a)(3)(iii).

[4] See Prohibition Against Conflicts of Interest in Certain Securitizations, 88 Fed. Reg. 85396 (Dec. 7, 2023).

[5] 88 Fed. Reg. at 85423-4.

[6] In the context of using a CDS index-based hedge, the Adopting Release did provide guidance that the use of an index hedge that would otherwise be permissible under Regulation RR would not be a conflicted transaction. See 88 Fed. Reg. at 85424, n.386, and the description of permissible index hedges under 12 CFR 373.12(d).

[7] For purposes of the No-Action Letter, "Restricted ABS Information" means, with respect to an ABS,

nonpublic information about the ABS or the asset pool supporting the ABS.

[8] See 17 CFR 230.192(c). For purposes of Rule 192, the terms "affiliate" and "subsidiary" have the same meaning as in Securities Act Rule 405 (17 CFR 230.405). Under Securities Act 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, and a "subsidiary" of a specified person means an affiliate controlled by such person directly, or indirectly through one or more intermediaries. Securities Act Rule 405 also defines the term "control" to mean 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. On July 31, 2024, the Division published Compliance and Disclosure Interpretation 103.01 providing that access to, or receipt of, information that is publicly available on EDGAR, by itself, would not result in the affiliate or subsidiary being a securitization participant under paragraph (ii)(B) of the "securitization participant" definition in Rule 192(c).

[9] 88 Fed. Reg. at 85417.

[10] 88 Fed. Reg. at 85416.

[11] 88 Fed. Reg. at 85417.

[12] See footnote 3 in the No-Action Letter and footnote 307 and the related discussion in the Adopting Release at 88 Fed. Reg. 85416-7.

[13] For additional Commission statements regarding the use of information barriers in other contexts, see the "Indicia of Separate Accounts" for purposes of Rule 105 of Regulation M in Securities Exchange Act Release No. 56206 (Short Selling in Connection with a Public Offering: https://www.sec.gov/files/rules/final/2007/34-56206.pdf); the conditions related to trading unit aggregation for purposes of Regulation SHO in Securities Exchange Act Release No. 50103 (Short Sales: https://www.sec.gov/files/rules/final/34-50103.htm); and the discussion of effective practices and potential concerns in Staff Summary Report on Examinations of Information Barriers: Broker-Dealer Practices under Section 15(g) of the Securities Exchange Act of 1934. https://www.sec.gov/about/offices/ocie/informationbarriers.pdf. See also Section 204A of the Investment Advisers Act of 1940.