William J. Harrington
51 5th Avenue, Apartment 16A
wjharrington@yahoo.com

Via Electronic Mail

December 28, 2020

Re: Deficient Accounting, Capitalization, Credit Ratings, and Regulation of EVERY Party to a Swap Contract with a Flip Clause or Other Walk-Away Provision

> "***The Bankruptcy Court detailed the 100% loss of contract values*** ***that the plaintiff-appellant (LBSF) incurred*** ***under 100% of a 'multitude' of in-the-money, flip-clause-swap-contracts*** ***in the [initial] decision*** [emphasis added]."

—William J. Harrington, "Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities)," June 25, 2019, (Filed with the US Court of Appeals for the Second Circuit Re: *Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al*., Case No. 18-1079-bk), page 22.

> "***The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges*** *for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments,* ***which, in the Commission's long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach****, in conjunction with other charges discussed herein,* ***appropriately accounts for*** *the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including* ***bespoke swap transactions involving flip clauses*** *or other unique* features. *Overtime, the Commission may consider adjusting these charges as a result of experience with their impacts on required capital in these firms and as market developments may warrant* [emphasis added throughout]."

—**Commodity Futures Trading Commission, "Capital Requirements of Swap Dealers and Major Swap Participants**" (September 15, 2020). 85 FR 57465, page 57475.

"***Section 706(2)(A) of the Administrative Procedure Act** (APA) **instructs courts reviewing regulation to** **invalidate any agency action found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law*** [emphasis added].***'** The arbitrary-or-capricious test is used by judges when reviewing the factual basis for agency rulemaking. Courts can overturn agency rules if they find the underlying rationale or factual assertions to be unreasonable*."

—**Center for Effective Governance**

"***Please provide all information pertaining to 'swap transactions involving flip clauses' that the Commission either used or uses in establishing that it 'believes' that the 'standardized market risk capital charges' in Commodity Futures Trading Commission 'Capital Requirements of Swap Dealers and Major Swap Participants' (September 15, 2020) 85 FR 57465 are 'effective and appropriately calibrated'*** [emphasis added]. *'The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments, which, in the Commission's long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including bespoke swap transactions involving flip clauses or other unique* features.'"

—William Harrington FOIA Request to Commodity Futures Trading Commission of December 17, 2020 (CFTC Acknowledged as 21-00039-FOIA on December 18, 2020)

Dear Secretary Kirkpatrick, Edward (Manchester), Nicolas (Weill), Mr. Van Walsum, Mr. Pover, Mr. Abonamah, **Ms. Wolfe, Ms. Coffey, Mr. Ganz, Mr. Klingler, Mr. Lemos-Stein, Mr. Steel, and Mr. Torgenson:**

My name is Bill Harrington. I registered "Harrington Independent Flip Clause Assessments" with New York County on November 3, 2014.[1]

[1] Harrington, William J., "Electronic Letter to the US Securities and Exchange Commission Re: Fixed Income Market Structure Advisory Committee Re: Harrington Independent Flip Clause Assessments, SEC File Number 265-30, and Moody's Investors Service Violations of Moody's Compliance Commitments in Settlement with United States Department of Justice and Attorneys General of 21 States and the District of Columbia (January 13, 2017)," November 3, 2019, HTML-pages 106-109. (Available at: https://www.sec.gov/comments/265-30/26530-6383231-197808.pdf.)

I was a Senior Vice President in the Derivatives Group of Moody's Investors Service. I co-developed and co-authored Moody's Structured Finance Rating Methodology "Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions," May 25, 2006 (Moody's Hedge Framework).[2] It was the first US and the first global credit rating methodology for two parties — a swap end user and a swap provider — that make swap payments by reference to a "flip clause" (flip-clause-swap-contract).[3]

The flip clause is the global ABS sector's: 1) best practice; 2) black hole; 3) Escher-staircase-to-nowhere; 4) foundation; 5) nifty lawyering; 6) original sin; and 7) quicksand.[4]

The flip-clause-swap-contract was a root cause of the 2008 global financial catastrophe.

The flip-clause-swap-contract was an integral component of the under-capitalized structured debt that started, fueled, and pro-longed the 2008 financial catastrophe.

The flip-clause-swap-contract was a tool that financial institutions such as AIG, Bear Stearns, Lehman Brothers, and many others used to under-capitalize themselves.

The flip-clause-swap-contract was a tool that Greece, with the active assistance of Goldman Sachs, used to crash its own economy.

> ***"Every party that agreed to, guaranteed, or endorsed a flip clause generated the financial crisis. None was a blindsided casualty."***[5]

The multi-billion dollars of additional losses that Lehman Brothers imposed on its already bankrupt estate via flip clauses, and the ensuing twelve years of litigation regarding the very same flip clauses, perfectly corroborate the perfect deficiency of the flip clause. In another calamity in

---

[2] See Appendix A to "Proposed Brief of Amicus Curiae SIFMA and ISDA in Support of Defendants Appellees and Affirmance in *Lehman Brothers Special Financing, Inc. versus Bank of America National Association et al.*" (Case No. 17-cv-1224-LGS, Document 87. June 16, 2017.) (Available at: https://www.sifma.org/wp-content/uploads/2017/06/LehmanBrothers061617.pdf as of December 23, 2020.)

[3] Op. cit., "Harrington Letter to the SEC FIMSAC (November 3, 2019)," in its entirety. (Available at: https://www.sec.gov/comments/265-30/26530-6383231-197808.pdf.)

[4] Harrington, William J., "Proposed Amicus Curiae Brief to the US 2nd Circuit Re: Case No. 18-1079 (Lehman vs 250 Financial Entities) - WJH V2.0 -07-30-19," June 25, 2019, page 20. (Filed with the US Court of Appeals for the Second Circuit Re: *Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al*., Case No. 18-1079-bk. A clean-up revision dated July 30, 2019 is available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

[5] Harrington, William J., "Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities), June 25, 2019, page 16. (Filed with the US Court of Appeals for the Second Circuit Re: *Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al*., Case No. 18-1079-bk. Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf.)

the same global catastrophe, a single, perfectly deficient flip-clause-swap-contract helped destroy the Greek economy.[6]

Clearly, the Commission is long overdue in "adjusting these [flip clause] charges as a result of experience with their impacts on required capital" of swap providers.

On May 26, 2020, I filed a § 13.1 petition to embarrass the Commission into fulfilling responsibilities to the Country and the global financial system. My § 13.1 petition seeks a rulemaking by the Commission to prohibit a swap dealer, major swap participant, or other regulated entity from predicating a swap obligation on a flip clause, walk-away, or variable subordination.[7] After much prodding on my part, the Commission finally acknowledged my § 13.1 petition (which I believe is the first such petition to be filed for any type of rulemaking) on June 26, 2020. See Appendix A to this letter (page 26, turquoise-shaded background).

When enacted, my proposed rule will belatedly align Commission rules with the Dodd-Frank-mandated protections for bankrupt entities overseen by other regulators such as the Federal Deposit Insurance Company and the Federal Housing Finance Agency. "The non-enforceability of walkaway clauses advances the dual purposes of receivership / conservatorship — namely, preserving the assets of a covered financial company in default and limiting taxpayer losses. If walkaway clauses were enforceable, counterparties would immediately and simultaneously activate them and strip an already defaulted company of still more assets."[8]

When enacted, my proposed rule will perfect the post-2008-crisis evaluation, treatment, and market rejection of the flip-clause-swap-contract.[9] On October 2, 2010, the U.S. Court of Appeals for the Second Circuit completed the penultimate step by issuing a mandate with respect to its August 11, 2020 ruling in *Lehman Brothers Special Financing Inc. v. Branch Banking & Trust Co. (In re Lehman Brothers Holdings Inc.)*, No. 18-1079, --F.3d--, 2020 WL 4590247 (2d Cir. Aug. 11, 2020).[10] In that ruling, the Court upheld the enforceability of the 200-plus flip clauses which imposed 100% losses on 100% of Lehman Brothers swap assets.

> "*Whatever the Court's decision, it will confirm US market and regulatory assessments that the flip clause is inherently and irredeemably defective. Upholding the flip clause*

---

6 Ibid., pages 22-24.

7 Harrington, William J. "§ 13.1 Petition to the Secretariat for the Commission to Issue a Rule that Prohibits a Swap Dealer, Major Swap Participant, or Other Regulated Entity from Predicating a Swap Obligation on a Flip Clause, Walk-Away, or Variable Subordination," May 26, 2020. (Available at: https://comments.cftc.gov/PublicComments/ViewComment.aspx?ID=62638&GUID=ba69c106-048b-4ca9-b9f8-b0b8e7b4a64f.)

8 Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 28-29. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

9 Ibid., pages 29-43.

10 Kramer Levin, "Second Circuit Holds That So-Called "Flip" Clause Payments Are Protected by Section 560 of the Bankruptcy Code," *Broken Bench Bytes*, September 9, 2020. (Available at: https://www.jdsupra.com/legalnews/second-circuit-holds-that-so-called-33538/.)

will render it unacceptable to swap dealers. Striking down the flip clause will render it unacceptable to investors. Splitting the difference will exposure future parties to a decade of litigation."[11]

Almost All Moody's Analysts Know All About All the Myriad Flip Clause Problems

Moody's Hedge Framework remained operational in near-original form until November 12, 2013. Moody's most recent iteration of the successor global cross-sector methodology contains significant components of Moody's Hedge Framework, including the Collateral Provisions of Appendix 3 (which I alone developed and formatted, and which remain in original presentation) and the Model Swap Framework in Appendix 5 (which one of the addresses, my former colleague Edward Manchester, drafted to implement the work that another former Moody's legal colleague Marlow Gereluk and I did.)[12]

A third former legal colleague Nicolas Weill, also an addressee and Chief Credit Officer for Moody's Structured Finance Globally, can attest to the foregoing and to the entirety of this letter.[13]

A fourth former Moody's legal colleague Rick Michalek and I are writing a peer-reviewed article with the working title "Should Swaps be Prohibited in Securitization Transactions?"

The short answer:

"*Yes, except for swaps that conform completely and in all respects to the US swap margin rules as in effect as of this writing.*"

A swap that conforms completely and in all respects to the US swap margin rules swap would, through the daily, two-way exchange of full variation margin, defuse the flip clause and thereby make the flip-clause-swap-contract redundant.[14] Such a swap would, again through the daily,

---

[11] Op. cit., "Harrington Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities), page 15. (Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf.)

[12] Moody's Investors Service, "Moody's Approach to Assessing Counterparty Risks in Structured Finance," *Cross-Sector Methodology*, June 5, 2020. (Available at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1208915.)

[13] "Structured Finance Responds to Issues of Counterparty Risk and Basel II in Calls for Comment," *Inside Moody's Credit Policy*, January 2006, page 4. (Available at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_96515.)

[14] Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 32-34. "The daily, two-way exchange of variation margin 'defuses' the flip clause by enabling both a swap dealer and an ABS issuer to terminate a swap contract without referencing the deal's priorities of payments. Moreover, the reason for termination becomes largely irrelevant because the party that is owed payment will hold collateral with market value that is at least equal to the previous day's swap valuation. Crucially, both parties will have agreed all prior daily valuations since having entered the

two-way exchange of full variation margin, also be more expensive than a flip-clause-swap-contract.[15]

> "*As a result, the cost of issuing ABS from an SPV that is or may become party to a new swap will be significantly higher than now. Depending on the size of the swap, the additional cost may be 1%-7% of the par of securitized assets for many types of basis and interest rate swaps that are often characterized as 'plain vanilla,' and considerably more for long-dated or currency swaps.*
> *II*
> *"The Dodd-Frank Act that generated swap margin rules was intended to ensure that the two financial counterparties to a swap — in this case an ABS issuer and swap provider — were fully insulated from each other's non-performance. But this insulation will come at a cost and one can't help but look to the industry's recent dance with risk retention rules if the hope is that the music will play on and on and never stop*."
> *II*
> *"Add balance-guarantee features, such as those that were often used in pre-crisis RMBS, to a fixed-for-floating swap and the potential exposure increases. Finally, for currency swaps, which can be used in any sector and are common in re-packagings, the potential exposure could easily by 20% or higher."* [16]

Owing to the higher costs, no U.S. structured debt issuer has entered into such a new swap since the US swap margin rules took effect.[17]

During our respective Moody's tenures, Rick and I were lead analysts or voting committee members for an estimated 1,200 structured entities that were party to an estimated 1,600 flip-clause-swap-contracts.[18]

---

swap, i.e., they will have established a track record of mutually accepting both the termination valuation and the means of monetizing it."
(Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

[15] Harrington, Bill, "Existing ABS swaps also caught in swap margin net," *Debtwire ABS*, August 12, 2016; Section entitled "Margin requirements makes swap amendments prohibitively expensive?" (Available at: https://www.debtwire.com/info/existing-abs-swaps-also-caught-swap-margin-net-%E2%80%94-analysis.) Also, Harrington, Bill, "ANALYSIS: US margin rule for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures," *Debtwire ABS*, August 12, 2016. (Available in Appendix B to this letter, pages 27-31, green-shaded background.)

[16] Harrington, Bill, "Margin posting: swaps increase ABS issuance costs by 1%, 3%, 7% of deal size," *Debtwire ABS*, May 16, 2016. (Available upon request to the author.)

[17] Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 23 and 35-38. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

[18] Appendix C to this letter, page 32, grey-shaded background, details the estimates.

Former colleagues who remain at Moody's and can attest to Rick and my bona fides regarding the flip clause include Rodrigo Araya, Fabian Astic, Greg Bauer, Kent Becker, William Black, Rudy Bunja, David Burger, Richard Cantor, Eun Choi, Jack Dorer, Marty Duffy, Elena Duggar, Katherine Frey, Yehudah Forster, Michael Friedman, Jerry Gluck, Peter Hallenbeck, David Ham, Jian Hu, Bhargav Jhani, Ivan Jiang, Lina Kharnak, Jun Kim, Elina Kolmanovskaya, Warren Kornfeld, Steve Lioce, Arnaud Lasseron, Nicholas Lindstrom, Bill May, Edward Manchester, Maria Miagkova, Leon Mogunov, Maria Muller, Jonathan Polansky, Al Remeza, Stan Rouyer, Dan Rubock, Suzanna Sava, Jody Shenn, Julien Sieler, Teresa Stock, Yu Sun, Ramon Torres, Oksana Yerynovska, and Qian Zhu.[19] Most of these people continue to vote in committees that assign a credit rating to debt issued by an entity with a flip clause in the priorities of payments. In each such instance, the committee ignores the governance failures of a party that uses a flip-clause and thereby assigns a credit rating that conflicts with Moody's global credit rating methodology.[20] A separate email will deliver this letter to each of these Moody's employees. The delivering email copies the principal authors of Moody's ESG methodology Mr. Swami Venkataraman and Mr. James Leaton.

Former colleagues now at Moody's Analytics who can attest to Rick and my bona fides regarding the flip clause include Gus Harris. Joy Hart, and Greg Schoellig. They develop, market, and use products and services that analyze deals with a flip clause in the priorities of payments. The delivering email copies Gus Harris. A separate email will deliver this letter to Joy and Greg.

Financial Sector Apologists, Enablers, Cowering ChurchMice, and Fence-Sitters Also Know All About All the Myriad Flip Clause Problems

Former colleagues now at the US Securities and Exchange Commission who can attest to Rick and my bona fides regarding the flip clause are Abe Putney and David Teicher.[21] The SEC Office of Credit Ratings actively encourages Nationally Recognized Statistical Rating Organizations

[19] Harrington, William J., "Electronic Letter to Moody's Investors Service 'Re "General Principles for Assessing Environmental, Social and Governance Risks: Proposed Methodology Update'," pages 1-8. October 19, 2020.
(Available at: http://croataninstitute.org/documents/WJH_Comment_to_Moodys_RFC_-_General_Principles_for_Assessing_ESG_Risks_-_Oct_19_2020_1.pdf.
As of December 23, 2020, Moody's also posted the comment at https://www.moodys.com/RFC/response/ViewComments/UEJDXzEyNDM0NTQ=.)

[20] Moody's Investors Service, "General Principles for Assessing Environmental, Social and Governance Risks Methodology," *Cross-Sector Rating Methodology*, December 14, 2020, Page 26, footnote 14. "For structured transactions, we consider the impact of ESG risks that are expected to unfold within the legal final maturity of the transaction."
(Available at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406.)

[21] Harrington, William J., "Comment on SEC Proposed Rules for Nationally Recognized Statistical Rating Organizations," August 8, 2011. Search "Teicher," "swaps," "flip clause," "replacement," "hedge," "AIG," & "MLDP" & "compliance." (Available at: https://www.sec.gov/comments/s7-18-11/s71811-33.pdf .)

(NRSROs) to mask the deficiencies of the flip-clause-swap-contract in methodologies and dependent credit ratings.[22] The delivering email copies Abe and David.

The Structured Finance Association habitually mis-informs financial regulators such as the CFTC and the SEC, the US judicial system, and the public on the flip-clause-swap-contract while lobbying for the contract's reinstatement.[23]

> "*SFA is pleased about this outcome and very much appreciates the hard work by our counsel at Freshfields Bruckhaus Deringer in representing our industry as* amicus curiae *in this litigation. . . If you have questions about SFA's advocacy on this matter, please contact Jennifer.Wolfe@structuredfinance.org.*"[24]

The Loan Syndications and Trading Association (LSTA) lobbies for and otherwise supports CLO issuers that place flip clauses in priorities of payment in contravention of the US swap margin rules.[25] My estimates show that 75% of 700 US CLOs have flip clauses in the priorities of payments, yet not one of the 75% of CLOs can comply with the US swap margin rules because every single one of the CLOs lacks both the operational capabilities and the capital resources that the daily, two-exchange of variation margin requires.[26]

---

[22] Op. cit., "Harrington Letter to the SEC FIMSAC (November 3, 2019)," in its entirety. (Available at: https://www.sec.gov/comments/265-30/26530-6383231-197808.pdf.)

[23] Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 22-23, and 43. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

[24] Structured Finance Association, "Court Rules in Favor of Investors in Lehman 'Flip Clause' Case," August 11, 2011. (Available at: https://structuredfinance.org/news/court-rules-in-favor-of-investors-in-lehman-flip-clause-case-still-in-review/.)

[25] For a very recent instance of a CLO issuer placing a flip clause in the priorities of payment, see "S&P Global Ratings Presale: Madison Park Funding XLV Ltd./Madison Park Funding XLV LLC," July 7, 2020, Tables 11 & 12. The CLO, like the 32 other CLOs with flip clauses that Credit Suisse Asset Management manages, lacks the capability for the daily, two-way exchange of variation margin and therefore cannot comply with the US swap margin rules. (Formerly available at: https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2474176.)

[26] As of August 3, 2020, my research showed that 542 of 722 US CLOs have a flip clause in the priorities of payments. However, not one of the 542 CLOs has either the operational capabilities or the capital resources that the daily, two-exchange of variation margin requires. In short, none of the 542 CLOs can comply with the US swap margin rules. Even so, the respective NRSROs have assigned the same credit ratings to debt of the 542 CLOs as to debt of the 180 CLOs without a flip clause in the priorities of payment. ***Managers of the 542 CLOs with flip clauses are***: Oak Hill Advisors; Redding Ridge Asset Management (an asset management company established by Apollo Global Management); Bain Capital Credit; Pinebridge Galaxy; Credit Suisse Asset Management; Five Arrows Managers, a subsidiary of Rothschild & Co; Fortress Investment Group; BlueMountain Capital Management; Voya Alternative Asset Management; Columbia Management Investment Advisers, a subsidiary of Ameriprise Financial; Elmwood Asset Management; Anchorage Capital Group; WAMCO; Onex Credit Partners; ZAIS; Pretium Credit Management; AGL; Oaktree Capital; Ares CLO Management; Octagon Credit Investors; Gulf Stream Asset Management; AIG; Palmer Square Capital Management; Partners Group US

The LSTA advocates that its vendors such as Sidley Austin threaten financial regulators with both a reduction of appropriations and litigation to induce them to dilute regulatory and capital treatment for US CLOs, including ones that cannot comply with the US swap margin rules despite having a flip clause in the priorities of payments and also CLOs that issue combo notes.[27]

Following are people who were my principal contacts at derivative product companies (DPCs) for which I was lead Moody's analyst. Each can attest to my thoroughness in evaluating their portfolios of, or proposals to provide, flip-clause-swap-contracts: Scott Herman, former CEO of two Bear Stearns DPCs Bear Stearns Financial Products (BSFP) and Bear Stearns Trading Risk Management (BSTRM); Michael Bellacosa, successor to Scott at BSFP and BSTRM; Jason Silverstein, former Counsel to BSFP and BSTRM; Ken Fisher, former President of Merrill Lynch Derivative Products; Neville Nagarwalla, formerly of the two Lehman Brothers DPCs Lehman Brothers Financial Products and Lehman Brothers Derivative Products; and Wendy Brewer, former president of Nomura Derivative Products. The delivering email copies Jason. A separate email will deliver this letter to Scott, Mike, Ken, Neville, and Wendy.

The article by Rick and me will examine the many deficiencies of the flip-clause-swap-contract, including the competition by DBRS Morningstar, Fitch Ratings, Moody's, and S&P Global Ratings to produce *worst-in-class*, global credit rating methodologies for the flip-clause-swap-contract.[28]

> "*SPVs that issue rated ABS lack the assets to post margin and also repay notes with a probability that is commensurate with their ratings, according to Standard & Poor's. Its 'Global Derivative Agreement Criteria,' which the company uses to analyze 'derivative agreements in new and existing structured finance transactions,' is based*

Management CLO; Partners Group US Management CLO; ArrowMark Colorado Holdings; Canyon CLO Advisors; Guggenheim Partners; TCW; PGIM; GoldenTree Loan Management; and Blackstone. ***Managers of the 180 US CLOs that do not have flip clauses are***: Ballyrock Investment Advisors, a subsidiary of Fidelity; GC Investment Management; HalseyPoint Asset Management; Benefit Street Partners, a subsidiary of Franklin Templeton; Kayne Anderson Capital Advisors; CVC Credit Partners; Jocassee Partners; Owl Rock Capital Advisors; Neuberger Berman; and Halcyon Loan Advisors.

[27] See Appendix D to this letter, "WJH Transcript of Sidley Austin / LSTA Webinar: 'End of the (Loan Regulatory) World as We Know It?" May 9, 2018, pages 33-42, yellow-and white shaded background. See comments by Mr. Richard Klingler, pages 35-37, in toto, including the following. "I mean, if you want to upset a regulator, go talk to the appropriations committee on the Hill and ask that they [the regulator in question] not get the money that they want or that their framing statute be changed. That's the way to upset a regulator and the finance industry has no problem doing that." II "Beyond the initial ask . . . Do you want in some ways to get more? And can litigation and the related policy arguments help get you there? Classes of securitizations are entitled to relief from risk regulations. You should do this. It's the right thing to do. Oh, by the way, I potentially have this judicial path."
(The webinar was available at: https://sidley.rev.vbrick.com/#/videos/9bb231c9-cc80-48bb-b13d-8d9505e51050 as of December 23, 2020.)

[28] Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 23 and 35-38. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

in part on the assumption that an 'issuer does not have the financial resources both to maintain the ratings on its obligations and post collateral to a counterparty.'"[29]

DBRS, Fitch, Moody's, and S&P are the four largest NRSROs that the US Securities and Exchange Commission "regulates." The same four companies are the only external credit assessment institutions (ECAIs) that the Eurosystem uses to designate debt as eligible collateral and assign valuation haircuts.[30]

This letter poses a total of 45 questions regarding the US swap margin rules, the flip clause, and the flip-clause-swap-contract. See pages 15-23. (Six questions are joint to all of you, 10 questions are to the CFTC, four questions are to the LSTA, and 25 questions are joint to DBRS, Fitch, Moody's, and S&P.

This letter will be available on the site of the non-profit research entity Croatan Institute, where I am a senior fellow. I will also post this letter on additional public sites, such as my LinkedIn profile.[31]

DBRS, Fitch, Moody's, and S&P have first-hand knowledge of my critiques of the companies' respective global methodologies for the flip-clause-swap-contract.[32] I have contacted each company many times, including as a research journalist for *Debtwire ABS* during the period October 2015 to November 2016.[33] Neither DBRS, nor Fitch, nor Moody's, nor S&P one of the

---

29 Harrington, Bill, "Margin posting: swaps increase ABS issuance costs by 1%, 3%, 7% of deal size," *Debtwire ABS*, May 16, 2016. (Available upon request to the author.)

30 "Eurosystem credit asessment framework (ECAF)" tab, *European Central Bank* site, accessed December 11, 2020.
(Available at: https://www.ecb.europa.eu/paym/coll/risk/ecaf/html/index.en.html.)

31 Available at: https://www.linkedin.com/in/williamjharrington/.

32 Harrington, William J., "Electronic Letter to the US Commodity Futures Trading Commission Re: CFTC Letter No. 17-52, No Action, 27 October 2017, Division of Swap Intermediary Oversight ("Re: No-Action Position: Variation Margin Requirements Applicable to Swaps with Legacy Special Purpose Vehicles")," February 2, 2018. Appendix A, pages 81-91, contains my email correspondence with staff of Fitch Ratings, the CFTC, the SEC, and SFIG from 17 November 2016 to 11 January 2017. The correspondence addressed two topics **(1)** The lack of either an empirical or legal basis for the "replacement" assumption that the CFTC Letter No. 17-52 cites. (2) The Fitch public call for the CFTC to issue a no-action position. (Available at: https://www.wikirating.org/data/other/20180203_Harrington_J_William_31_Misrepresentations_in_CFTC%20_Letter_No_17-52.pdf.)

33 Harrington, Bill, "Moody's bets Germany will support Deutsche bank derivatives above all else," *Debtwire ABS*, October 12, 2016; "Existing ABS swaps also caught in swap margin net," *Debtwire ABS*, August 12, 2016; and "US Margin Rules for Swaps Obliges Securitization Issuers to Overhaul Structures, Add Resource and Rethink Capital Structures," *Debtwire ABS,* 4 November 2015.
(Available at, respectively: https://www.debtwire.com/info/moody%E2%80%99s-bets-germany-will-support-deutsche-bank-derivatives-above-all-else-%E2%80%94-analysis;
https://www.debtwire.com/info/existing-abs-swaps-also-caught-swap-margin-net-%E2%80%94-analysis; and Appendix B to this letter, pages 27-31, green-shaded background.)

responded to my detailed questions regarding its credit rating methodology for the flip-clause-swap-contract.[34]

Moody's and S&P have first-hand experience with my use of academic and journalistic tools to produce best-practice work on the flip-clause-swap-contract and place the work in the public domain. In July 2018, Croatan Institute, where I am a senior fellow, posted my Working Paper "Can Green Bonds Flourish in a Complex-Finance Brownfield?"[35] The paper addresses the use of the flip-clause-swap-contract globally.

In preparing the Working Paper, I emailed a joint questionnaire to Moody's, S&P, Obvion (a Dutch residential mortgage company and serial user of flip-clause-swap-contracts in residential-mortgage-backed security programs), the Climate Bond Initiative, and Sustainalytics (now wholly owned by Morningstar Inc., the parent company of DBRS Morningstar) on December 4, 2017.[36] Obvion, the Climate Bond Initiative, and Sustainalytics each emailed a response. Moody's and S&P did not respond.[37]

Sidebar — A Handful of Securitization and Derivative Contract Practitioners Openly Critique the Sectors' Deficient Underpinnings

The delivering email copies: Mark Adelson, Editor, *Journal of Structured Finance*; Dorian Crede, Chairman Wikirating; Norbert Gaillard, NG Consulting; Marc Joffe, Senior Policy Analyst, Reason Foundation; Gene Phillips, CEO, PF2 Securities; Joe Pimbley, Editor, *Journal of Derivatives*; Ann Rutledge, Founding Principal & CEO, Credit Spectrum Corp.; Alberto Thomas, Partner, Fideres Partners LLP; and Mayra Rodriguez Valladares, Managing Principal, MRV Associates.

An even smaller handful of research practitioners are open to critiquing the workings of the entire financial sector. The delivering email copies: Andy Green, senior fellow for Economic Policy at American Progress; Jerome Jérôme Tagger, CEO Preventable Surprises; and Hamish Stewart.

---

[34] Harrington, Bill, "Margin posting: swaps increase ABS issuance costs by 1%, 3%, 7% of deal size," *Debtwire ABS*, May 16, 2016. (Available upon request to the author.) "DBRS, Fitch, Kroll, Morningstar, Moody's Investors Service and S&P each declined to comment on margin posting by ABS issuers."

[35] Harrington, Bill, "Can Green Bonds Flourish in a Complex-Finance Brownfield?" *Croatan Institute Working Paper*, July 2018.
(Available at: http://www.croataninstitute.org/publications/publication/can-green-bonds-flourish-in-a-complex-finance-brownfield.)

[36] Harrington, Bill, "Questions Posed by Bill Harrington to Spokespersons and Analysts at Obvion, Climate Bonds Initiative, Moody's Investors Service, S&P Global, and Sustainalytics via Group Email," December 4, 2017. (Posted as the LinkedIn article "GREEN STORM RMBS and ABS Flip Clause Swaps," February 28, 2018, which is available at: https://www.linkedin.com/pulse/green-storm-rmbs-abs-flip-clause-swaps-bill-harrington/.)

[37] Op. cit., "Harrington: Can Green Bonds Flourish in a Complex-Finance Brownfield?", *Croatan Institute Working Paper*, pages 6-7 and 20-21.
(Available at: http://www.croataninstitute.org/publications/publication/can-green-bonds-flourish-in-a-complex-finance-brownfield.)

I have shared my work with academicians who specialize in ethics, the financial crisis, securitizations, derivative contracts, and credit rating companies. The delivering email copies John C. Coffey, Jr., Columbia Law School; Greg Feldberg, Yale School of Management; Robert J. Jackson, NYU School of Law; Elisabeth Kempf, University of Chicago Booth School of Business; Larry Lessig, Harvard Law School; Frank Partnoy, Berkely Law; Katharina Pistor, Columbia Law School; Jessica Roth, Cardozo Law; and Nancy Wallace, Berkeley Haas.

The delivering email also copies my brother-in-law Dean Leistikow, Gabelli School of Business, Fordham University.

Using First-Person Journalism to Beat Back Financial Sector Apologists and Enablers and to Flush Out Out Cowering ChurchMice and Fence-Sitters

The delivering email copies Itay Goldstein, Wharton School, University of Pennsylvania; Francesco Sangiorgi, Frankfurt School of Finance and Management; and Chester Spatt, Carnegie Mellon University.

My work breaks ground as an advocacy tool that combines deep experience, rigorous research, and first-person journalism. The delivering email copies Steve Coll, Columbia Journalism School; the International Consortium of Investigative Journalists; John L. Jackson, Jr., Annenberg School for Communications, University of Pennsylvania; Joe Mathewson, Medill School of Journalism, Northwestern; Cezary Podkul, Hong Kong University; and Stephen D. Solomon, Arthur L. Carter Journalism Institute, NYU.

CreditFlux is an online publication that covers the CLO sector and, like *Debtwire ABS*, is owned by Acuris, Inc. The delivering email copies my former colleague Said Perwaiz Kadiri, Editor of *CreditFlux*.

For reasons that should be painfully obvious to the addressees, as well as to many of those copied, the delivering email copies Jesse Eisinger, author of "The CHICKENSHIT CLUB: Why the Justice Department Fails to Prosecute Executives."

I will physically mail this letter to the US Department of Justice persons and to the states and District of Columbia attorneys general to whom the CEO of Moody's Corporation must submit regular certifications pertaining to Moody's Compliance Commitments under the $864 million settlement that Moody's Corporation, Moody's Investors Service, and Moody's Analytics agreed with the US Department of Justice and the attorneys general of 21 states and the District of Columbia on January 13, 2017.[38]

[38] US Department of Justice, "Justice Department and State Partners Secure Nearly $864 Million Settlement with Moody's Arising from Conduct in the Lead up to the Financial Crisis," January 13, 2017. (Available at: https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-nearly-864-million-settlement-moody-s-arising.)

The delivering email copies Mr. Kyle Plotkin, Chief of Staff for US Senator Joshua D. Hawley of Missouri. Senator Hawley was a signatory to the Moody's settlement in his previous capacity as Missouri Attorney General.

Moody's violates the Compliance Commitments that it agreed in the settlement, as this letter documents. In many cases, the violations have been ongoing since 2016.[39] In other instances, the violations started as recently as December 14, 2020.[40] The delivering email copies Ms. Amy Winkelman, Assistant General Counsel at Moody's Investors Service and Ms. Sharon Nelles, Partner, Sullivan & Cromwell.

The delivering email copies the State of New York Office of the Attorney General and the New Jersey Office of the Attorney General. Appendix E, pages 43-44, yellow-shaded background, contains the letter to me from the State of New York Office of the Attorney General "Re: Moody's Investors Service Reference Number: 20-055709 Matter Identification Number: 1-208010483" dated November 16, 2020. Appendix F, pages 45-46, also yellow-shaded background, contains

---

[39] For instance, see Moody's credit ratings of Natixis, debt of its U.S. based end users of flip-clause-swap-contracts, most other providers of flip-clause-swap-contracts globally, Navient, student loan ABS, and debt of all other U.S. based end users of flip-clause-swap-contracts in Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages A-B and 51-53. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.) Also, Moody's credit ratings of **(1)** US CLOs without flip clauses in the priorities of payment viz-a-viz **(2**) US CLOs with flip clauses in the priorities of payment but without either the operational capability or financial capacity to comply with the daily, two-way exchange of variation margin. Among other violations, Moody's ignores its methodology claim to fully assess the "four-corners" of a given CLO, i.e., to address all actions that an issuer *may take* per the governing documents as opposed to only those actions that the issuer *has taken* at time of committee vote. Also, **(3)** Moody's credit ratings of every provider of a flip-clause-swap-contract in the world viz-a-viz **(4)** similar entities that do not provide flip-clause-swap-contracts.

[40] For instance, every voting member of a Moody's committee that assigns, reviews, or otherwise assesses a credit rating to debt issued by an entity anywhere in the world with a flip clause in the priorities of payments. In each such instance, the committee ignores the ***governance*** failures of a party that uses a flip-clause and thereby assigns a credit rating that conflicts with Moody's Investors Service, "General Principles for Assessing Environmental, Social and Governance Risks Methodology," *Cross-Sector Rating Methodology*, December 14, 2020, Page 26, footnote 14. "For structured transactions, we consider the impact of ESG risks that are expected to unfold within the legal final maturity of the transaction." Likewise, every voting member of a Moody's committee that assigns, reviews, or otherwise assesses a credit rating to debt issued by an entity anywhere I the world that provides a flip clause in the priorities of payments. In each such instance, the committee ignores the ***governance*** failures of the respective entities' management. The same methodology, page 17, including footnote 4. "Boards have a critical oversight role in the area of risk management, [footnote]4 including involvement in setting and monitoring the firm's risk appetite, ensuring that a proper risk management framework is in place, and protecting the interests of all stakeholders, including creditors." "[Footnote] 4. This includes management of ESG-related risks."
(Available at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406.)

the letter to me from the New Jersey Office of the Attorney General "Re: Moody's File Number: 10133000.OCP" dated November 9, 2020.

Appendix G, pages 47-52, white-shaded background, contains the CFTC Acknowledgement of the following Freedom of Information Act request that I filed on December 17, 2020.

Questions for the CFTC, the SEC, the SFA, LSTA, DBRS, Fitch, Moody's, and S&P Global

1. Do you agree that the flip-clause-swap-contract was a root cause of the 2008 global financial catastrophe? That the flip-clause-swap-contract was an integral component of the under-capitalized structured debt that started, fueled, and pro-longed the 2008 financial catastrophe? That the flip-clause-swap-contract was a tool that financial institutions such as AIG, Bear Stearns, and Lehman Brothers used to under-capitalize themselves? That the flip-clause-swap-contract was a tool that Greece, with a big assist from Goldman Sachs, used to crash its own economy?

2. Does every structured issuer around the world still undercapitalize debt when party to a flip-clause-swap-contract?

3. Does every provider of a flip-clause-swap-contract around the world still undercapitalize its self-referencing exposure to 100% loss of contract value under each flip clause?

4. The financial sector in general, and each of your respective entities in particular, practice strict omertà regarding the deficiencies of the flip-clause-swap-contract and the global havoc that it wreaked. **If "no," please prove it.**

5. **If "yes," why practice strict omertà?** Does observation, cultivation, and enforcement of omertà regarding the flip-clause-swap-contract resemble well-known instances of people who know better and should speak out but instead hold their tongues? A current instance includes those Republicans in public office who have not recognized the success of the US Presidential election, particularly given the ongoing pandemic. Historic instances include people who did not speak out against life-threatening prejudice such as racism and anti-semitism.

6. For those of you based in the United States of America, do you love your Country? Does your work strengthen the Country or tear it down?

Questions for the CFTC

7. Please substantiate the belief that the *Capital Requirements of Swap Dealers and Major Swap Participants* "appropriately accounts for . . . bespoke swap transactions involving flip clauses." Are the CFTC letters No. 17-52 and 15-21 the best work that the Commission has produced in its "long experience" with "bespoke transactions involving flip clauses?"[41]

[41] Harrington, Bill, "U.S. Financial Regulators Balk at Examining Complex Finance," *Croatan View*, February 8, 2018. (Available at: http://croataninstitute.org/latest/news/us-financial-regulators-balk-at-examining-complex-finance.) Also, Op. cit., "Harrington Letter Re '31 Misrepresentations in CFTC Letter No. 17-52'," February 2, 2018, pages 1-79 and 92-110, respectively. (Available at:

8. If the CFTC cannot substantiate the belief, is it because the belief as unfounded as beliefs of President Trump that the coronavirus will "just disappear" and the 2020 presidential election was "rigged?"[42] **If "yes,"** are the *Capital Requirements of Swap Dealers and Major Swap Participants* "arbitrary, capricious, and an abuse of discretion?"

9. What will the CFTC provide in response to the following Freedom of Information Request that I filed on December 17, 2020?

   Please provide all information pertaining to "swap transactions involving flip clauses" that the Commission either used or uses in establishing that it "believes" that the "standardized market risk capital charges" in Commodity Futures Trading Commission "Capital Requirements of Swap Dealers and Major Swap Participants" (September 15, 2020) 85 FR 57465 are "effective and appropriately calibrated".

   "The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments, which, in the Commission's long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including bespoke swap transactions involving flip clauses or other unique features."[43]

10. In diluting its regulations to harmonize with the content-free regulations of the SEC, is the CFTC racing the SEC to the bottom in the same manner as DBRS, Fitch. Moody's, S&P Global, and other NRSROs? Do the respective races to the bottom create a circular, self-reinforcing, negative multiplier effect that harms the Country because **(1)** the NRSROs treat regulatory policy as an input to inflate all manner of credit ratings for all manner of issuers worldwide while, at the same time, and **(2)** the CFTC bases its own regulations on the same inflated credit ratings from DBRS, Fitch, Moody's, and S&P Global?[44]

---

https://www.wikirating.org/data/other/20180203_Harrington_J_William_31_Misrepresentations_in_CFTC%20_Letter_No_17-52.pdf.)

[42] Wolfe, Daniel and Daniel Dale, "'It's going to disappear': A timeline of Trump's claims that Covid-19 will vanish," *CNN*, updated as of October 31, 2020. Levin, Bess "Breaking: Trump Throws Impotent Fit Over 'Rigged' Election for 38th Day Straight," *Vanity Fair*, December 15, 2020. (Available at, respectively: https://www.cnn.com/interactive/2020/10/politics/covid-disappearing-trump-comment-tracker/ & https://www.vanityfair.com/news/2020/12/donald-trump-impotent-fit-2020.)

[43] See Appendix G, pages 47-52, white-shaded background.

[44] US Commodity Futures Trading Commission, "CFTC Letter No. 17-52 Re No-Action Position: Variation Margin Requirements Applicable to Swaps with Legacy Special Purpose Vehicles," October 27, 2017, en toto. Federal Register, Vol 82, No. 200, 48394-48413, "COMMODITY FUTURES TRADING COMMISSION 17 CFR Chapter I Comparability Determination for the European Union: Margin

11. Does the CFTC welcome a new Section 13.1 Petition to issue the following rule? "*The Commission must abide by Dodd-Frank Section 939A, which 'directs each federal agency to . . . [remove] . . . all references to or requirements of reliance on credit ratings and substituting alternative standards of creditworthiness. In establishing such alternative standards, an agency must, to the extent feasible, establish uniform standards, taking into account the entities it regulates and the purposes for which such entities would rely on the alternative standards of creditworthiness'*"[45]

12. Is the widespread use of NRSRO credit ratings by the global financial sector, including by US regulators with global reach such as the CFTC and the Federal Reserve Board, a market and governance failure that both undermines and repudiates the free market system?

13. Given the CFTC and SEC race to the bottom, was the 111th United States Congress correct to strip the CFTC and the SEC of standard exemption-granting ability with respect to Title VII of the Dodd-Frank Act?[46]

Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," October 17, 2017, page 48409. "Other differences concern corporate bonds, the most senior tranche of a securitization, and convertible bonds that can be converted only into equities listed on specific indexes, all of which are allowed under the EU margin rules but not under the Final Margin Rule. However, the EU margin rules do address the inherent risk posed by these assets by including additional safeguards when using these types of collateral. ***Regarding corporate bonds and convertible bonds, a counterparty subject to the EU margin rules must assess the credit quality of the assets using a specified internal rating or a credit quality assessment issued by a recognized External Credit Assessment Institution ("ECAI"). Regarding the most senior tranche of a securitization, a counterparty must use an ECAI's credit quality assessment to assess the tranche's credit quality*** [emphasis added]."
(Available at, respectively: https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/17-52.pdf & https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-22616a.pdf.)

[45] Board of Governors of the Federal Reserve System, "Other Reports to the Congress, Report on Credit Ratings," July 2011. Also, Pimbley, Joe and Bill Harrington, "Federal Reserve Trashes Dodd-Frank Restrictions on Credit Ratings," *Croatan View*, May 20, 2020.
(Available at, respectively: (https://www.federalreserve.gov/publications/other-reports/credit-ratings-report-201107.htm & http://www.croataninstitute.org/latest/news/federal-reserve-trashes-dodd-frank-restrictions-on-credit-ratings.)

[46] Op. cit., "Harrington: Can Green Bonds Flourish in a Complex-Finance Brownfield?", page 8, including footnote 27, and pages 25-27. Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," pages 24-25. "To ensure CFTC and SEC compliance, Congress curbed the agencies' 'exemptive authority with respect to the swaps requirements of Dodd-Frank.'" Also, page 42. "Had Congress intended to protect the flip-clause-swap-contract under US bankruptcy law, Congress would have passed the Financial Choice Act of 2017. The bill would have eased the CFTC-Swap-Margin-Rule by exempting many swap contracts from margin posting."

14. Is the CFTC proud to be the regulator-of-record for the flip clause? **If "yes,"** why did the Commission disregard cross-border assessment of the flip-clause-swap-contract in recent cross-border rule-making?[47]

15. Has the Loan Syndications and Trading Association (LSTA) or a vendor such as Sidley Austin threatened the CFTC with a reduction of appropriations, litigation, or both to obtain favorable treatment for US CLOs that have a flip clause in the priorities of payment but lack the both the operational capacity and the financial resources to comply with the daily, two-way exchange of variation margin that the U.S. swap margin rules mandate.[48]

16. Will the CFTC ever opine on whether the TRIPRA exemption applies to the securitization entities of "captive finance companies?"[49]

(Available at, respectively: http://www.croataninstitute.org/publications/publication/can-green-bonds-flourish-in-a-complex-finance-brownfield & http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

[47] Federal Register, Vol 85, No. 178, 56924-57016, "COMMODITY FUTURES TRADING COMMISSION 17 CFR Part 23 Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants," September 14, 2020, page 56926, footnote 20. "The Commission also received letters from . . . William Harrington that were not relevant to the Proposed Rule."
(Available at: https://www.cftc.gov/sites/default/files/2020/09/2020-16489a.pdf.)

[48] See Appendix D to this letter, "WJH Transcript of Sidley Austin / LSTA Webinar: 'End of the (Loan Regulatory) World as We Know It?" May 9, 2018, pages 33-42, yellow-and white shaded background. See comments by Mr. Richard Klingler, pages 35-37, in toto, including the following. "I mean, if you want to upset a regulator, go talk to the appropriations committee on the Hill and ask that they [the regulator in question] not get the money that they want or that their framing statute be changed. That's the way to upset a regulator and the finance industry has no problem doing that." II "Beyond the initial ask . . . Do you want in some ways to get more? And can litigation and the related policy arguments help get you there? Classes of securitizations are entitled to relief from risk regulations. You should do this. It's the right thing to do. Oh, by the way, I potentially have this judicial path."
(The webinar was available at: https://sidley.rev.vbrick.com/#/videos/9bb231c9-cc80-48bb-b13d-8d9505e51050 as of December 21, 2020.)

[49] Harrington, Bill, "Existing ABS swaps also caught in swap margin net," *Debtwire ABS*, August 12, 2016. "As an aside, the question of whether the securitization entities of 'captive finance companies' benefit from the TRIPRA exemption for new swaps, and thus amended ones, remains open. The CFTC still had not responded to the following question — *Does the hedging swap of an SPV of a 'captive finance company' benefit from the TRIPRA exemption from margin requirements?* — at the time of this writing. *Debtwire ABS* first posed this question more than a week ago, as previously reported (see article, 4 August)." (Available at: https://www.debtwire.com/info/existing-abs-swaps-also-caught-swap-margin-net-%E2%80%94-analysis.)

Questions for the LSTA

17. No US CLO has the financial or operational capacity for the daily, two-way exchange of variation margin. Why do 75% of US CLOs have a flip clause in the priorities of payments?

18. Of the universe of managers and underwriters of US CLOs with a flip clause in the priorities of payment, how many can articulate how a flip clause operates? If the answer is "**few-to-none**," does the answer indicate a failure of market information, governance, and capitalism?

19. Do you advocate that the 25% of U.S. issuers of CLOs without flip clauses in the priorities of payments badger NRSROs for better credit ratings and for better governance ratings viz-a-viz debt of the 75% of U.S. CLOs with flip clauses in the priorities of payments but without either the operational capacity or financial resources to comply with the daily, two-way exchange of variation margin that the U.S. swap margin rules mandate? **If "no," why not?**

20. Has your organization or a vendor such as Sidley Austin threatened the CFTC with a reduction of appropriations, litigation, or both to obtain favorable treatment for US CLOs that have a flip clause but lack the both the operational capacity and the financial resources to comply with the daily, two-way exchange of variation margin that the U.S. swap rules mandate?[50] If the answer is "**yes**," does the answer indicate a failure of market information, governance, and capitalism?

Questions for DBRS, Fitch, Moody's and S&P

21. Which persons or entities anywhere in the world have analyzed the flip-clause-swap-contract robustly since 2000?[51]

---

[50] See Appendix D to this letter, "WJH Transcript of Sidley Austin / LSTA Webinar: 'End of the (Loan Regulatory) World as We Know It?" May 9, 2018, pages 33-42, yellow-and white shaded background. See comments by Mr. Richard Klingler, pages 35-37, in toto, including the following. "I mean, if you want to upset a regulator, go talk to the appropriations committee on the Hill and ask that they [the regulator in question] not get the money that they want or that their framing statute be changed. That's the way to upset a regulator and the finance industry has no problem doing that." II "Beyond the initial ask . . . Do you want in some ways to get more? And can litigation and the related policy arguments help get you there? Classes of securitizations are entitled to relief from risk regulations. You should do this. It's the right thing to do. Oh, by the way, I potentially have this judicial path."
(The webinar was available at: https://sidley.rev.vbrick.com/#/videos/9bb231c9-cc80-48bb-b13d-8d9505e51050 as of December 21, 2020.)

[51] Op. cit., "Harrington Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities), in toto. Also, Op. cit., "Harrington Proposed Amicus Curiae Brief in Lehman Brothers Flip Clause Case," in toto.

22. For each year since 1995, how many parties globally have entered into how many flip-clause-swap-contracts?

23. A flip-clause-swap-contract exposes the swap provider to deep subordination of termination assets in event of its own default or non-performance. The cumulative exposure is inordinately large because flip-clause-swap-contracts are essentially ring-fenced by individual structured debt issuer. For each provider of one or more flip-clause-swap-contracts in the world, what is the aggregate, un-netted exposure to flip-clause-swap-contracts assets? Does each swap provider robustly capitalize the aggregate, un-netted exposure to flip-clause-swap-contracts assets?[52]

24. Are virtually all structured debt issuers globally that are party to a swap contract party to only a single type of swap contract, namely the flip-clause-swap-contract?

25. Does a smart contract recognize the deficiencies in law and in capitalization that a flip-clause-swap-contract embeds viz-a-viz each of the two parties?

26. Why does your company lock deal reports such as presale and new issuance reports so quickly? What other sources report the presence or absence of a flip clause in the priorities of payment?

27. Does the daily, two-way exchange of variation margin and all other components of the US swap margin rules significantly reduce the respective credit exposures of both structured debt and a swap dealer viz-a-viz a flip-clause-swap-contract? ***If "no***," please explain why not. ***If "yes***," should all debt of an issuer that is party to a flip-clause-swap-contract be downgraded? Should every swap provider of a flip-clause-swap-contract be downgraded?

28. Why is your credit rating methodology for the flip-clause-swap-contract so voluminously prescriptive? In contrast, why is your credit rating methodology for a structured debt issuer that enters into a swap with the daily, two-way exchange of variation margin so sparse as to be essentially non-existent?

29. How many credit rating methodologies work in tandem with your credit rating methodology for the flip-clause-swap-contract?

30. Regarding non-US structured debt, do your assign lower recovery rates, and where applicable higher expected losses, to debt when a flip-clause-swap-contract is present viz-a-viz debt when no flip-clause-swap-contract is present?

(Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf & http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf, respectively.)

[52] Op. cit., "Harrington Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities), June 25, 2019, pages 25-29 and 35.
(Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf.)

31. Do you publish studies on the global use and performance of the flip-clause-swap-contract since its first use approximately 25 years ago? ***If "yes***," is the study as comprehensive as possible in that it uses data for parties to which your company did not assign and monitor credit ratings or, alternatively, does the study solely use in-house data? Does the study validate ***all*** assumptions in your flip-clause-swap-contract methodology? In addition to enforceability of the flip clause by domicile, assumptions include "one-way collateralization," "replacement / guarantee," and "rating agency confirmation, notification, or RAC."[53]

32. **Also, if "yes,"** How does the "replacement" component of your study treat the losses to a replaced counterparty such as Bear Stearns and BSFP in light of the JPMorgan guarantee?[54]

33. **Also, if "yes,"** how does your study compare losses ***to structured debt with flip-clause-swap-contract assets*** in different cases where "replacement" failed, for example where Lehman Brothers continued to provide a flip-clause-swap-contract viz-a-viz when a propped-up counterparty such as BSFP, AIG, or Merrill Lynch entities continued to provide a flip-clause-swap-contract?[55]

34. **If you do not publish studies on the global use and performance of the flip-clause-swap-contract, why not?** If you cannot validate your credit rating methodology for the flip-clause-swap-contract, how do you validate the credit rating methodologies that work in tandem with flip-clause-swap-contract methodology?

35. Do you train and test managers and analysts of each sector where issuers are end-users of the flip-clause-swap-contract, or place flip clauses in the priorities of payments, on the credit exposures that the flip-clause-swap-contract creates? Notable sectors where issues are end-users of the flip-clause-swap-contract include most non-U.S. structured debt and the US student loan ABS, which Navient dominates. The notable sector that places flip clauses in the priorities of payments is US CLOs.

---

[53] Gaillard, Norbert J., and William J. Harrington, Efficient, commonsense actions to foster accurate credit ratings, *Capital Markets Law Journal*, Volume 11, Issue 1, January 2016, Pages 38–59, https://doi.org/10.1093/cmlj/kmv064. Regarding the respective provisions' failures, see pages 42-44, including footnotes 37, 40, 41, 42, 44, and 45, 46, and 47. Also, Harrington, William J., "Comment on SEC Proposed Rules for Nationally Recognized Statistical Rating Organizations," August 8, 2011. Search "swaps," "flip clause," "replacement," "guarantee," "hedge," "AIG," & "MLDP" & "compliance." (Available at: https://www.sec.gov/comments/s7-18-11/s71811-33.pdf .)

[54] Moody's Investors Service, "Moody's issues rating confirmation for Bear Stearns affiliate," *Announcement*, 4 June 2008. (Available at: https://www.moodys.com/research/Moodys-issues-rating-confirmation-for-Bear-Stearns-affiliate--PR_156804.)

[55] Op. cit., "Harrington Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities), June 25, 2019, pages 25-29 and 35.
(Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf.)

36. Since the US swap margin rules that mandate the daily, two-way exchange of variation margin took effect on March 1, 2017, how many US issuers of structured debt have entered into a swap that complies the US swap margin rules?

37. Alternatively, since the US swap margin rules took effect on March 1, 2017, how many US issuers of structured debt have placed a flip clause in the priorities of payment?

38. How do you assess the ***ability to pay*** interest and principal in full as due for a US issuer with a flip clause in the priority of payments, given that the flip clause contravenes applicable US law and regulations? In the ongoing, real-world instance that I document earlier in this letter, 75% of outstanding US CLOS **(1)** have flip clauses in the priorities of payments but **(2)** lack the operational and capital resources for daily, two-way exchange of variation margin, i.e., cannot comply with the US swap margin rules.[56] Do you assign lower credit ratings to the debt of these 75% of US CLOs viz-a-viz the credit ratings of otherwise similar debt of the remaining 25% of US CLOs without flip clauses in the priorities of payments? If not, are you assigning credit ratings that are inconsistent with the applicable credit rating methodologies? Are you failing to abide by applicable credit rating methodologies that purport to assess the "four-corners" of a CLO?[57]

39. How do you assess the ***governance*** of a US CLO issuer, manager, or agent that places a flip clause in the priority of payments when doing so is inconsistent with applicable US law and regulations? Do these US CLOs have lower governance scores than the remaining 25% of US CLOs that do not have flip clauses in the priorities of payments? If not, are you assigning governance scores that are inconsistent with the applicable credit rating methodologies?

40. How do you incorporate your ***governance*** assessment of a US issuer or agent such as CLO manager into the credit ratings of the associated debt? Does a higher governance score map to higher credit ratings to the issuer's debt viz-a-viz comparable debt where the issuer or agent has a lower governance score?

41. How do you assess the ***governance*** of your company and that of your competitors based on the respective credit rating methodologies and credit ratings for entities that are party to a flip-clause-swap-contract or that place a flip clause in the priorities of payments?

42. Does any NRSRO credit rating company, including your own, have the standing to assess the ***governance*** of any other entity?

43. Does the prevalence of the flip-clause-swap-contract outside of the US undermine or strengthen the respective economies and financial systems? Does the absence of flip-

[56] See footnote 26 to this letter.

[57] NRSRO credit rating companies use the term "four-corners" to represent that credit ratings of a given CLO, particularly a new credit rating, addresses all actions that an issuer *may take* per the governing documents as opposed to only those actions that the issuer *has taken* at time of committee vote.

clause-swap-contracts in US structured debt (the prevalence of flip clauses without flip-clause-swap-contracts in US CLOs notwithstanding) strengthen or undermine the US economy and financial system?

44. Do you train and test analysts of financial institutions that provide flip-clause-swap contracts to end-users on the self-referencing credit risk that an institution incurs under each flip-clause-swap-contract? **If "yes,"** do you use Lehman Brothers as an example of how an institution can lose 100% of a swap asset after it has entered bankruptcy? **Also, if "yes,"** do you use BSFP as an example of the losses that a parent company takes when forced to divest flip-clause-swap-contracts that are assets at fire-sale prices?

45. Should the Federal Reserve System comply with Dodd-Frank 939A and remove all references to the credit ratings of your company and other NRSROs from all recovery programs?[58] Is the Fed's use of your credit ratings self-referencing and circular, given that, in turn, your company uses Fed policy as a rating input? How do you evaluate the impact of capital rules of the CFTC, the SEC, and any other financial regulators that do not obligate a swap dealer to hold much more capital against a flip-clause-swap-contract viz-a-viz an otherwise similar swap contract with no flip clause?[59] Are such capital rules a credit negative for the respective domiciles?

Respectfully,

/s/William J. Harrington

Harrington Independent Flip Clause Assessments
Senior Fellow, Croatan Institute
Wikirating.org Experts Board — Structured Finance Topics

CC: Mr. Rostin Benham, Commissioner, U.S. Commodity Futures Trading Commission

Mr. Dan Berkovitz, Commissioner, U.S. Commodity Futures Trading Commission

---

[58] Pimbley, Joe and Bill Harrington, "Federal Reserve Trashes Dodd-Frank Restrictions on Credit Ratings," *Croatan View*, May 20, 2020. (Available at: http://www.croataninstitute.org/latest/news/federal-reserve-trashes-dodd-frank-restrictions-on-credit-ratings.)

[59] U.S. Commodity Futures Trading Commission, "Capital Requirements of Swap Dealers and Major Swap Participants," 85 FR 57462, September 15, 2020, page 57475. "The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, ***including bespoke swap transactions involving flip clauses or other unique features*** [emphasis added]."
(Available at: https://www.federalregister.gov/documents/2020/09/15/2020-16492/capital-requirements-of-swap-dealers-and-major-swap-participants#page-57475.)

Ms. Dawn Stump, Commissioner, U.S. Commodity Futures Trading Commission

Ms. Allison Herren Lee, Commissioner, United States Securities and Exchange Commission

Mr. Abe Putney, US Securities and Exchange Commission

Mr. David Teicher, Office of Credit Ratings, US Securities and Exchange Commission

Mr. Rick Michalek, RJM Consulting

Mr. Swami Venkataraman, Moody's Investor Service

Mr. James Leaton, Moody's Investors Service

Mr. Gus Harris, Moody's Analytics

Mr. Jason Silverstein, Securities Industry and Financial Markets Association

Mr. Mark Adelson, *Journal of Structured Finance*

Mr. Norbert Gaillard, NG Consulting

Mr. Marc Joffe, Reason Foundation

Mr. Gene Phillips, PF2 Securities

Dr. Joe Pimbley, *Journal of Derivatives*

Ms. Ann Rutledge, Credit Spectrum Corp

Mr. Alberto Thomas, Fideres Partners, LLP

Ms. Mayra Rodriguez Valladares, MRV Associates

Mr. Andy Green, American Progress

Mr. Jerome Jérôme Tagger, Preventable Surprises

Mr. Hamish Stewart

Professor John C. Coffey, Jr., Columbia Law School

Professor Greg Feldberg, Yale School of Management

Professor Itay Goldstein, Wharton School, University of Pennsylvania

Professor Robert J. Jackson, NYU School of Law

Professor Elisabeth Kempf, University of Chicago Booth School of Business

Professor Larry Lessig, Harvard Law School

Professor Frank Partnoy, Berkeley Law

Professor Katharina Pistor, Columbia Law School

Professor Jessica Roth, Cardozo Law

Professor Francesco Sangiorgi, Frankfurt School of Finance and Management

Professor Chester Spatt, Carnegie Mellon University

Professor Nancy E. Wallace, Berkeley Haas

Professor Dean Leistikow, Gabelli School of Business, Fordham University

Professor Steve Coll, Columbia Journalism School

International Consortium of Investigative Journalists

Professor John L. Jackson, Jr., Annenberg School for Communications, University of Pennsylvania

Professor Joe Mathewson, Medill School of Journalism, Northwestern

Mr. Cezary Podkul, Hong Kong University

Professor Stephen D. Solomon, Arthur L. Carter Journalism Institute, NYU

Mr. Said Perwaiz Kadiri, *CreditFlux*

Mr. Jesse Eisinger, ProPublica

United State Attorney for the District of New Jersey,
United States Attorney's Office for the District of New Jersey,
970 Broad Street, 7th Floor Newark, NJ 07102

Director, Consumer Protection Branch, U.S. Department of Justice
450 5th Street NW Washington, DC 20530

Mr. Kyle Plotkin, Chief of Staff for US Senator Joshua D. Hawley

Ms. Amy Winkelman, Moody's Investors Service

Ms. Sharon Nelles, Sullivan & Cromwell

Ms. Letitia James, Attorney General, State of New York State Office of the Attorney General Re: "Moody's Investors Service / Reference Number: 20-055709 / Matter Identification Number: 1-208010483"

Mr. Gregory Turner, Assistant Deputy of Enforcement New Jersey, Office of the Attorney General, Re: "Moody's File Number: 10133000.OCP"

Appendix A — CFTC Acknowledgement of WJH 13.1 Proposal for Rule to Bar an Entity from Agreeing to a Flip Clause or Walk-Away

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100 Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

June 26, 2020

William J. Harrington

51 5th Avenue, Apartment 16A

New York, NY 10003

Re: Petition for a Rule that Bars an Entity from Agreeing to a Flip Clause or Walk-Away

Dear Mr. Harrington:

This acknowledges receipt by the Commodity Futures Trading Commission ("CFTC" or "Commission"), on May 26, 2020, of the petition you submitted pursuant to Commission Rule 13.1 (17 CFR 13.1). The petition seeks a rulemaking by the Commission to prohibit a swap dealer, major swap participant, or other regulated entity from predicating a swap obligation on a flip clause, walk-away, or variable subordination.

As provided in Rule 13.1, this petition will be referred to the Commission for such action as the Commission may deem appropriate. This office will notify you of any action taken by the Commission on the petition.

Sincerely,

Christopher J. Kirkpatrick

Secretary of the Commission

Appendix B — 2016 *Debtwire ABS* Article on US Swap Margin Rules

Formerly publicly available from 2016-to-2019 on *Debtwire* public site at: http://www.debtwire.com/info/2015/11/04/analysis-us-marginrule-swaps-obliges-securitization-issuers-overhaul-structures-add-resources-rethink-capitalstructures/.

ANALYSIS: US margin rule for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures

05 November 2015 | 14:45 EST

This is a reissue of Debtwire intelligence ID# 2121791, which was originally published on 4 November.

By 1 March 2017, many issuers of rated securitizations and structured vehicles will need a lot more resources to enter into a swap contract with a regulated US swap provider. From this date on, a swap provider will be subject to a new requirement to collect and post margin with respect to new swaps with many types of financial counterparties, including securitization issuers.

Five US regulators - the FDIC, Federal Reserve Board, FCA, FHFA, and OCC have adopted a joint rule for margin requirements for swap contracts that are not centrally cleared. Under this rule, a US swap provider must "collect and post " margin on a daily basis under a "new" non-cleared swap contract with another swap dealer, a major swap participant, or a "financial end user" - the broad category that includes many securitization issuers.

The swap margin rule works in conjunction with SEC and CFTC rules. As such, it may be augmented by future SEC and CFTC rulemaking. Under the swap margin rule, a "covered swap entity" is a swap dealer or major swap participant that is: 1) registered with, or exempted from registration by, the SEC or CFTC; and 2) also "prudentially regulated" by the FDIC, Federal Reserve Board, FCA, or OCC. At the time of the rule's adoption, there were 100+ "covered swap entities."

Securitization issuers: Pick your poison

The big impact for issuers of securitizations and structured finance products is that "hedging" (i.e., offsetting the potential depreciation of assets such as fixed-rate residential mortgages viz-a-viz floating-rate debt) with swap contracts will be much less attractive. A give-up is in store, one in which issuer will have to weigh hedging versus ratings. Swap hedging per industry practice will be much more expensive. Partial or no hedging will cost less, but likely result in lower ratings as debt will be more exposed to asset depreciation. Mitigating factors such as additional overcollateralization or substituting swaps for options could also come into play.

Securitization issuers may discover exclusions as they examine the swap margin rule and review future SEC and CFTC rulemaking. However, the securitization industry is taking no chances. SFIG has been lobbying Congress for an exemption from the swap margin requirements for all securitization issuers, (see article, 26 October).

For a covered swap entity (i.e., a swap provider), one impact will be that it holds "variation" margin against the market value of a swap contract with a securitization issuer when the contract is in-the-money (out-of-the-money to the issuer) and posts variation margin against the market value of the contract when it is out-of-the-money (in-the-money to the issuer).

The swap margin rule is not retroactive, i.e., it will not apply to a swap contract that was entered into prior to the applicable compliance date. The rule also exempts a swap contract that hedges the commercial risk of a "captive finance company," as previously reported by this news service.

The rule intentionally establishes a tight compliance date of 1 March 2017 with respect to variation margin under the rationale that in aggregate, daily exchange of variation margin is standard practice between swap dealers and many market participants. Most if not all securitizations covered by the rule will fall into this subcategory. (Programs that are party to an annual average of USD 8bn or more in notional amount of derivative contracts and short-dated foreign exchange trades may fall into a separate subcategory - "financial end users with material exposures" - with separate margin requirements.)

Start-up compliance costs

Being party to a swap contract under which a swap provider both collects and posts margin is not standard practice for issuers of rated securitizations, however. In order not to be shut out by swap providers from 1 March 2017 onwards, a securitization issuer will have to have set up margin financing and operations well beforehand and also to have finalized trade documentation. Under the swap margin rule, a swap provider must have all trading documentation in place to enter into a new swap.

Setting up margin financing and operations will require dedicated resources on both an upfront and ongoing basis, which in turn will impact the capital structure. In contrast, the pricing of a new swap contract itself should not be affected significantly, given that the contract will more closely mirror ones that swap providers have long entered into with other financial counterparties.

Exchanging variation margin must occur on at least a daily basis and the cumulative amount of margin that has been either collected or posted by a swap provider (depending on whether the swap contract is in-the-money or out-of-the-money to the provider) must at least equal the market value of the swap contract. A swap provider and financial end user without material exposures are free to define market value (e.g., as the mid-market value of the swap contract) as well as to specify amounts of variation margin that exceed the margin requirement. They will also have to decide whether variation margin will be held in a segregated account and whether it can be re-used.

By design, the swap margin rule casts a very wide, very tightly knit web with respect to types of derivative contracts, swap provider, and financial counterparties. "Swaps" refers to swap contracts that reference basis rates, interest rates, currencies (other than very short-dated foreign exchange swaps and forwards), credits, commodities, and equities.

Commentary in the swap margin rule states that it will cover swap dealers and major swap participants registered in the US, their subsidiaries and overseas branches, as well as the US branches and subsidiaries of foreign companies active in the US swaps market.

Furthermore, each of the five prudential regulators also has the ability to designate any other entity as a covered swap entity, i.e., as a swap provider that must comply with the rule.

Relief unlikely for offshore SPVs

Because the swap margin rule will cover overseas branches and subsidiaries of registered US swap providers, securitization issuers outside of the US may be impacted. The rule allows for the five prudential regulators to decide jointly on a jurisdiction-by-jurisdiction basis if compliance with foreign regulations can be "substituted" for compliance with the swap margin rule. However, in the absence of a joint determination, a swap provider must comply with the swap margin rule. Moreover, rule commentary states that foreign regulations that do not obligate a US swap provider to collect margin are unlikely to qualify for "substituted compliance."

The rule is more relaxed with respect to the "eligible collateral" that can be posted as variation margin between a swap provider and a financial end user without material exposures (such as a securitization issuer). Cash, US treasuries, debt guaranteed by a range of government and multi-lateral entities (such as the US Treasury, a US agency, a GSE, the European Central Bank, some sovereigns, and entities such as the IMF), as well as gold and some equities and publicly traded debt securities are all eligible (subject to specified haircuts).

However, ABS are not eligible collateral, unless "they are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the US Department of the Treasury or another US government agency whose obligations are fully guaranteed by the full faith and credit of the US Government; or if they are fully guaranteed by a US GSE that is operating with capital support or another form of direct financial assistance received from the US government that enables repayment of the securities."

To avoid idiosyncratic "wrong-way risk", eligible collateral excludes securities issued by either party or affiliates. To avoid general wrong-way risk, eligible collateral also excludes "securities issued by a bank holding company, a savings and loan holding company, a foreign bank, a depository institution, a market intermediary, or any company that would be one of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of one of the foregoing institutions," For the same reason, "securities issued by a non-bank systemically important financial institution designated by the Financial Stability Oversight Council" are also excluded.

Spotlight on flip clauses

Rather than post margin under a swap contract, issuers of rated securitizations have generally entered into swap contracts that hew closely to rating methodologies. Consistent with these methodologies, an issuer of rated securitizations generally pays amounts owed to a swap provider at a senior place in the priority of payments but also stipulates that this seniority can "flip" to a junior place in certain instances of swap provider impairment (such as bankruptcy).

For its part, a swap provider that is counterparty to a securitization issuer under a swap contract that adheres to a rating methodology typically does not post margin from the outset but instead agrees to do so (or take other remedial actions) only if it is downgraded to a specified level. However, many of these swap contracts also contain procedures to relieve a downgraded swap provider of the obligation to post margin or take other remedial actions.

Under the swap margin rule, a swap provider will have no discretion to collect or post variation margin in amounts below the margin requirement, nor to do so any less frequently than daily. Similarly, the ratings of a swap provider (or securitization obligations) will no longer activate (or deactivate) the obligation of a swap provider to post variation margin.

Accordingly, issuers of rated securitizations will have lots to decide and will have to consult with swap providers at each decision node given that it is the providers (and not securitization issuers or other financial end users) that are responsible for compliance with the swap margin rule, including finalizing trade documentation.

For instance, in developing new custodial and financing arrangements to support the daily, two-way exchange of margin, a securitization issuer will have to query swap providers on the attributes that they require to treat a swap contract as being compliant. Securitization issuers will also have to understand the rating implications from entering a swap contract with immediate, two-way margin posting.

Questions abound

Working backwards, input from swap providers and rating agencies will help securitization issuers determine the costs of financing margin and beefing up margin operations. Working backwards further still, these costs help will a securitization issuer to weigh entering into a swap contract against other means to offset the potential depreciation of securitized assets, such as buying an option or increasing overcollateralization.

Two-way margin posting should also prompt a securitization issuer to re-examine features of industry-standard swap contracts. Given that a swap provider will be holding variation margin under a swap contract that is in-the-money (out-of-money to an issuer), will the swap provider require its payments to be made from a senior position in a securitizations' priority of payments? Is there a reason to continue "flipping" these payments to a subordinate position when a swap provider is insolvent or in bankruptcy?

This re-examination will require still more input from swap providers. How will a swap provider adjust the calculation of the market value of a swap contract to reflect holding margin when a swap contract is in-the-money (out-of-the-money to a securitization issuer)? Or the presence or absence of a flip clause? Or the unequivocal obligation to post margin against the market value of a swap contract that is out-of-the-money (in the-money to an issuer), rather than the currently contingent obligation that activates only after swap provider downgrade?

Again, the responses from swap providers and input from rating agencies may convince a securitization issuer to forego hedging in part or altogether and instead opt to expose rated liabilities to asset depreciation and in turn issue senior debt with lower ratings (and potentially new types of subordinated debt or equity).

Because the swap margin rule exempts swap contracts that hedge commercial risks of "captive finance companies", the decision to collect margin under these swaps will remain the judgment of a swap provider. (A "captive finance company" is defined as an "entity whose primary business is providing financing and uses derivatives for the purposes of hedging underlying commercial risks relating to interest rate and foreign exchange exposures, 90% or more of which arise from financing that facilitates the purchase or lease of products, 90% or more of which are manufactured by the parent comp any or another subsidiary of the parent company.")

If swap providers continue to use the current industry-standard template for swap contracts that hedge the commercial risks of captive finance companies, the securitization sector will see a bifurcation of swap contracts. Captive finance companies will continue to hedge commercial risks with swap contracts that adhere to current rating methodologies, whereas other securitization issuers will enter into swap contracts that are compliant with the swap margin rule.

Rating agency methodologies will have to assess the impacts from the two types of swap contracts. And other providers of securitization analytics will also have to boost their assessments of the potential depreciation of securitized assets relative to rated liabilities.

by Bill Harrington

[Bill Harrington has been conducting research on the obligations and risks of derivative contracts in the structured finance sector for 15 years, most recently at Debtwire ABS and previously at Moody's Investors Service. He has filed evaluations of rating processes and derivative methodologies with US and European regulators and with credit rating agencies. Bill has also worked as derivative structurer at Merrill Lynch and a currency analyst at Wharton Econometrics. Bill has an MBA from The Wharton School.]

2016 MERGERMARKET GROUP. ALL RIGHTS RESERVED.
To be used for the internal business of the assigned users only. Sharing, distributing or forwarding the entirety or any part of this article in any form to anyone that does not have access under your agreement is strictly prohibited and doing so violates your contract and is considered a breach of copyright. Any unauthorised recipient or distributor of this article is liable to Debtwire for unauthorised use and copyright breach.

Appendix C – Estimates of Flip-Clause-Swap-Contracts in Deals for which Bill Harrington and Rick Michalek Were Voting Committee Members During Their Respective Tenures at Moody's Investors Service

Final Tally: 1200 Flip-Clause-Swap-Contracts that Structured Finance Entities Entered into Between June 1999 and July 2010.

Mr. Harrington and Mr. Michalek have significant first-hand experience in reviewing flip-clause-swap-contracts and in assessing both the separate, but singularly out-sized credit exposures that the contract imposes on each party, as well as the legal exposures that both parties share.

During his Moody's tenure from June 1999 to July 2010, Mr. Harrington was the lead credit analyst for at least 65 structured finance entities that collectively entered into an estimated 460 flip-clause-swap-contracts. Of the 65 structured finance entities, 60 were structured debt issuers that were end-users of the flip clause-swap-contract. The remaining five entities were derivative products companies (DPCs), four of which provided flip-clause-swap contracts and a fifth that withdrew a proposal to do so based on Mr. Harrington's evaluation. One of the four DPCs that provided flip-clause-swap-contracts — Bear Stearns Financial Products — was a major provider of flip-clause-swap-contracts to the pre-crisis RMBS sector. Mr. Harrington was also lead credit analyst for seven other DPCs and five credit default product companies that did not provide flip-clause-swap-contracts.

During his Moody's tenure from June 1999 to December 20007, Mr. Michalek was the legal analyst for at least 150 structured finance entities that entered into an estimated 140 flip-clause-swap-contracts.

For a subset of the above deals, Mr. Harrington was lead quantitative analyst and Mr. Michalek was lead legal analyst. Each such deal is counted only once, i.e., <u>is not double counted</u>, in the above tallies.

During the overlap of Mr. Harrington and Mr. Michalek's tenures from June 1999 to December 2007, lead analysts in Moody's Derivative Groups also voted to assign ratings in committees for deals in which a third colleague was lead analyst. An estimate of the ratio of committee participations as lead analyst viz-a-viz non-lead voting member = one-to-three. Using this ratio, Mr. Harrington was a voting committee member for an additional 180 deals with a flip-clause-swap-contract and Mr. Michalek was a voting committee member for an additional 420 deals with a flip-clause-swap-contract.

APPENDIX D WJH Transcript of Sidley Austin / LSTA Webinar: "End of the (Loan Regulatory) World as We Know It?" of May 9, 2018

N.B. Yellow-Shaded Text is Especially Noteworthy

(Available at: https://sidley.rev.vbrick.com/#/videos/9bb231c9-cc80-48bb-b13d-8d9505e51050)

Presenters

Allison Satyr, Sidley Austin https://www.sidley.com/en/people/s/satyr-allison-j
Richard Klingler, Sidley Austin https://www.sidley.com/en/people/k/klingler-richard-d
Peter ????, Sidley (per Elliott Ganz @19:00)
Elliott Ganz, LSTA
Meredith Coffey, LSTA
Lee ?????, (LSTA per Richard Klingler @24:09)

0:00 - 4:10 Allison Satyr introduction

4:11 - 16:20 Elliott Ganz
5:07 - 5:36
"Many people have asked me after the [risk retention] decision 'What am I going to do now?'"
"Some of them meant what have you done for me lately and what are you going to do now? But, some of them literally mean 'What are you going to do now?'"
"We have spent so much time on risk retention over the last eight years, what's our next act?"
"Meredith and I have no plans to take the summer off. On the contrary, there is a very full agenda and we're going to talk about some of those things."

5:37 - 6:04
"Talk about risk retention, kind of from an inside baseball perspective."
"Richard is going to pivot and talk about litigation as a strategic tool."

6:22 - 8:03
"In July of 2010, Dodd-Frank was passed on a partisan basis."
"No time to engage in Congress or get anything done."
"Our view initially on risk retention was that it couldn't possibly apply to CLOs for two reasons."
"Number 1, CLOs performed very well during the financial crisis."
"Number 2," CLOs weren't RMBS.
"The agencies had a very, very different view."
"The agencies didn't really read the statute carefully."
"we had countless meetings with all of the agencies."
"We filed letters, six comment letters" re CLOs and risk retention to the regulatory agencies.

Six comment letters "from the time the rule was proposed until the final rule."

8:00 - 11:10
"The efforts were unavailing. And let's talk about why."
"Number 1, the political environment was very, very challenging."
"The agencies were probably under political pressure to implement the rule in as strict a way as possible."
"Moreover, regulatory agencies are risk adverse."
"You don't get credit for going out on a limb and giving relief to certain aspects of the regulatory universe."
"As compelling a case as we may have had, just as a matter of how regulators work, they were not going to go out on a limb to help us."
"...[T]he next point. That the banking agencies in particular had a very clear view on leveraged lending. They certainly were not interested in helping out the loan market or the CLO market."
"They thought that the leveraged loan market had gone way too far and they viewed the CLO risk retention rule as an avenue to pull it back."
"As much as anything is the fact that this [CLO risk retention] is a multi-agency rule-making, which I think was fairly new."
"Two parts of that [this last point]"
"Number 1, Dodd Frank in general pushed an incredible amount down to the agencies."
"The statute itself, believe it or not, it was probably 2000 pages, but there are probably hundreds of thousands of pages of rules written on that."
"so, they pushed down to the agencies the implementation."
"They did it in a way that was guaranteed not to work well, which is to have many agencies involved in the rule-making."
"In our case, you had the SEC and three banking agencies."
"SEC is the primary regulator for 97% or 98% of CLO managers."
Yet, we had to deal with the banking agencies, who really didn't like leveraged loans."
"Had it only been the SEC, we might have been able to get somewhere."
"With the banking agencies the requirement to get them on board, it was pretty hopeless."
"That led to a change in strategy, which involved litigation."

12:10 - 16:23
"You can't just sue the regulator because you don't like what they're doing. You have to have a reason. The reason that we had is the statute didn't appear to give the agencies the ability to do what they were doing."
"We also think the agencies go the math wrong, they were imposing the risk retention at 5% of fair value whereas the statute says" credit exposure.

"We started to develop relationships on the hill. Democrats, Republicans," we developed relationships "with the Finance Committee in the House," a little with the Senate banking committee
"At that point, we also didn't think we would get a complete carve-out, but it was important to start developing these relationships."

"Once you get beyond a few people in the House and Senate, the perspective of the people in Congress is 'The Big Short.' That's what they know about securitization."
"That's kind of the level you had to deal with in terms of educating them."
"We had an interesting strategy for the end of 2016, which is to try to do a 'Hail Mary' and get something attached to an omnibus bill at the end of 2016."

"Pivot to litigation."
"We had two goals [for our regulatory approach of submitting risk retention comments].
"One was to try to persuade the agencies through our commenting. But, the real goal was to build a record for our litigation."
"The litigation is effectively an appellate litigation and the only thing you can talk about, the only thing you can address is what's in the record."

16:20 - 18:20 Richard Klingler (commenting to regulators to help future litigation)

"Two major concerns."
On is that "You're getting in things that you need to rely on in argument in challenging the agencies."
"It has to be brought before the agency to give them a bite at fixing the problem first."
"Is that you're getting things in. It's defensive in a way but it's also offensive."
"It makes them [the regulatory agencies] actually go through the process of drafting and writing, it makes them focus on and gives you a greater chance of actually prevailing."
"Make sure that the record enables you to have the information to educate the courts about the broader context, not just about the particular arguments you are making but the industry dynamics...the effects of the agencies disregarding the alternatives that Elliott and Meredith were putting in front of them."
"At the end of the day, we were anticipating going to the District of Columbia's court of appeals, which is one of the most sophisticated courts in the country for appellate matters but they don't know a lot about finance."
"[S]ome of them are certainly well beyond 'The Big Short' view, but unlike say the Second Circuit, finance isn't their bread and butter and administrative law is."
"That was the other objective to developing the record."

18:20 - 23:10 Elliott Ganz

"We didn't hide the fact that we were going to sue."
"We were very clear with the agencies that we were going to sue."
"There were reasons for the agencies to work with us in light of the litigation threat."
"Our transparency was purposeful."
"The agencies didn't have the political will to do anything."

23:10 - 27:50 Richard Klingler, [Litigation as a strategy in a much deeper way]

"Two broad points"

One: "Using litigation to shape the regulatory environment, to change the terms of debate that you have with the government."
"Thinking like a litigator for the next generation risk retention issues and the potential for other types of strategic applications that may arise....how risk retention unfolds in the second generation of cases."
"Strategic litigation."
"win on the policy issues."
"preparing the judicial case. What type of result would we like the court to lead us to?"
Finance generally a laggard in this regard. However, "LSTA a thoughtful pioneer"
"In finance, it has been used, but on occasion...but the industry is moving only slowly."
"Fear of upsetting the regulators. Inviting adverse regulatory action."
Fear is "Overblown."
Most other industries litigate as one of many tools.

27:50 - 28:29
"Compare it [litigation] to sY, lobbying. I mean, if you want to upset a regulator, go talk to the appropriations committee on the hill and ask that they not get the money that they want or that their framing statute be changed. That's the way to upset a regulator and the finance industry has had no problem doing that."
"That's because, certain segments of the industry, particularly the larger segments, are happier with the current regime than outliers like managers of open-market CLOs, for example.

28:30 - 30:20 Elliott Ganz
No backlash
Board made up of people from large banks and large investment firms reluctant to sue. Some abstained from the vote to sue, even though the LSTA didn't record votes in these instances. However, no adverse outcome from having sued.
"If anything, there's a little more respect for the LSTA, that we were willing to stand up and go to the mat.
"Just with the SEC, in particular," continued engagement during litigation.
We were able to get a very important no-action letter on re-financings."
"We're working on another no-action letter on custody. We're getting pretty close."
"So the agencies don't take it personally."

30:25 - 37:40 Richard Klingler
Re: litigation as tool to influence initial rule-making.
"We have seen other cases" re: Dodd-Frank." They have been relatively successful.
Use litigation to "influence the agencies as they write rules" to avoid the problem that you are raising. Incentivize the agencies to Write the rule to be more advantageous to your clients.
After the rule has written, encourage the agency to incorporate your view to limit the rule's scope.
Second point
"Thinking like a regulator" can help influence agencies re the next generation of rules on risk retention and other areas.

"Next generation like are there other type of assets or securitizations" that should benefit from a carve-out from risk retention.
"middle market CLOs and the distinction between balance sheet CLOs and open market purchases is another area"
"The overlap of the EU and US risk regulations regimes."

37:40 - 39:45 Richard Klingler
Re:thinking like a litigator
Elliott and Meredith of the LSTA do this already.
Beyond the initial ask
"Do you want in some way to get more? And can litigation and the related policy arguments help you get there?"

"Classes of securitizations are entitled to relief from risk regulations. You should do this. It's the right thing to do. Oh, by the way, I potentially have this judicial path."
Citing analysis on fair value as a proxy for credit risk in the subordinate tranche of a transaction and to develop a record on the adverse impact on the industry. Ultimately not needed, at least in last suit.
"The scope of fair value to determine credit risk is the gun on the wall that should be used in the third act."
"Well, it didn't get used. The gun is still up on the wall. And you know, we put in a tremendous amount of time into engaging a Harvard Business School professor. to analyze the...iniquities and the nonsense, frankly, in the industries using fair value as a proxy for credit risk" in the most subordinate tranche in a securitization. And to develop a record on the adverse impact of the industry..."
"That can't be taken to court immediately but that kind of argument still has the potential to be deployed.

39:45 - Meredith Coffey

"End of risk retention"
"What does it mean for the CLO market today?"
"What does it mean for CLO managers?"
"What does it mean for the loan and CLO market in the future?"

For CLO market today:
Chart shows strong issuance of CLOs that conform to risk retention.
Loan availability, which is not impacted by easier risk retention, is main limit on growth in CLO issuance.

43:00 - 43:24
For CLO managers:
Clearly, the end of risk retention has an impact on managers.

"We've seen a lot of consolidation in recent years. And we use this term consolidation like its a bloodless thing, like it's nothing. But, what it means is that someone built a business and was forced to sell it due to risk retention. And that is actually ethically, I have problem with that."
"Now, we probably have no consolidation pressure due to risk retention."

Long-term
"People are conflating what's happening today with what may be happening long-term in the CLO market."
"Capital will not always be cheap."
"We, the LSTA, speaking as the loan organization and not a CLO organization, think that CLOs are very good for the loan market because they stabilize the loan market. They're not forced sellers. They're not subject to pressures that others face. So we want CLOs"

45:00 -Questions
Meredith Coffey asks for questions and also mentions CLE credit.
A woman (potentially Allison Satyr) says that there is only one question on line. Some confusion about how balance sheet CLOs fit into the topic?

Elliott Ganz answers. Effectively, balance-sheet CLO still governed by old risk retention based on definition of term "transfer."

46:00 "Lightning round" & Leveraged lending guidance. Still Meredith Coffey
LSTA has talked to agencies, which seem amenable to amending the leveraged lending guidance.
Four major areas:
1) Definition of a leveraged loan. It's extraordinarily broad. Captures lots of investment grade loans
49:30
Banks "Request Number 1: Don't make us include investment grade loans in the leveraged loan portfolio"
49:50
2) "Origination defined as "origination, re-financing, or any modification."
Address the problem that any change or amendment to a 'non-pass credit' activates the origination definition and banks are not allowed to originate "non-pass credits."
50:05
3) Pricing, particularly re-pricing of a non-pass credit.
50:21
4) Underwriting flexibility. Banks want flexibility to underwrite non-pass credits where there are mitigating factors.

51:58 Lightning Round Elliott Ganz
Volcker Rule
"Real issue is related to CLO notes. The agencies took a crazy position that CLO debt instruments are ownership interests in covered funds because the holders of the notes have

the right to replace the manager. They kind of made that up and it reflected their view on leveraged loans and that was not a good view."
"As a result of that, because there's a carve-out for loan securitizations, all CLOs, virtually all US CLOs, are loan only. And that remains the case to today. So, there are no baskets for securities."
"The good news is the agencies could change that, just the way they imposed it, which is with the stroke of a pen to say 'we have a different view.' In the current regulatory environment, that's certainly a possibility. It doesn't take a rule-making and so it's pretty low-hanging fruit."
"The Treasury Department actually put that in one of its reports and identified that as an issue that could be fixed and ought to be looked at in Volcker."
"Unlike the big fixes in Volcker, which will require rule-making among all the banking agencies, this thing, this fix could happen really quickly and easily. And I think as soon as the new leader of the FDIC comes in, as early as May is what we're hearing, that might be an opportunity for us to seek that relief."

54:00 - Elliott Ganz on Custody

"I love posing problems that we've fixed."

56:00 - 57:25 Elliott Ganz on Small Business Bankruptcy Reform

57:25 - 61:00 Elliott Ganz on Mandatory Commercial Flood Insurance

61:00 - 61:30 Allison Satyr
"Wow" that was great!"
"Does anybody have questions? There are no questions on the web. Does anyone in the room have questions on the topics that we've just covered?"
"I am going to quickly read the CLE code and then move on to LIBOR."
"The CLE code is SA as in Sidley Austin CLE 18-155"
N.B. SACLE18-155

61:30 – 81:16 Meredith Coffey on Transition from LIBOR
"How many people in the room think that by 2025 LIBOR will be dead?"
"Only a handful? OK, well I'm here to disabuse you."
We went through "risk retention issues, and it a was a very big issue for CLOs and the LSTA and the loan market...but the reality is that it is dwarfed by the issues around LIBOR."
"LIBOR is probably one of the biggest issues that we are going to face in the loan markets, in the capital markets, in the markets, period...that any of us will face in our lifetimes."
"It's a big deal."
"The ARC was set up in 2014 with the Fed, working with the swaps markets participants."
"Late last year [i.e., 2017], it became clear that this wasn't just a swaps problem...a derivatives problem, it's a cash market problem as well."
In recognition, the Fed broadened the ARC committee and "The LSTA is on the broader ARC committee."

"I'm [i.e., Meredith Coffey] the representative on the broader ARC committee, along with the Fed, all the ex officio members, all the buy side members, sell side end users, as well as corporates. And, I'm also the co-head of the ARC's business loans and CLOs working group."
"That said, all the information that I'm going to share with you today is public information."
"These are my views," not the views of the ARC

63:30 - 75:00 Meredith Coffey on Transition from LIBOR
"The reality is that is a simple problem, but a really, really, really big problem."
"There are USD 200 trillion, that's trillion with a 'T,' of LIBOR-based contracts.
"If something happens to LIBOR...like it ceases to exist suddenly, much of that USD 200 trillion comes crashing down. And that would be very bad. That is like Y2K, but real. And that's what we're trying to avoid."
"So, what do we do?"
"The reality is that the market has been trying to fix LIBOR for the last half decade."
"But, the feeling is maybe it can't be fixed. Maybe, it can't be redeemed."
"Expert judgement means they're [the banks] kind of making it [daily LIBOR settings] up, but with a lot of expert judgments behind it."
Regulators, which have been compelling banks to submit LIBOR quotes, are now saying "We're going to stop that compulsion at the end of 2021."
"So, LIBOR may or may not exist after 2021."
"The issue is, we cannot afford to assume that it will continue to exist after 2021. We have to prepare. We have to work on finding a new rate. And that is what many people around the globe are doing."
"So we're working on finding something more robust and, importantly, we're working to make it fit the loan market."
"LIBOR has a lot of flaws, but we all know it. We're all comfortable with it."

75:00 - 81:16 Meredith Coffey on Transition from LIBOR
People in this room are probably thinking "What the heck do I need to do?"
Loans and CLO in relatively good shape compared to other asset classes.
"A lot of other asset classes are 10-30 years."
"Loans already have a fallback [PRIME]"
"There are asset classes out there that have much longer tenors than loans... [with]... literally no fall-back if LIBOR goes away and cannot be amended."
"No one knows what to do with these asset classes. This is very problematic."
"Loans are in a better place. So what do we have with loans? At least we have schadenfreude, so that's good."
"ideally we end up with a credit spread adjustment where at least at the point of transfer, there is no economic value transfer. You lend on LIBOR one day. You lend on SOFR the next day. Ideally, the economics are the same.
"Ideally, you get to a situation where there is no value transfer at that time."
"Then the hard stuff happens."
"But, we really need to synchronize with other classes, or at least many asset classes." i.e., CLOs & derivatives. "And that's not that simple."

"If you think about it, we have to make all these decisions. And, then banks have to operationalize all of this."
"So, there's a lot of operational work that needs to go on. And, by the way, we need to have it all done by 2021. Have it tested. Have it working."
"So, there is a lot to do on LIBOR. It is a very, very substantial challenge."

81:17 - 83:55 Meredith Coffey
"With that, open it up to any questions that we might have."
Allison Satyr
"Any questions?"
81:30 - A person with a strong Scottish accent who seems to be in the room with the presenters asks two questions related LIBOR transitions: 1) alternatives to SOFR; and 2) working with European analogs?
83:00 Meredith Coffey
"Coordination globally. Yes, that is happening. It's going to be challenging."
"We are coordinating as best we can. All other geographies are going to overnight rates... Some of the overnight rates are secured. Some are not...could be differences in the basis rates...and they may be implemented at different times."
"We are trying to coordinate as best we can. It is going to be a little bit disruptive, though."

"So there are a couple of other questions out there."
83:55 Allison Satyr
"I would note for all those deals that are out there that are multi-currency, the amendment process becomes even more cumbersome... Certainly from a drafting perspective."
84:00 Meredith Coffey
"And from an operational perspective... What happens when you get a whole bunch of currencies. It gets a whole lore more complicated.
84:15 - New question, apparently from a gentleman in the room.
1. "Assuming the derivatives markets adopt a protocol process and everything moves fairly smoothly, but ICE continues to publish LIBOR in some static form...How do you synch a LIBOR loan to all the derivative adjustments that are tied to the LIBOR loan?"
2. "And then, will there be any relief within Volcker, to adjust banks to trade or adjust for what we don't consider a static spread between SOFR and... in our cost of funds on the basis risk?"
84:45 - Meredith Coffey
"I'll..[pass].. the Volcker question" to Elliott Ganz.
Future deal docs may allow for PRIME / LIBOR / SOFR.
86:46 - 87:23 Elliott Ganz
"In terms of Volcker, I think you're probably a couple of years ahead of your time... I don't think anyone's thinking about that. It's a great question, but these things haven't been worked out yet... that's sort of the next step.... My head is exploding thinking of all those issues just like the one you raised that they're not talking about because they're... blocking and tackling to get to a solution... I think there's going to be millions of issues like that that are going to pop out... I think it's going to be really ugly."

87:23, Another question by a gentleman (possibly the same who asked the question at 84:15.)
Small borrowers may not want to make the same adjustments as the derivatives market.
88:00 - 88:20 Meredith Coffey
"It's absolutely right. How do you encourage earlier transition? It's going to be very challenging."
88:20 - A woman, also apparently in the room, who identifies herself as an attorney asks a technical question on credit agreements. Can the process be shepherded to make the transition more effective, more of a fait accompli?
89:10 - 90:00 Elliott Ganz
"We have to deal with the real world right now, which is that it's an extremely hot market and the sponsors have a lot of leverage right now and they're trying to do documents that put them in the best possible positioning and give them the most flexibility. So I think... on the most basic level, that's what we're really seeing today... I see transitioning to more nuanced loans is going to take some time... U think that's what we're seeing as a matter of reality."

90:00 - 91:00 Elliott Ganz
"It's just going to take some time... As you get closer to something more concrete, you're going to see documentation that reflects that. But, right now, the borrowers don't want to get hosed by base rate and the lenders don't want to get hosed by SOFR."

91:00 - 91:15 Allison Satyr
"If there are no other questions, I think that concludes today's panel discussion. Thank you so much."

APPENDIX E—Letter from State of New York Office of the Attorney General to William J. Harrington Re: Moody's Investors Service / Reference Number: 20-055709 / Matter Identification Number: 1-208010483 / December 16, 2020

State of New York
Office of the Attorney General

Letitia James	Division of Economic Justice
Attorney General	Investor Protection Bureau

November 16, 2020

William J. Harrington
51 Fifth Avenue, #16A
New York, NY 10003

Re: Moody's Investors Service
Reference Number: 20-055709
Matter Identification Number: 1-208010483

Dear William J. Harrington:

Thank you for writing to the New York State Office of the Attorney General regarding the above-referenced matter. We appreciate your alerting us to the situation you describe.
Submissions like yours help our Office identify patterns of fraud in the securities industry that may warrant investigation.

While the staff of the Investor Protection Bureau reviews every submission we receive, the Bureau does not act on every submission, and, as our investigations are confidential, we are unable to provide details regarding ongoing investigations (including whether a particular investigation has been opened).

Further, the Investor Protection Bureau does not investigate or litigate cases on behalf of individual investors, and the Bureau's staff members are not private attorneys for individuals who may wish to

pursue personal claims. Therefore, if you believe you may have been harmed, you should consult with a private attorney regarding any civil remedies that may be available to you.

If you do not have an attorney and would like a referral, you may call your city or county bar association. Additional information and resources are also available at https://ag.ny.gov/investor-protection/legal-referral-services-and-clinics and https://ag.ny.gov/investor-protection/faqs. Please note that the passage of time may bar any claims that you might have. It is therefore important for you to act promptly if you wish to pursue a private claim.

If your complaint involves misconduct by a registered broker or dealer, you may be able to file a claim with one or more self-regulatory organizations that govern the securities markets. The appropriate forum for your complaint will depend upon the account agreements you signed and the exchange on which the securities you invested in are traded. A review of your contract or account agreement should reveal which forum, if any, has been specified to resolve disputes pertaining to your account. You may wish to directly contact the forum that has been specified to request information about how to pursue a claim.

If your broker or dealer is a member of the Financial Industry Regulatory Authority ("FINRA"), your customer agreement will likely contain a mandatory arbitration clause. You also have the right to independently request arbitration with a FINRA member. You can find information about filing a claim with FINRA at: http://www.finra.org/ArbitrationAndMediation/. You may also reach FINRA by telephone at: (240) 386-4357.
If your complaint involves commodities, such disputes typically are arbitrated before the National Futures Association ("NFA"). You can find information about filing a claim with NFA at: http://www.nfa.futures.org/NFA-arbitration-mediation/index.HTML. You may also reach NFA by telephone at: (800) 621-3570.
Thank you again for reaching out to the New York State Office of the Attorney General Sincerely,

The Investor Protection Bureau

28 Liberty Street-15th Floor, New York, NY 10005 | Phone (212) 416-8222 | http://www.ag.ny.gov

APPENDIX F—Letter from New Jersey Office of the Attorney General to William J. Harrington Re: Moody's File Number: 10133000.OCP / November 9, 2020

New Jersey Office of the Attorney General

PHILIP D. MURPHY *Governor*
Division of Consumer Affairs
Consumer Service Center – Complaint Review Unit
GURBIR S. GREWAL *Attorney General*
124 Halsey Street, 3rd Floor, Newark, NJ 07102
SHEILA Y. OLIVER *Lt. Governor*
PAUL R. RODRIG *Acting Direct*
Mailing Addr
P.O. Box 4502
Newark, NJ 071
(973) 504-620

November 9, 2020

William Harrington
51 5th Avenue, Apartment 16A
New York NY 10003

Re: Moody's
File Number: 10133000.OCP

Dear William Harrington:

Thank you for writing to the New Jersey Division of Consumer Affairs - Office of Consumer Protection and bringing this matter to our attention. Hearing from the public helps the Division in its efforts to protect the health, safety and economic well-being of the public as consumers in the marketplace and to identify the best use of our investigative resources.

The Division has reviewed the materials you submitted to determine how we can best assist you with this matter. After a careful review of the matter, we have concluded that you may benefit from a referral to the following agency which may be better able to assist you:

Office of the Attorney General of New York
Dept. of Law - The Capitol 2nd Floor
Albany, NY 12224
800-771-7755

We have taken the liberty of forwarding your materials to that agency for action and future inquiries should be directed to that agency.

Once again thank you for contacting the New Jersey Division of Consumer Affairs. If you have any questions please contact our Consumer Service Center at (973) 504-6200.

Sincerely,

Gregory Turner

Assistant Deputy of Enforcement

Consumer Service Center

GT/td

Appendix G – CFTC Acknowledgement of 21-00039-FOIA (December 18, 2020) Filed by William J. Harrington (December 17, 2020)

Please provide all information pertaining to "swap transactions involving flip clauses" that the Commission either used or uses in establishing that it "believes" that the "standardized market risk capital charges" in Commodity Futures Trading Commission "Capital Requirements of Swap Dealers and Major Swap Participants" (September 15, 2020) 85 FR 57465 are "effective and appropriately calibrated". "The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments, which, in the Commission's long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including bespoke swap transactions involving flip clauses or other unique features."

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre

1155 21st Street, NW, Washington, DC 20581

www.cftc.gov

FOIA Office

December 18, 2020

William Harrington
51 5th Ave. Apt. 16A,
New York, NY 10003

RE: 21-00039-FOIA

Dear Mr. Harrington

This letter is to acknowledge receipt of your Freedom of Information Act ("FOIA") request dated December 17, 2020, and received by the FOIA Office in the Commodity Futures Trading Commission ("Commission") on December 17, 2020, seeking access to: [All information pertaining to "swap transactions involving flip clauses" that the Commission either used or uses in establishing that it "believes" that the "standardized market risk capital charges" in Commodity Futures Trading Commission "Capital Requirements of Swap Dealers and Major Swap Participants" (September 15, 2020) 85 FR 57465 are "effective and appropriately calibrated". "The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments, which, in the Commission's long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including bespoke swap transactions involving flip clauses or other unique features."

This letter is to inform you that we will be unable to respond to your request within the statutory 20-business day deadline as codified in 5 U.S.C. § 552(a)(6)(A)(i).

The FOIA, as amended in 2002, allows for an extension of the 20-day deadline if one of three types of "unusual circumstances" exist. *See* 5 U.S.C. § 552(a)(6)(B)(i)-(iii). Your request falls under one or more of these three circumstances:

(1) The need to search for and collect the requested records from field facilities or other establishments that are separate from the office processing the request;

(2) The need to search for, collect, and appropriately examine a voluminous amount of separate and distinct records which are demanded in a single request; and/or

(3) The need for consultation, which shall be conducted with all practicable speed, with another agency having a substantial interest in the determination of the request or among two or more components of the agency having substantial subject matter interest therein.

Because of these unusual circumstances, we need to extend the time limit to respond to your request by ten additional working days as provided by the statute, and may extend the time limit beyond the ten additional days in certain circumstances. For your information, we use multiple tracks to process requests, but within those tracks we work in an agile manner, and the time needed to complete our work on your request will necessarily depend on a variety of factors, including the complexity of our records search, the volume and complexity of any material located, and the order of receipt of your request. At this time we have assigned your request to the complex track. In an effort to speed up our process, you may wish to narrow the scope of your request to limit the number of potentially responsive records so that it can be placed in a different processing track. You can also agree to an alternative time frame for processing, should records be located; or you may wish to await the completion of our records search to discuss either of these options. You may also contact the Office of Government Information Services ("OGIS") at the National Archives and Records Administration to inquire about the FOIA mediation services they offer. The contact information for OGIS is as follows:

Office of Government Information Services,

National Archives and Records Administration, Room 2510

8601 Adelphi Road

College Park, Maryland 20740-6001

Telephone: 202-741-5770
Toll Free: 1-877-684-6448
Facsimile: 202-741-5769

Email: ogis@nara.gov

Please note that pursuant to the Commission regulations, processing fees may be charged even if no records are ultimately furnished to you, and the Commission will begin charging interest on unpaid bills starting on the 31st day following the day on which the bill was sent. If you have

requested a fee waiver and/or expedited processing of your request, we will provide a response once a determination has been made.

I regret the necessity of this delay, but I assure you that your request will be processed as soon as possible. If you have any questions or wish to discuss reformulation or an alternative time frame for the processing of your request, you may contact me at 202-418-6273 or Jonathan Van Doren, our FOIA Public Liaison, at 202-418-5505. Please refer to the control number (2100039-FOIA) that has been assigned when making your inquiry.

Sincerely,

Emily F. Blitzer

FOIA Paralegal Specialist

FOIA Request Form

UNITED STATES
COMMODITY FUTURES TRADING COMMISSION

This is an automatically generated response.
You will receive a separate acknowledgement letter from the CFTC FOIA Office when they receive and begin processing your request.

SUBMISSION INFORMATION		
Confirmation Number 2012-1709-1331-01		**Submission Received** 12/17/2020 9:13:31 AM ET
REQUESTOR CONTACT INFORMATION		
First Name William		**Last Name** Harrington
Firm Name		
Address 1 51 5th Avenue		
Address 2 Apartment 16A		
City New York		**State** New York
Province/Region/Territory	**Zip/Postal** 10003	**Country** United States
Email wjharrington@yahoo.com		
Daytime Phone Number +1 917-680-1465		**Fax Number**
DESCRIPTION OF REQUESTED FOIA INFORMATION		

CERTIFICATION

☑ **I agree to the collection, processing, use, and disclosure of my personal information as stated in the Privacy Policy for www.cftc.gov.**

Please specify the information you are requesting. Be specific and include the time period covered by your request if possible.

Please provide all information pertaining to “swap transactions involving flip clauses" that the Commission either used or uses in establishing that it “believes” that the “standardized market risk capital charges” in Commodity Futures Trading Commission “Capital Requirements of Swap Dealers and Major Swap Participants” (September 15, 2020) 85 FR 57465 are “effective and appropriately calibrated”. “The standardized market risk capital charges being adopted are generally based on existing Commission and SEC standardized market risk charges for positions in foreign currencies, commodities, U.S. treasuries, equities and other instruments, which, in the Commission’s long experience, have generally proven to be effective and appropriately calibrated to address potential market risk in the positions. The Commission believes at this time that this approach, in conjunction with other charges discussed herein, appropriately accounts for the wide variety of possible uncleared swap transactions that FCMs, FCM-SDs, and covered SDs may engage in, including bespoke swap transactions involving flip clauses or other unique features."

PROCESSING FEES

Please specify the maximum fee you are willing to pay.

$1,000.00

Confirmation Number 2012-1709-1331-01 Submitted 12/17/2020 9:13:31 AM