RIN 3038-AD54 // RIN 3038–AE84 // § 13.1 Petition for a Rule that Bars a Regulated Entity from Agreeing to a Flip Clause or Walk-Away // GMAC Subcommittee on Margin Requirements for Non-Cleared Swaps

ERADICATE THE CRISIS-CAUSING FLIP CLAUSE

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March 3, 2020

VIA ELECTRONIC MAIL

Mr. Christopher Kirkpatrick
Secretary of the Commission
and
Secretariat of the Commission
and
Chair Wendy Yu
Global Markets Advisory Committee
Subcommittee on Margin Requirements for Non-Cleared Swaps

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN 3038-AD54
Commodity Futures Trading Commission "Capital Requirements of Swap Dealers and Major Swap Participants" (A Proposed Rule by the CFTC on 12/19/2019)

RIN 3038-AE84
Commodity Futures Trading Commission "Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants" (A Proposed Rule by the CTFC on January 8, 2020)

§ 13.1 Petition to the Secretariat for the Commission 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

"Comment to Global Markets Advisory Committee Subcommittee on Margin Requirements for Non-Cleared Swaps"

RIN 3038-AD54 // RIN 3038–AE84 // § 13.1 Petition for a Rule that Bars a Regulated Entity from Agreeing to a Flip Clause or Walk-Away // GMAC Subcommittee on Margin Requirements for Non-Cleared Swaps
ERADICATE THE CRISIS-CAUSING FLIP CLAUSE

Dear All:

The CFTC Must Eradicate the Flip Clause.

My name is William J. Harrington. I am a private US citizen who assesses the capitalization, regulation, and credit ratings of complex finance, publicly reports findings, and disseminates them widely.

Your colleagues and you are all well informed on my conclusion that the flip clause swap contract was an integral cause of the financial crisis, harms both a regulated swap contract provider and the associated end-user, cannot be fixed, and must be banished from the US financial system.[1]

As an entirely self-funded, human being person who engages in full-time advocacy against deep-pocketed corporate persons that want to re-inflict the flip clause on the US financial system, I leverage output to the maximum extent.

Today's letter, with the clear, simple, and irrefutable message above, and equally clear, simple and irrefutable rationales further below, is a complete submission for the first of the four heading items and a potentially partial submission for the remaining three heading items:

1. Rulemaking RIN 3038-AD54;
2. Rulemaking RIN 3038-AE84;
3. A § 13.1 petition per the CFTC Rule on Public Rulemaking Procedures;[2] and
4. Deliberations of the Global Markets Advisory Committee (GMAC) Subcommittee on Margin Requirements for Uncleared Swaps.

With respect to the last three heading items, I intend to submit an update letter on March 9, 2020, which is the deadline to submit a comment re Rulemaking RIN 3038-AE84, **"Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants"** (A Proposed Rule by the CTFC on January 8, 2020**).**

Accordingly, the CFTC must post the entirety of this letter, including Appendices I and II, on all respective webpages for each of the four items. At a minimum, the CFTC must post the entirety of today's letter on the respective comment sites for RIN 3038-AD54 Proposed Rule 84 FR 69446

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[1] For example, see the CFTC posting of "External Meetings: Conference Call with Mr. William Harrington and Mr. Rick Michalek," May 12, 2015. "Commenters argue against an exemption from margin requirements for issuers of asset-backed securities. Commenters believe ABS issuers' current practice for dealing with counterparty credit risk is inadequate by construction and presents a systemic risk. See attached presentation. Conference call was joint with staff of Prudential Regulators."

[2] "Commission Rulemaking Explained." "The Commission may promulgate, amend, or repeal rules based on statutory directives, discretionary objectives, ***or petitions for rulemaking submitted by the public*** [Emphasis added]."

and for RIN 3038-AE84 Proposed Rule 85 FR 952 and on the site for public petitions for rulemaking.[3]

A. Letter Organization

Today's letter provides a rationale with respect to each of the four heading items further below.

Appendix I ("*William J. Harrington Analyses of the Capitalization, Regulation, and NRSRO Credit Ratings of Complex Finance, Including Securitizations, Derivative Contracts, and Combinations of Both*"), pages i-xxxi, contains 39 of my analyses, many of which I have already shared with CFTC staff and commissioners. Each of the 39 entries quotes representative passages that support this letter's clear, simple, and irrefutable message. The analyses are in reverse chronological order starting with the most recent of January 28, 2020 and concluding with the earliest of August 8, 2011.

The CFTC Must Eradicate the Flip Clause.

Appendix II (*"31 Misrepresentations in CFTC Letter No. 17-52, William J Harrington Electronic Letter to the CFTC, February 2, 2018"*), pages "–1–" to "–123–", is self-explanatory.[4] The letter identifies and corrects 31 instances in which the CFTC lies to all American persons, both human being and corporate, by perpetuating CFTC Letter No. 17-52.[5]

CFTC Letter No 17-52 props up the inflated credit ratings of a small number of legacy asset-backed securities (ABS) with flip clauses for the benefit of a handful of corporate persons,

[3] "Public Rulemaking Procedures: A Rule by the Commodity Futures Trading Commission on 12/17/2019." "[I]t will be the Commission's policy to post the petitions for rulemaking on the Commission's website. The electronic submissions of petitions will facilitate the submission of petitions for rulemaking and thereby the public's engagement in the Commission's rulemaking process."

[4] Wikirating.org posts the letter with original pagination, i.e. different pagination than Appendix II. See, "*31 Misrepresentations in CFTC Letter No. 17-52*, William J Harrington Electronic Letter to the CFTC, February 2, 2018*.*"

[5] For a summary, see my Croatan View "US Financial Regulators Balk at Examining Complex Finance," February 8, 2018. "The main US regulator for complex finance — the CFTC — intentionally got many basic features of a complex type of derivative contract exceptionally wrong in its recent No-Action Letter from late October of last year on margin requirements for swaps used by 'special purpose vehicles.' II The numerous misrepresentations that underlie the CFTC's decision not to take action on these complex, undercapitalized swaps raise serious concerns regarding the CFTC's mission, competency, and trustworthiness. The same goes for other US financial regulators such as the US Department of the Treasury, the US Securities and Exchange Commission (SEC), and the National Futures Association. II The type of complicated derivative product that the CFTC intentionally got all wrong — an 'ABS flip clause swap' — started and fueled the financial crisis."

principally the student loan company Navient and the NRSRO credit rating agencies DBRS Morningstar, Fitch Ratings, Moody's Investors Service, and S&P Global Ratings.[6]

Furthermore, CFTC Letter No. 17-52 not only lies repeatedly to all US persons, both human being and corporate, but also violates an overarching provision of the Dodd-Frank Act by increasing CFTC and systemic reliance on NRSRO credit ratings. The Dodd-Frank Act explicitly directs government agencies and regulators to lessen both their own reliance and that of the entire financial system on NRSRO credit ratings.[7] The SEC itself is admitting the complete failure of its NRSRO regulation in light of the pervasive NRSRO rating inflation in all sectors.[8]

As an aside, my analysis of Navient student loan ABS (SLABS) with flip clauses, and also of SLABS with maturity extensions to 2060, 2070, 2080, and beyond, provided WSJ reporter Cezary Podkul with the theme and underlying data for "A Borrower Will Be 114 When Bonds Backed by Her Student Loans Mature" (January 7, 2020). I also fine-tuned the story with Cezary and his editor in a 90-minute, in-person meeting last fall.

B. Tell 'em what you're going to tell 'em; then tell 'em; then tell 'em what you told 'em

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[6] For a summary, see my Croatan View "A Welcome if Belated Victory for Financial Stability," January 16, 2018.

[7] Concerningly, the Republican-dominated Commission has doubled-down on increasing its reliance, and that of the US financial system, on NRSRO credit ratings. As example, the Commission cited NRSRO credit ratings for corporate bonds and for structured finance debt as rationale for issuing favorable comparability determinations viz-a-viz the swap margin rules of certain non-US jurisdictions. See CFTC, 17 CFR Chapter I, "Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," *Federal Register*, Vol. 82, No. 200, October 18, 2017, Rules and Regulations, "3. Commission Determination," page 48409. "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")*** [Emphasis added]. 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]." **Please note:** The NRSRO oligopoly of Fitch Ratings, S&P Global Ratings, and Moody's Investors Service also constitute the EU ECAI oligopoly.

[8] Podkul Cezary, "SEC Rethinks Approach to Conflicts Among Bond-Rating Firms (Agency is seeking industry input on how to combat rating inflation as 2010 fix falters)," *Wall Street Journal*, February 24, 2020. "The Securities and Exchange Commission's top official overseeing credit-rating firms said Monday the agency is rethinking its post-crisis effort to improve the quality of bond ratings, ***a tacit acknowledgment that the decade-old program has been a failure*** [emphasis added]."

The CFTC Must Eradicate the Flip Clause.

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The CFTC must blame itself for the labyrinth of evidence herein that supports the clear, simple, and irrefutable message above.

Since 2015, I have repeatedly contacted the CFTC to discuss the flip clause, to little avail.

In contrast, the CFTC maintains an open-door policy for corporate persons who shill for the flip clause, most notably the Structured Finance Association. The deep-pocketed entity, which is the main "public advocate" for the flip clause, repeatedly lies about the flip clause to the CFTC and, for that matter, to all US persons, both human being and corporate.[9] Others who repeatedly lie about the flip clause include the corporate persons and financial regulators whom I have contended with since 2011. The corporate person liars include DBRS Morningstar, Fitch Ratings, Moody's Investors Service, and S&P Global Ratings. Chief among the regulatory liars is the US Securities and Exchange Commission.

The CFTC must also blame both academia and the legal industry for the labyrinth of evidence herein. I have repeatedly contacted both academicians and practicing attorneys who evaluate derivative contracts, securitizations, NRSRO credit rating agencies, and the financial crisis, also to little avail. Few academics even know about the flip clause. Many practicing attorneys know of the flip clause, but none publicly speak or write about its deficiencies.

Finally, the CFTC must blame the flip clause itself for the labyrinth of evidence herein. The flip clause confounds even diligent researchers such as Cezary Podkul. While at Propublica, Cezary organized a January 30, 2015 meeting in which a former Moody's legal colleague and I mapped the flip clause for Cezary, his editor, and other Propublica colleagues. Cezary subsequently related, and very recently reiterated, that the flip clause is too convoluted for him to grasp, let alone convey clearly to readers of either Propublica or the Wall Street Journal.

The complete absence of common-sense analysis of the flip clause prompted me, a non-attorney, to spend eight, full-time months researching, writing, formatting, serving, and submitting a Motion to File a Proposed Amicus Curiae Brief to the United States Court of Appeals for the Second Circuit regarding a 10-year-and-counting flip-clause case. The case is not only old but also huge. pitting Lehman Brothers against 250-odd financial entities including 50 failed CDOs of ABS. A

[9] See Appendix II, especially pages "–117–" to "–123–" and pages "–82–" and "–83–". See also pages "–5–", "–9–","–13–", "–17–","–18–", "–25–", and "–65–". **Please Note:** References are to the Structured Finance Industry Group ("SFIG"), which subsequently became the Structured Finance Association.

total of 50 attorneys represent one or more of the various parties.[10] Simply fitting all entities in the title requires 6 full pages.

Croatan Institute, where I am a senior fellow, posts both the Motion to File and the Proposed Amicus Curiae Brief.[11]

"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" (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* on June 25, 2019. See pages 1-55, which is a clean-up revision dated July 30, 2019. In turn, the revision was included in an update letter to the Court of August 8, 2019 (first three pages A-C.) The update letter and the proposed amicus curiae brief were also delivered to the CFTC, the SEC, the US Department of Justice, US Senator Josh Hawley (R-MO), the global financial company Natixis, the largest US student loan company Navient, and the NRSRO credit rating agencies DBRS, Fitch Ratings, Moody's Investors Service, and SP Global.)

"Motion to File Proposed Amicus Curiae Brief with the US 2nd Circuit Re: Case No. 18-1079 - WJH - 06-25-19" (Submitted to the US Court of Appeals for the Second Circuit Re: *Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al* on June 25, 2019.)

This letter cites both the Proposed Amicus Curiae Brief (WJH Proposed Amicus Curiae Brief) and the accompanying Motion to File (WJH Motion to File.)

For a start, WJH Motion to File presents my bona fides regarding the flip clause.

"I have scrutinized the flip clause from the following **18** vantages: **1)** academic literature of the financial crisis; **2)** bankruptcy law of the US and other jurisdictions; **3)** byline journalism; **4)** competing exposures of the two parties to a swap contract, including the zero-sum exposure that a flip clause creates; **5)** global market practice since 1999; **6)** investigation by the US Department of Justice and attorneys general of 21 states and District of Columbia that resulted in them obtaining an $864 million settlement, including a Statement of Facts, from Moody's Corporation, Moody's Analytics, and Moody's in 2017;[12] **7)** lead NRSRO credit analyst and team leader who proposed

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[10] *Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al* (US Court of Appeals for the Second Circuit, Case No. 18-1079-bk).

[11] Croatan Institute is an independent, nonprofit research institute whose mission is to harness the power of investment for social good and ecological resilience. My Croatan Institute biography lists other of my work on the flip clause and links to much of it. I am also a Key Expert on Structured Finance Topics for the Experts Board of Wikirating.org. The platform posts my work on credit ratings, derivative contracts, and structured finance. See both the main page and https://wikirating.org/wiki/UserWiki:WilliamHarrington.

[12] 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," Announcement, January 13, 2017.

credit ratings, voted in 1500 ABS, banking, derivative, insurance, municipal, and sovereign committees, and co-developed global methodologies for derivative contracts, including both standard swap contracts and ones in which an ABS issuer referred to a flip clause in paying a swap dealer (**flip-clause-swap-contract**); **8)** lead NRSRO analyst for 50 ABS, collateralized loan obligations (**CLOs**), and collateralized debt obligations (**CDOs**), including three that defendants appellees issued or insured; **9)** lead NRSRO analyst for ten derivative dealers, including two Lehman Brothers affiliates, that provided swap contracts both with and without a flip clause; **10)** lead NRSRO liaison with the swap trading desks at 15 financial institutions, including both the plaintiff-appellant and five defendants-appellees, regarding development and implementation of a global NRSRO methodology for flip-clause-swap-contracts; **11)** legal enforceability opinions with carve-outs; **12)** longitudinal tracking of core components of the flip-clause-swap-contract, including but not limited to the flip clause; **13)** review of NRSRO methodologies for the flip clause-swap-contract; **14)** self-financed, public citizen advocate for responsible US finance whose advocacy against the flip-clause-swap-contract US financial regulators both cited and adopted in Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank Act**) rulemaking; 6 **15)** Structured Finance Industry Group (**SFIG**) member from May 13, 2013 to December 31, 2013 and participant on the "Derivatives in Securitization Committee," which champions the flip clause swap-contract, from May 15, 2013 to December 31, 2013;7 **16)** the student loan crisis; **17)** pro bono "whistleblower" who regularly provides analysis to the SEC and the US Commodity Futures Trading Commission (**CFTC**) while explicitly opting **not** to be considered for a financial award; and **18)** the respective regulations and proposals of 14 financial regulators — Australian Prudential Regulation Authority, Bank of England, European Banking Authority, European Central Bank, European Commission, European Securities and Markets Authority, Japanese Financial Services Agency, Board of Governors of the US Federal Reserve Board System (**Federal Reserve**), US Farm Credit Administration, US Federal Deposit Insurance Corporation (**FDIC**), US Federal Housing Finance Agency, Office of the Comptroller of the Currency (collectively, the preceding five US regulators, **the prudential regulators**), the CFTC, and the SEC."[13]

Equally importantly, WJH Proposed Amicus Curiae Brief rebuts the misrepresentations regarding the flip clause that the Structured Finance Association (formerly SFIG) made in its own amicus curiae brief. In plain language, the Structured Finance Association repeatedly misled, misinformed, deceived, and duped the Court about the flip clause, just as the entity has repeatedly misled, misinformed, deceived, duped and outright lied to the CFTC.[14]

In equally plain language, WJH Proposed Amicus Curiae Brief describes the flip clause and explains why it must be eradicated.

"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."

II

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[13] "WJH Motion to File" to File, pages 13-15.

[14] "WJH Proposed Amicus Curiae Brief," pages 22-23, especially footnote 4.

"Parties that refer to a flip clause in making payments under a swap contract (flip-clause-swap-contract) knowingly drafted it to fail. The plaintiff appellant, defendants-appellees, and other crisis-causing entities routinely embedded ABS deals with flip-clause-swap-contracts, thereby wrecking our economy and undermining our Country."[15]

C. INTENTIONALLY BLANK

D. RIN 3038-AD54, CFTC "Capital Requirements of Swap Dealers and Major Swap Participants"

The Commission re-opened the comment request "Capital Requirements of Swap Dealers and Major Swap Participants" on December 19, 2019.[16]

The Commission first requested comments on "Capital Requirements of Swap Dealers and Major Swap Participants" on December 16, 2016. Subsequently on March 17, 2017, the Commission extended the comment period to May 15, 2017.[17] I submitted a comment on May 4, 2017.[18]

My 172-page comment of May 4, 2017 is intentionally comprehensive. Most importantly, I proposed the following in each applicable section of the comment request.

> "*'To ensure the safety and soundness' of a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap, the CFTC must adjust each aspect of the proposed bank-based capital approach to reflect the 100% exposure to itself that a Swap Dealer, Major Swap Participant, or Other Regulated Entity bears.*
>
> "*The adjustments must require a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap to hold capital equal to the following for each such swap and security-based swap.*

[15] Ibid., page 20.

[16] CFTC Announcement, "CFTC Approves One Final, Two Proposed Rules at December 10 Open Meeting," December 10, 2019. "On a 3-2 vote, the Commission reopened the comment period for the proposed capital and financial reporting rules for swap dealers and major swap participants."

[17] "Capital Requirements of Swap Dealers and Major Swap Participants," 82 *Federal Register* 13971. "The comment period for the Proposal published on December 16, 2016, at 81 FR 91252, is extended until May 15, 2017."

[18] Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017. See entirety of comment.

> "*The maximum of: [0, 100% of the 'uncleared swap margin' as defined in footnote 25 of the CFTC proposal + 100% of the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity].*

"***N.B.** Using the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity will ensure its 'safety and soundness.' Otherwise, the last term may converge to USD 0.00 for 24 even a deeply in-the-money swap as a Swap Dealer, Major Swap Participant, or Regulated Entity approaches bankruptcy, insolvency, nonperforming status or similar credit-impairment.*"

My comment of May 4, 2017 also provided the following, irrefutable empirical evidence in support of the proposal, as well as question-specific rationales.

"*The bankruptcy of Lehman Brothers provided a real-world example of a bankrupt swap provider that received USD 0.00 per USD 1.00 owed under 100% of in-the-money, uncleared swaps that contained flip clauses with 44 securitization issuers. United States Bankruptcy Judge Shelley C. Chapman detailed these "payments" of USD 0.00 in a ruling on Lehman Brothers Special Financing Inc. vs. Bank of America National Association et al of 28 June 2016.*

"*'Upon providing notice of an Event of Default under the Swaps and the Indentures, the Trustees liquidated the assets, including the Collateral securing the Issuers' obligations under the Swaps and Indentures, and deposited the proceeds into accounts held by each Trustee for that purpose. The Trustees subsequently distributed the proceeds pursuant to the applicable Waterfall (the "Distributions"). In each instance, the Trustees applied Noteholder Priority because the Early Terminations were the result of an Event of Default and LBSF was the Defaulting Party. The amount of **the proceeds of the liquidation of the Collateral was insufficient to make any payment to LBSF** [emphasis added] under the Waterfall after proceeds were paid pursuant to Noteholder Priority.*'

"*Unfortunately, Judge Chapman went on to confuse cause and effect by characterizing the broader financial crisis as 'a time we truly hope was a 'singular' event.*

"*In fact, Lehman Brothers was not an unlucky bystander to the crisis nor was the company blindsided by the 100% losses that it incurred under 100% of uncleared swaps with flip clauses that were in-the-money assets. These swaps performed exactly as Lehman Brothers itself and other global counterparties had both structured and advertised.*

"The shoddy practices of the financial sector writ large — accountants, counsel, investors, issuers, investors, Lehman Brothers, Lehman Brothers trading partners, other swap providers, rating agencies, regulators and underwriters — made the financial crisis inevitable.

> *"In other words, there was nothing 'singular' about the financial crisis. Nor can 'hope' alone prevent a recurrence. Robust capital, liquidity and financial reporting requirements are needed."*[19]

My comment of May 4, 2017 also responds to other questions in the initial comment request, including ones that the new comment request re-asks. As such, the Commission must evaluate my comment of May 4, 2017 as explicitly addressing the respective questions in the initial comment request as well as the following questions from the new comment request.

For the avoidance of doubt, following is my response to questions that the new comment request poses in "A. Capital, 1. Swap Dealer Capital Amount—8% Risk Margin Amount 2. FCM Minimum Capital Requirement 3. Composition of common Equity Tier 1 Capital 4. Standardized Market Risk Charges—Netting of Uncleared Currency and Commodity Swaps 5. Revision of Minimum Market Risk Capital Charge for Uncleared Interest Rate Swaps 6. Revision of the Length of Time to Maturity Categories for Credit Default Swaps and 7. Tangible Net Worth Capital Approach " beginning on page 69666 (89 *Federal Register* 69664).

> *To ensure the safety and soundness' of a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap, the CFTC must adjust each aspect of the proposed bank-based capital approach to reflect the 100% exposure to itself that a Swap Dealer, Major Swap Participant, or Other Regulated Entity bears.*
>
> *The adjustments must require a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap to hold capital equal to the following for each such swap and security-based swap.*
>
>> *The maximum of: [0, 100% of the 'uncleared swap margin' as defined in footnote 25 of the CFTC proposal + 100% of the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity].*
>
> ***N.B.*** *Using the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity will ensure its 'safety and soundness.' Otherwise, the last term may converge to USD 0.00 for 24 even a deeply in-the-money swap as a Swap Dealer, Major Swap Participant, or Regulated Entity approaches bankruptcy, insolvency, nonperforming status or similar credit-impairment.*

For the avoidance of doubt, following is my response to questions that the new comment request poses in "A. Capital, 8. Quantitative and Qualitative Requirements for Internal Models" beginning on page 69666 (89 *Federal Register* 69675).

[19] Ibid., throughout, e.g., page 10.

The Federal Reserve, the FDIC, and the other prudential regulators prohibit walk-aways owing in large part to the Lehman Brothers losses from flip clauses. Accordingly, to the extent that the Commission wishes to conform with the Federal Reserve and other prudential regulators the Commission must do so in all respects, most particularly by adopting the prudential regulator prohibition against walk-aways.

"'[N]o walkway clause shall be enforceable in a qualified financial contract of a covered financial company in default.' (Dodd-Frank Act, § 210, 124 Stat. 1488.) ***The flip clause is a type of walkaway clause.***

"'WALKAWAY CLAUSE DEFINED . . . any provision in a qualified financial contract that suspends, conditions, or extinguishes a payment obligation of a party, in whole or in part, or does not create a payment obligation of a party that would otherwise exist, solely because of the status of such party as a nondefaulting party in connection with the insolvency of a covered financial company that is a party to the contract or the appointment of or the exercise of rights or powers by the Corporation as receiver for such covered financial company.'

"(Dodd-Frank Act, § 210, 124 Stat. 1488.)

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"If walkaway clauses were enforceable, counterparties would immediately and simultaneously activate them and strip an already defaulted company of still more assets*[emphasis added]."*[20]

Indeed, Lehman counterparties did exactly that, i.e., simultaneously activated all flip clause and stripped the already defaulted Lehman Brothers of at USD 3-6 billion of swap assets.

***For the avoidance of doubt, following is my response to questions that the new comment* request poses in "A. Capital 8. Quantitative and Qualitative Requirements for Internal Models and 9. Model Approval Process"** beginning on page 69677 (89 *Federal Register* 69675).

All models must demonstrate the following property. ***Output is defensible without reliance on a bail-out assumption!***

"For example, the only defensible finding with respect to uncleared swaps with flip clauses and uncleared security-based swaps with flip clauses is that none of these swaps are needed because the costs to the US financial system and economy outweigh the benefits. As an analogy, the only sensible finding with respect to construction in earthquake zones using specifications for non-earthquake zones and materials that fail basic quality controls is that 'all of this deficient construction is risky and outright criminal when knowingly designed or

[20] "WJH Proposed Amicus Curiae Brief," Section entitled "Walkaway Clauses Are NOT Enforceable Against FDIC or FHFA (Section 210)," pages 28-29.

> *built 6below standard. Architects, engineers and builders are responsible for loss of life and property in such an instance.'[Footnote]7*
>
> *"[Footnote] 7. Per an architect friend who added: "I do like the building analogy because it demonstrates that only those who are involved in setting up these [complicated finance] constructs really understand the danger to the unsuspecting public."*[21]
>
> *The caveat —* ***without reliance on a bail-out assumption —*** *eliminates all models approved by foreign regulators. Many foreign jurisdictions such as the EU and the UK condone bail-outs and, as a result, promote the use of flip clauses.*[22]
>
> *The US has decided against future bail-outs and barely uses the flip clause.*[23] *As a result, the US economy has performed much better viz-a-viz the flip-clause-dependent-domiciles such as the EU and the UK.*[24]

For the avoidance of doubt, following is my response to <u>additional</u> questions that the new comment **request poses in "B. Capital 8. Quantitative and Qualitative Requirements for Internal Models and 9. Model Approval Process"** beginning on page 69677 (89 *Federal Register* 69675).

> *"****Each aspect of <u>the proposed net liquid assets capital approach ignores the 100% exposure to itself that an SD bears under a flip clause</u>, walkaway or similar provision in***

[21] Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017, pages 6-7.

[22] "Harrington, Bill, "Moody's bets Germany will support Deutsche Bank derivatives above all else," *Debtwire ABS*, 12 October 2016. "Moody's has been upping the ante for a full bailout of at least the bank's counterparty obligations since March 2015. . . II The rationale? Moody's credits German regulators with a singular willingness and ability to prop up the counterparty obligations of Deutsche Bank AG, including the London, New York, Paris, Singapore and Sydney branches."

[23] For Commission corroboration see Coughlan, John and Richard Haynes, Madison Lau, and Bruce Tuckman "Legacy Swaps under the CFTC's Uncleared Margin," *Office of the Chief Economist Commodity Futures Trading Commission*, May, 2019 (Updated September and November 2019). The report omits all mention of "flip clause," "securitization," "asset-backed security," and "special-purpose vehicle."

[24] "WJH Motion to File," section entitled "US Issuers Shunned the Flip-Clause-Swap-Contract After 2008; Quit Cold Turkey in 2016; Issued Record Amounts in 2018!" pages 35-38. Following is from page 35. "'The good news is that embedded swaps are less prevalent in U.S. deals than . . . in European deals.'" Following is from page 38. "The flip-clause-swap-contract was central to the EU financial crisis. Even so, EU issuers of RMBS and other ABS use the flip-clause-swap-contact under policy that the US has prudently rejected. As evidence, the US economy habitually outperforms the EU. Also, our social compact rejects bailing out financial companies again, whereas the EU tolerates public support for private entities."

an uncleared swap or an uncleared security-based swap *[emphasis added]. These provisions enable a counterparty to an uncleared swap that is in-the-money to an SD or an uncleared security-based swap that is in-the-money to an SD to write off all payments that would otherwise be due the SD simply because it is bankrupt, insolvent, non-performing or similarly impaired.*

"As ***example, a ubiquitous aspect of the net liquid assets capital approach — the use of credit risk models in the computation of the minimum capital requirement — typically evaluates only the swap receivables that might not be paid to an SD because a counterparty rather than the SD itself is bankrupt, insolvent, non-performing or similarly impaired. These credit risk models entirely neglect the 100% loss that a credit-impaired SD will incur under an uncleared swap that is in-the-money or an uncleared security-based swap that is in-the-money if the counterparty activates a flip clause, walkaway or similar provision*** *[emphasis added]***.***

"For the same reason, core calculations in the net liquid assets capital approach — the calculations of tentative net capital and net capital — overstates both amounts.

"These overstatements invalidate the remaining steps in the net liquid assets capital approach – the 'Computation of Minimum Capital Requirement,' and 'Swap Dealers Computation of Tentative Net Capital and Net Capital Without Approval to Use Internal Capital Models.'

"Footnote 50 of the CFTC proposal [of December 16, 2016] provides a definition of tentative net capital and net capital. 'SEC rules generally define 'tentative net capital' as the registrant's assets less liabilities (excluding certain qualifying subordinated debt), and 'net capital' as tentative net capital less certain capital deductions such as market risk and credit risk deductions.'

"The CFTC proposal reveals a deficiency in how tentative net capital — and thus also net capital — is overstated when an SD is exposed to a flip clause, walkaway or similar provision in an uncleared swap or uncleared security-based swap.

"'SDs would also be required to compute standardized credit risk charges pursuant to proposed Rule 18a-1. Rule 18a-1 generally provides that a SBSD's unsecured receivables are subject to a 100 percent credit risk charge (i.e., the SBSD would have to deduct 100 percent of any unsecured receivable balance from tentative net capital in computing its net capital).'

"Technically, the 'receivable balance' that a SBSD is owed under an uncleared security-based swap with a flip clause, walkaway or similar provision is secured and hence would not be deducted 'from tentative net capital in computing net capital.'

*"****SFIG [now Structured Finance Association] has made this same, very disingenuous point in its so far unsuccessful lobbying for the CFTC and the prudential regulators to exempt securitization and structured finance issuers — 100% of whom place flip clauses, walkaways and similar provisions in uncleared swaps and uncleared security-based swap***

> ***— from the daily exchange of variation margin with SDs, MSPs and covered swap entities*** *[emphasis added].*
>
> *"**However, the security that an SD enjoys in an in-the-money uncleared swap or in-the-money uncleared security-based swap is illusory when a counterparty activates a flip clause, walkaway or similar provision.** [emphasis added] In these cases, the security does not apply to the full in-the-money amount but only to the newly-reduced receivable which can be as little as USD 0.00.*
>
> *"In other words, the activation of a flip clause, walkaway or similar provision reduces an uncleared swap or uncleared security-based swap that is in-the-money to an SD to a subordinated asset. Furthermore, the degree of subordination is so pronounced that the newly-subordinated asset is effectively worth USD 0.00, notwithstanding the extent to which the asset was previously in-the-money."* [25]

For the avoidance of doubt, following is my response to questions that the new comment request poses in "C. Financial Reporting," beginning on page 69678 (89 *Federal Register* 69664).

> *"Unfortunately, the 'proposed financial reporting, recordkeeping and notification requirements' don't adequately address the 100% exposure to itself that an SD or MSP bears under a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap. These provisions enable the counterparty to an uncleared swap or an uncleared security-based swap to write off all payments that would otherwise be due an SD simply because it is bankrupt, insolvent, non-performing or similarly impaired.*
>
> *"Redressing this omission with respect to all SDs and MSPs — i.e., those that are 'subject to the capital rules of a prudential regulator' and those that are not — will help 'ensure the safety and soundness of each SD and MSP' by allowing market participants to independently evaluate its financial condition.*
>
> *"Redressing this omission will also promote efficient and self-sustaining derivative markets by increasing transparency and also by augmenting the incomplete assessment, oversight and investigations by the CFTC when it is limited by budget constraints.*
>
> "*'Proposed Regulation 23.105(d)(1) would require and SD or MSP to file a monthly unaudited financial report within 17 business days of the close of business every month, and Proposed Regulation 23.105(e)(1) would require and SD or MSP to file an annual audited financial report within 60 days of the close of the SD's or MSP's fiscal year-end date.*'
>
> "*The unaudited and audited reports must include, among other information: '(6) any further materials that are necessary to make the required statements not misleading.' Non-*

[25] Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017, page 26. See also pages 27-30, 40-57, 58-61, 111-122.

disclosure of the presence of a flip clause, walkaway or similar provision in an uncleared swap or uncleared security-based swap makes the required statements of an SD or MSP very misleading. Accordingly, an SD or MSP must require such a disclosure with respect to both Proposed Regulation 23.105(d)(1) and Proposed Regulation 23.105(e)(1).

"The Commission may also require that an SD or MSP disclose each uncleared swap and uncleared security-based swap with a flip clause, walkaway or other provision in Proposed Regulation 23.105(h).

"This 'additional financial and operational information' will certainly be 'necessary at times when an SD or MSP is experiencing a financial or operational crisis' and will be critically 'necessary for the Commission to assess whether the SD or MSP will be able to meet its obligations to counterparties and other creditors.' The correlation of activation of all flip clauses, walkaways or similar provisions will be 100%, i.e. 100% of counterparties to uncleared swaps and uncleared security-based swaps with these clauses and provisions that are in-the-money to an SD will simultaneously activate them against the SD when it is bankrupt, insolvent, non-performing or similarly impaired.

"*The Commission must amend Proposed Regulation 23.105(c). The bolded words in the amended section of the summary of Proposed Regulation 23.105(c) in the CFTC proposal below provide a template.*

"'..., if any such withdrawal or payment, and any other similar transactions that are scheduled to occur within the succeeding six months, result in the SD holding less than 120 percent of the minimum regulatory capital that the SD is required to hold, ***such calculation of minimum regulatory capital to exclude all future receipts under an uncleared swap or uncleared security-based swap that contains a flip clause, walkaway or similar provision****...'"*[26]

For the avoidance of doubt, following is my response to questions that the new comment request poses in "11. Use of International Financial Reporting Standards," beginning on page 69678 (89 *Federal Register* 69679).

The Commission must not rely on the use of international financial reporting standards.

For a start, the Commission regulates what is now far and away the world's largest derivatives markets. The Commission responsibility in doing so is orders of magnitude greater than other financial regulators, such as those of the now diminished EU and much more diminished UK.

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[26] Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017, pages 61-63. See also pages 63-68.

Additionally, international financial reporting standards are also insufficient because foreign jurisdictions such as the EU and the UK condone bail-outs and, as a result, promote the use of flip clauses.[27]

The US has decided against future bail-outs and barely uses the flip clause.[28] *As a result, the US economy has performed much better viz-a-viz the flip-clause-dependent-domiciles such as the EU and the UK.*[29]

For the avoidance of doubt, following is my response to questions that the new comment request poses in "D. Additional Requests for Comment, 15. SEC's Alternative Compliance Mechanism," beginning on page 69680 (89 *Federal Register* 69664).

No alternative compliance of any kind is permitted for a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap.

To ensure the safety and soundness' of a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap, the CFTC must adjust each aspect of the proposed bank-based capital approach to reflect the 100% exposure to itself that a Swap Dealer, Major Swap Participant, or Other Regulated Entity bears.

The adjustments must require a Swap Dealer, Major Swap Participant, or Other Regulated Entity that is exposed to a flip clause, walkaway or similar provision in an uncleared swap

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[27] "Harrington, Bill, "Moody's bets Germany will support Deutsche Bank derivatives above all else," *Debtwire ABS*, 12 October 2016. "Moody's has been upping the ante for a full bailout of at least the bank's counterparty obligations since March 2015. . . II The rationale? Moody's credits German regulators with a singular willingness and ability to prop up the counterparty obligations of Deutsche Bank AG, including the London, New York, Paris, Singapore and Sydney branches."

[28] For Commission corroboration see Coughlan, John and Richard Haynes, Madison Lau, and Bruce Tuckman "Legacy Swaps under the CFTC's Uncleared Margin," *Office of the Chief Economist Commodity Futures Trading Commission*, May, 2019 (Updated September and November 2019). The report omits all mention of "flip clause," "securitization," "asset-backed security," and "special-purpose vehicle."

[29] "WJH Motion to File," section entitled "US Issuers Shunned the Flip-Clause-Swap-Contract After 2008; Quit Cold Turkey in 2016; Issued Record Amounts in 2018!" pages 35-38. Following is from page 35. "'The good news is that embedded swaps are less prevalent in U.S. deals than . . . in European deals.'" Following is from page 38. "The flip-clause-swap-contract was central to the EU financial crisis. Even so, EU issuers of RMBS and other ABS use the flip-clause-swap-contact under policy that the US has prudently rejected. As evidence, the US economy habitually outperforms the EU. Also, our social compact rejects bailing out financial companies again, whereas the EU tolerates public support for private entities."

or an uncleared security-based swap to hold capital equal to the following for each such swap and security-based swap.

> *The maximum of: [0, 100% of the 'uncleared swap margin' as defined in footnote 25 of the CFTC proposal + 100% of the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity].*

N.B. *Using the market value of the swap or security-based swap on the books of the Swap Dealer, Major Swap Participant, or Other Regulated Entity will ensure its 'safety and soundness.' Otherwise, the last term may converge to USD 0.00 for 24 even a deeply in-the-money swap as a Swap Dealer, Major Swap Participant, or Regulated Entity approaches bankruptcy, insolvency, nonperforming status or similar credit-impairment.*

For the avoidance of doubt, following is my response to questions that the new comment request poses in "D. Additional Requests for Comment, 16. Commercial End Users—Margin Collateral to Offset Credit Risk Charges," beginning on page 69681 (89 *Federal Register* 69664).

No swap dealer, major swap participant, or other regulated entity should recognize any alternative form of collateral. In particular, no swap dealer, major swap participant, or other regulated entity should recognize any alternative form of collateral type that has a credit rating from a credit rating agency such as a Nationally Recognized Statistical Rating Organization (NRSRO). NRSROs routinely inflate all ratings in all aspect classes. Moreover, the Dodd-Frank Act directs the Commission to lessen the reliance of it and the financial system on NRSRO credit ratings.

For substantiation, beyond which the entirety of this letter provides, please see my submission to the SEC Fixed Income Market Structures Advisory Committee of November 4, 2019.

For further substantiation straight from the horse's mouth, the SEC itself is admitting the utter failure of its NRSRO regulation in light of the pervasive NRSRO rating inflation in all sectors.[30]

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[30] Podkul Cezary, "SEC Rethinks Approach to Conflicts Among Bond-Rating Firms (Agency is seeking industry input on how to combat rating inflation as 2010 fix falters)," *Wall Street Journal*, February 24, 2020. "The Securities and Exchange Commission's top official overseeing credit-rating firms said Monday the agency is rethinking its post-crisis effort to improve the quality of bond ratings, ***a tacit acknowledgment that the decade-old program has been a failure*** [emphasis added]." Also, Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017, pages 44-51.

For the avoidance of doubt, following is my response to questions, including those below highlighted in rose, that the new comment request poses in "D. Additional Requests for Comment, 18. Economic Implications," beginning on page 69681 (89 *Federal Register* 69664).

"The Commission requests comments and data on how the baseline of the economic analyses has changed since the publication of the *2016 Capital Proposal*. The swap market activity has experienced significant changes, in part due to the fact that participants in this market are now subject to various new rules. The Commission requests comments and data on how the baseline of the economic analyses has changed since the publication of the *2016 Capital Proposal*. The swap market activity has experienced significant changes in the past three years and the Commission requests comments on how those changes in the baseline would impact the potential benefits and costs of capital requirements"

> *"No US issuer of ABS has entered into any swap contract, neither one with daily, two-way exchange of variation margin nor a flip-clause-swap-contract, since January 2016. Nor is any US ABS issuer likely to enter into a swap in the foreseeable future, given that none has made the "significant structural change . . . to post and collect variation margin.*
>
> ***"The result? The ABS sector is thriving!***
>
> *"With respect to legacy US ABS deals, only 54 deals with investment grade debt are party to a flip-clause-swap-contract. Moreover, a single company, the student loan company Navient, sponsors 34 of the 54 legacy deals. To the extent additional US deals are parties to a contract, they are most likely pre-crisis, zombie CDO and RMBS deals with debt that incurred downgrades to "C" or lower years ago."*
>
> ***However!***
>
> *"Many US issuers of collateralized loan obligations (CLOs)* ***do*** *place a flip clause in the priority of payments* ***without*** *providing the capital, legal, and operational resources for the respective deals to exchange variation margin daily, i.e., to comply with the US swap margin rules. To-date, the CLOs have not entered swap contracts. Instead, CLO investors such as Japanese banks mitigate exposures themselves.*
>
> ***"In short, US markets have consigned the flip-clause-swap-contract to the garbage heap of history. There, the contract rots away with aerosol sprays, trans-fats, asbestos tiles, and other harmful synthetics that poisoned users, producers, and our Country."***[31]
>
> ***Furthermore!***
>
> "*Uncleared swaps with RAC provisions and flip clauses weakened the efficiency, competitiveness and integrity of the US swaps market, US financial system and US by facilitating the intentional undercapitalization of whole sectors of securitization debt and*

[31] WJH Motion to File," section entitled "US Issuers Shunned the Flip-Clause-Swap-Contract After 2008; Quit Cold Turkey in 2016; Issued Record Amounts in 2018!" pages 35-38.

structured product debt that started the financial crisis, exacerbated it and subsequently failed in some cases and benefited from significant government support in other cases.

"*Many of these undercapitalized sectors — cashflow CDOs; cashflow TRuPS CDOs; cashflow CDO-squared; cashflow RMBS; repackaged securitizations of all sectors; structured credit default swaps; structured notes of all securitization sectors; synthetic CDOs; and synthetic RMBS — are the poster children of the financial crisis.*

"*However, the remaining securitization sectors — e.g., those backed by auto loans, credit cards, levered loans, equipment leases, and student loans — were also undercapitalized owing to the presence of uncleared swaps with RAC provisions and flip clauses. These sectors benefited indirectly from the explicit bailouts and other support that the US government provided to global counterparties after Lehman Brothers failed. Without this government support, the undercapitalization of these remaining securitization sectors might have caused them to follow the poster children sectors into complete and ignominious collapse.*

"*On the other side of the ledger, uncleared swaps with RAC provisions and flip clauses also weakened the efficiency, competitiveness and integrity of the US swaps market, US financial system and US economy by contributing to the undercapitalization of major counterparties such as Lehman Brothers and AIG. Pre-crisis requirements for capital, liquidity and financial reporting did not address in-the-money, uncleared swaps with flip clauses and did not obligate swap providers to recognize that these very senior assets would instantaneously transform into deeply-subordinated ones when counterparties activated flip clauses.*"[32]

Moreover!

"*Admittedly, robust capital, liquidity and financial reporting requirements may result in few if any SDs providing new uncleared swaps or uncleared security-based swaps with flip clauses, walkaways or similar provisions in the future*.

"*This may be a boon for economic growth and financial stability, given the lose-lose track record of uncleared swaps with flip clauses, walkaways and similar provisions.*

"*Moreover, the timing for such a boon is ideal. Securitization issuers have not entered into many new uncleared swaps with flip clauses recently but this pattern could change as interest rates rise. However, the efficiency, competitiveness and integrity of the US economy depends on fewer rather than more uncleared and unmargined swaps with RAC provisions and flip clauses*.

"*To take one example, issuance of private-label cashflow RMBS must remain moribund to the extent that this sector remains undercapitalized owing to reliance on uncleared swaps with flip clauses.*

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[32] Harrington, William J. "Re RIN 3038-AD54 'Capital Requirements for Swap Dealers and Major Swap Participants,' Electronic Submission to the CFTC," May 4, 2017, page 77.

"*Had robust capital and liquidity requirements been in place prior to the financial crisis, global swap dealers might have provided fewer uncleared swaps with flip clauses to issuers of securitized and structured product debt and the financial crisis might have been staved off entirely.*"[33]

Also,

"*Yes, there are 'other public interest consideration that the Commission should consider.*'

"*The rule that the Commission ultimately adopts must ensure that both parties to an uncleared swap or uncleared security-based swap pay the true rather than the convenient, i.e., artificially cheap, price of being party to the swap*.

"*Accordingly, the Commission must be very skeptical in assigning benefits to the undercapitalization of uncleared swaps and uncleared security-based swaps and be very aggressive in estimating the commensurate costs.*

"*As a first step, the Commission must adjust the baseline assumption of the cost/benefit analysis of uncleared swaps and uncleared security-based swaps by 180 degrees as follows:*

> "*'Uncleared swaps and uncleared security-based swaps that are artificially cheap increase the costs and reduce the benefits to the economy, rather than vice-versa.*'

"*In doing so, the Commission will purge the cost/benefit analysis of the marketing mantras that the financial industry represents as being empirically-driven findings.*

"*For instance, uncleared swaps and uncleared security-based swaps do not hedge the risk exposures of end users. These swaps, simply by their nature as contracts, add to the risk exposures of an end user. More contractual obligations mean more that can go wrong.*

"*The intrinsic characteristic of an uncleared swap or an uncleared security-based swap — namely, that it is a one-off, highly-negotiated, bilateral contract — enables either party or both to laden the contract with convenient provisions that are potentially loss-inducing.*

"*The result is a highly-idiosyncratic contract with risk characteristics that differ markedly — and thus evolve differently — from other, ostensibly similar contracts.*

"*Moreover, most uncleared swaps, uncleared security-based swaps and uncleared options also add to the idiosyncratic exposures that US taxpayers underwrite, given that a significant amount of these derivatives are booked in the government-insured subsidiary of one of a few bank holding companies.*

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[33] Ibid., page 79.

"*Collectively, artificially cheap, uncleared swaps continue to wreak havoc on the US economy by distorting price signals and thereby directing capital to sub-optimal uses. This distorted pricing represents a failure of market accountability and capitalism.*

"*In fact, artificially cheap, uncleared swaps may well have engendered the endemically slow growth that has accompanied the emergence and growing use of these swaps in the last 30 years. On its own, the potential that artificially cheap, uncleared swaps will continue to be a drag on useful investment and economic growth indicates that these swaps are a cost to the economy and not a benefit.*

"*Certainly, the proliferation of artificially cheap, uncleared swaps drove the US and global financial system into near collapse and obligated US taxpayers to provide massive bailouts and implicit support to the financial sector. The potential for artificially cheap, uncleared swaps to do the same again is clearly a cost*."[34]

18-e. Other public interest considerations.

"***Three ways to calibrate cost/benefit analysis using uncleared swaps with flip clauses***

"*Exhibit Number 1 of an artificially cheap, uncleared swap is the uncleared and unmargined swap with RAC provisions and a flip clause.*

"*This type of swap has been the go-to swap of the securitized and structured product sectors for 20 years because it adds to the risks of both parties and allows them to undercapitalize, not despite this capacity.*

"*Much went wrong with artificially cheap, undercapitalized, uncleared swaps with RAC provisions and flip clauses as well as with the borrowing that the swaps facilitated. These swaps provide the Commission with a perfect tool for calibrating the cost/benefit analysis of the CFTC Proposal.*

"*For a start, the output of the cost/benefit analysis must satisfy the following condition*.

"1. The cost/benefit analysis produces a defensible finding.

"*For example, the only defensible finding with respect to uncleared swaps and uncleared security-based swaps with RAC provisions and flip clauses is that none of these swaps are needed because the costs to the US financial system and economy outweigh the benefits.*

"*As an analogy, the only sensible finding with respect to construction in earthquake zones using specifications for non-earthquake zones and materials that fail basic quality controls84is that "all of this deficient construction is risky and outright criminal when knowingly designed or built below standard.*

"*The phrase 'garbage in, garbage out . . .' refers 'to the fact that computers, since they operate by logical processes, will unquestioningly process flawed, even nonsensical, input*

[34] Ibid., pages 94-96. See also pages 98-104.

data ('garbage in') and produce undesired, often nonsensical, output ('garbage out'),' according to the entry on Wikipedia.org.

"*'The principle also applies more generally to all analysis and logic, in that arguments are unsound if their premises are flawed.'*

"*Accordingly, the cost/benefit analysis should reject a very flawed, unsound premise — namely that the financial crisis was akin to an act of god that 'no one could have foreseen' — and also satisfy a second condition.*

> ***"2. The CFTC Proposal, if in place in 2003, would have moderated or even prevented the financial crisis.***

"*For instance, had the CFTC Proposal been in place in 2003, would it have incentivized:*
- AIG not to lend money to CDOs under uncleared swaps with RAC provisions and flip clauses?;
- Lehman Brothers not to provide the uncleared swaps with flip clauses that lost 100% of value when counterparties activated flip clauses?; and
- global counterparties not to provide uncleared swaps with flip clauses to issuers of private-label RMBS?

"*Lastly, the cost/benefit analysis must incorporate an achievable benchmark so that this condition can be satisfied.*

> **"3. *The CFTC Proposal would have survived this cost/benefit analysis in 2003.***

"*Otherwise, the cost/benefit analysis understates the costs and overstates the benefits to the US economy from SDs, MSPs, CSEs and other swaps providers continuing to undercapitalize uncleared swaps with flip clauses. After all, subjecting AIG and Lehman Brothers to higher capital, liquidity and financial reporting requirements for uncleared swaps might have seemed unreasonably costly to AIG, Lehman Brothers, the financial system and the US economy in 2006.*

"*In retrospect, these 'costly' requirements would have been the deal of the century.*"[35]

Regarding barriers to entry that implementation of this proposal will create .

"Yes, the 'minimum capital requirements represent a barrier to entry to firms that may otherwise seek to trades swaps as SDs.'

[35] Ibid., pages 96-97.

> "*The market for uncleared swaps is still very young — less than 30 years old — and neither firms nor end users have established best practice templates for risk management or for accountability.*"[36]

In conclusion,

> "*Accurate pricing for each of these three approaches will direct the issuer to choose the approach that works best considering the transaction attributes rather simply opting for the artificially cheap, uncleared swaps with RAC provisions and flip clauses that rest on government support.*
>
> "*As many securitization and structured product issuers confront the same choice, capital will flow to the most effective uses.*
>
> "*Well, that's capitalism! Accurate prices that increase choice and economic utility are not necessarily convenient prices.*
>
> "*That's how free markets are supposed to work — users get what they pay for.*"[37]

The Commission must fulfill several responsibilities regarding my proposals and rationales in approving and drafting the final rule. Firstly, the final rule must clearly state my proposals and rationales of May 4, 2017. Secondly, the final rule must clearly state whether it adopts each of my proposals in whole, in part, or not at all. Finally, the final rule must provide the respective Commission rationales for the decisions to adopt each of my proposals in whole, in part, or not at all.

Commissioner Quintenz sidestepped his obligation and that of the Commission to fulfill the above responsibilities by damning responses to the initial comment request with faint praise.

> "*I appreciate that market participants have commented on two prior capital proposals and the* ***Commission will continue to consider all past comments*** *[emphasis added] in moving forward with a final rule.*" [38]

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[36] Ibid., pages 107. For evaluation of the impact on capital and continued operations of Swap Dealers such as Goldman Sachs Mitsui Marine Derivative Products LP, Merrill Lynch Capital Services, and Nomura Derivative Products Inc., see pages 107-109.

[37] Ibid., pages 121-122.

[38] Quintenz, Brian, "Opening Statement of Commissioner Brian Quintenz before the Open Commission Meeting Re Proposed Rule: Capital Requirements for Swap Dealers and Major Swap Participants – Reopening the Comment Period and Requesting Additional Comment," December 10, 2019.

Should the Commission not abide by the Administrative Procedure Act with respect to all submissions, I, the sole proprietor of Harrington Independent Flip Clause Assessments, will have grounds to sue the Commission.[39]

The SEC provides Commissioner Quintenz and the entire Commission with a how-to guide in "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers" of August 22, 2019.

The SEC rule cites "Letter from William J. Harrington (Nov. 19, 2018) ('*Harrington 11/19/2018 Letter*')" 14 times, including the following instance.

> "***Finally, a commenter recommended that the Commission apply a 100% haircut to a structured product, asset-backed security, re-packaged note, combination security, and any other complex instrument.[Footnote] 463 In response, the final margin rule requires margin collateral to have a ready market*** *[emphasis added]*. *[Footnote] 464 This is designed to exclude collateral that cannot be promptly liquidated.*
>
> *"[Footnote] 463 See Letter from William J. Harrington (Nov. 19, 2018) ("Harrington 11/19/2018 Letter").*
>
> *"[Footnote] 464 See paragraph (c)(4)(i)(A) of Rule 18a-3, as adopted.*"[40]

Commissioner Behnam cited the SEC rule in voting against re-opening the comment period for the CFTC proposal on December 10, 2019.

> "*The overall changes to the derivatives market over the last several years, the Commission's adoption and implementation of margin rules for uncleared swaps and growing knowledge and experience with SDs, and* ***recent movement by the Securities and Exchange Commission in finalizing capital, margin, and segregation requirements as well as***

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[39] Behnam, Rostin, "Statement of Dissent by Commissioner Rostin Behnam Re Capital Requirements of Swap Dealers and Major Swap Participants: Proposed rule; reopening of comment period; request for additional comment," December 10, 2019. "Too often over the last couple of years, I believe this agency has slowed its own progress by snaking outside clear Administrative Procedure Act ("APA") trajectories and adding unnecessary steps to the rulemaking process. In part, I fear that we are doing the same thing today. The competing threads throughout the Reopening make it harder for the public to discern what the Commission is proposing to do, and will make it more difficult to effectively comment on the existing proposal from 2016. This creates undue risk under the APA, and arguably poisons the well in regard to the reachable goals of this new request for comment."

[40] US Securities and Exchange Commission, "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers," August 22, 2019, 84 *Federal Register* 43872, page 43920.

> ***financial reporting requirements for security-based swap dealers and major security-based swap participants*** *[emphasis added] provide a reasonable basis for affording the public an opportunity to reevaluate the 2016 Capital Proposal.*"[41]

Commissioner Behnam's comments put me on high alert that the Commission re-opened the comment request for entirely bad faith reasons. Commissioner Behnam himself stated that the Commission re-opened the comment request to afford lobbyists a golden chance to request a grab bag of favors that are best tangentially related to the initial proposal.

> "*While I would have been comfortable supporting the Reopening as a matter of moving this critical Dodd-Frank Act rule forward to finalization,* ***to the extent it introduces supplementary avenues for future rulemaking such as a leverage ratio requirement, it is a deception. Impulsively inviting comment on matters tangential to the 2016 Capital Proposal, but perhaps relevant to determining appropriate capital standards and methodologies, as opposed to a thoughtful re-proposal sacrifices discipline for expediency, and runs afoul of proper process for notice and comment*** *[emphasis added]. I will not be complicit in supporting Commission action that I believe could invite backdoor rationalization when finalization is before us. The public deserves--and our integrity demands--that we play by the rules.*"[42]

I, a well-informed human being member of the public who has used best efforts to deliver objective analysis to the Commission since 2015, both deserve and demand that the Commission play by the rules.

For a start, the Commission must not privilege comments from the re-opening grab bag at the expense of those from the initial comment request, such as my proposal of May 4, 2017.

Additionally, the Commission must know that post-2016 developments and 2008-2020 empirical buttress my proposals. The US, which does not use new flip-clause-swap-contracts, has prospered relative to the EU, the UK, and other domiciles that actively use new flip-clause-swap contracts. Even so, the Commission has actively tried to join many US CLO issuers, and the Structured Finance Association, in re-inflicting the flip clause on the US.[43]

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[41] Behnam, Rostin, "Statement of Dissent by Commissioner Rostin Behnam Re Capital Requirements of Swap Dealers and Major Swap Participants: Proposed rule; reopening of comment period; request for additional comment," December 10, 2019.

[42] Ibid.

[43] "WJ Motion to File Proposed amicus Curiae Brief," section entitled "2019: CFTC Chairperson Gives Up on Exempting Flip-Clause-Swap-Contracts from Margin Posting," page 43. "On April 26, 2018, CFTC Chair Giancarlo co-published a White Paper that proposed to reverse many Dodd-Frank rules. Giancarlo did make good on many proposals by ushering the respective rule reversals to adoption. However, a backdoor protection of the flip-clause-swap-contract that SFIG had long sought, a reinterpretation of "financial entity in the Commodity Exchange Act" to exempt "a variety of end users, including . . . special purpose vehicles," never materialized.

Commissioner Stump and Commissioner Quintenz have validated my concerns that the Commission re-opened the comment request for entirely bad faith reasons.

> "*I think the Commission would be well-served from commenters speaking to the effective date and implementation timeframe for the CFTC's rule, especially as it relates to cooperation with other regulators and the impact of substituted compliance determinations.*"[44]

Taking Commissioner Stump at her word: Today! Make the effective date of my proposal today! Entirely ignore cooperation with other regulators and the impact of substituted compliance determinations."

> "*Much has changed since the 2011 and 2016 proposals concerning capital. We need to solicit a more contemporary snapshot of the issues. The matter before us today provides us with an opportunity to rethink our approach to capital and allows us to be more consistent with what other regulators have accomplished. I agree with the need to re-open the comment period and also ask additional questions, but I do that with an open mind and am not presupposing the outcome. I encourage commenters to not limit their potential answers to the examples provided but instead view the request for comment as a non-exhaustive list of options. Bottom line, it is time to get this right. To help us do that, this release has explicitly requested data driven responses that illustrate examples of the impact of various capital choices. Any such information commenters can share will help formulate the highest quality rulemaking possible.*"[45]

Speaking of the bottom line that does NOT change — We're AMERRICANS Who Want to Make America Great Again, Not Make America Grovel Again, Gosh Dang It to Heck! Our AMERRICAN economy grows more quickly without flip-clause-swap-contracts. Our AMERRICAN financial system is infinitely safer without flip-clause-swap-contracts.

Commissioner Quintenz is entirely WRONG!

Eliminating the flip clause in 2000 would have "have provided the market with enough certainty, given the size, nature, and opacity of these exposures, to remove the possibility of the panic, and the capital levels which could have done so would have rendered the entire swaps market obsolete and uneconomic."

The flip clause occludes, not "increased transparency and certainty."

The reinterpretation would have exempted flip-clause-swap-contracts from the CFTC-Swap-Margin-Rule."

44 Stump, Dawn, "Statement of Commissioner Dawn D. Stump for CFTC Open Meeting Re Proposed Rule: Capital Requirements for Swap Dealers and Major Swap Participants – Reopening the Comment Period and Requesting Additional Comment," December 10, 2019.

45 Ibid.

All US human being persons, and the vast majority of corporate persons, as well as the whole financial system benefit when swap dealers, major swap participants, and other regulated entities "restrict certain [flip clause] business activities, end unprofitable [flip clause] business lines, or, in some cases, exit the [flip clause] swaps or futures markets altogether."

These ARE "*the hallmarks of a healthy financial system,"* one in which the very small tale of derivatives trading does not wag the enormous dog of financial stability.

"The eight percent risk margin amount" is woefully inadequate with respect to a swap dealer, major swap participant, or other regulated entity that is exposed to a flip clause, variable subordination, or walk-away.

Any "model approval process" that ignores the self-referencing risk of 100% loss of swap assets that accompanies exposure to a flip clause, variable subordination, or walk-away is entirely deficient.

My past experience with the Commission leaves me doubtful that "the feedback we receive from commenters on this reopening helps the Commission establish appropriate capital requirements that are commensurate to a firm's risk and not detrimental to its clients."

> "*I have long lamented prior regulators' implementation of the important swaps market regulatory reforms by viewing them in isolation of each other – calibrating each to try to think it alone could have prevented the crisis. In fact, the elegance of the reforms is that they work together and build upon each other*."
>
> "*Therefore, in my view, it is wrong to think of capital in terms of what levels should have existed during the financial crisis that could have prevented it.* ***Very few capital regimes could have provided the market with enough certainty, given the size, nature, and opacity of these exposures, to remove the possibility of the panic, and the capital levels which could have done so would have rendered the entire swaps market obsolete and uneconomic*** *[emphasis added]. Therefore, regulatory capital regimes implemented to respond to the last crisis need to respect* ***the increased transparency and certainty*** *[emphasis added] which other reforms have already brought to the market. I believe we are asking the right questions in this reopening to respect that progress in calibrating our own capital regime appropriately.*"
>
> "*The final pillar of our Dodd-Frank Act reforms, capital ensures that firms are able to continue to operate during times of economic and financial stress by providing an adequate cushion to protect them from losses. Just as important as the safety and soundness of individual firms, capital is designed to give the marketplace confidence that any given firm has a high probability of surviving the next crisis*."
>
> "*Capital requirements also create important incentives that drive market behavior. The cost of capital may be the most determinative factor in a firm's decision to remain, or become, a swap dealer, or to continue to provide clearing services to clients, in the case of an FCM. If*

capital costs are too expensive, ***firms will restrict certain business activities, end unprofitable business lines, or, in some cases, exit the swaps or futures markets altogether. As a result, over time, the swaps and futures markets would become less liquid, less accessible to end users, more heavily concentrated, and less competitive. These are not the hallmarks of a healthy financial system.*** [emphasis added]"

"*Therefore, appropriate capital levels are directly linked to both the health and vibrancy of the derivatives markets and to the sustainability of the entire financial system more broadly*."

"*To promote a vibrant derivatives market, I believe it is critically important that the CFTC finalize a capital rule that is appropriately calibrated to the true risks posed by an SD's or FCM's business. I am pleased to support the re-opening and request for comment before us today. This document solicits comment on the key issues the Commission* ***must*** *get right in the final rule to ensure that capital requirements are appropriate and commensurate to a firm's risk. I appreciate that market participants have commented on two prior capital proposals and the Commission will continue to consider all past comments in moving forward with a final rule. Nevertheless, I hope commenters use this opportunity to provide the Commission with much needed data and quantitative analysis demonstrating the impact that various choices contemplated in this proposal would have on a firm's minimum capital level – and, by extension, on that firm's ability to participate in the market and adequately service clients. Data will be vital to the Commission's ability to evaluate various capital alternatives and identify those alternatives that would render certain business lines or activities uneconomic. It will also be vital to the Commission's assessment that the capital requirements established ensure the safety and soundness of the firm.*"

"*I welcome comments on all aspects of the reopening, but there are a few areas I am particularly interested in hearing from commenters.*"

"***The eight percent risk margin amount****. We heard from many commenters that, of all the alternatives, the eight percent risk margin amount would act not as a capital floor as intended, but rather as the primary driver of firms' capital requirements and as a potential binding constraint on their businesses. . .*"

"***Model approval process.*** *The Commission must have a workable model approval process. I am interested to hear commenters' views on how the Commission or NFA should review or accept capital models that have already been approved by another regulator. Should such models be granted automatic or temporary approval, while the Commission or NFA conducts its own review?*"

"*In closing, I have often worried that the accepted mantra on regulatory capital requirements has become "the higher, the better." Respectfully, I disagree. There is a direct tradeoff between the amount of capital regulators require firms to hold to ensure firms' resilience and viability, and the amount of available capital firms have to deploy in financial markets to support the market's ongoing liquidity and health. There is a balance necessary between capital levels that protect firms from losses on certain products, and capital levels that allow firms an economic benefit in servicing their customers' risk*

> *management needs through those products.* ***I hope the feedback we receive from commenters on this reopening helps the Commission establish appropriate capital requirements that are commensurate to a firm's risk and not detrimental to its clients[emphasis added*** *. . .*" [46]

E. RIN 3038-AE84 CFTC "Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants"

(As stated on page 2 of this letter, following is a potentially partial submission that I may augment on March 9, 2020.)

"International comity" and "deference" are dangerously inane, fawningly fatuous parameters for the CFTC to invoke in diluting margin and capital requirements for derivative contracts.

> "*Congress deliberately placed a clear and strong limitation on the CFTC's extraterritorial reach, recognizing the need for international* ***comity and deference*** *[emphasis added] in a global swaps market.*"[47]

> "*I believe that today's proposal is an expression of respect by the CFTC for our European colleagues. If they do not believe it is necessary or appropriate to impose margin requirements on these transactions, we should,* ***in the interest of international comity*** *[emphasis added], consider adopting the same approach.*"[48]

We're AMERRICANS Who Want to Make America Great Again, Not Make America Grovel Again, Gosh Dang It to Heck!

The CFTC must restrict "international comity and deference" to the proper spheres, e.g., when former Chair Giancarlo next attends a Downton Abbey tea party or beseeches His Holiness to beatify credit default swaps with flip clauses.[49]

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[46] Quintenz, Brian, "Opening Statement of Commissioner Brian Quintenz before the Open Commission Meeting Re Proposed Rule: Capital Requirements for Swap Dealers and Major Swap Participants – Reopening the Comment Period and Requesting Additional Comment," December 10, 2019.

[47] Quníntenz, Brian. "Remarks of CFTC Commissioner Brian Quintenz at 2019 ISDA Annual Japan Conference," October 25, 2019.

[48] Stump, Dawn. "Statement of Commissioner Dawn D. Stump for CFTC Open Meeting, October 16, 2019."

[49] CFTC Announcement, "Chairman Giancarlo to Receive Freedom of the City of London," May 30, 2019. CFTC Announcement, "CFTC Chairman J. Christopher Giancarlo Response to Bollettino," July 21, 2018.

Our AMERRICAN economy grows more quickly without flip-clause-swap-contracts. Our AMERRICAN financial system is infinitely safer without flip-clause-swap-contracts.

Comity and deference are particularly bad jokes given that other domiciles such as the EU are captive to NRSRO ratings, and accept flip-clause laden securitizations as eligible collateral.

Deference a joke given our pre-eminence in derivatives, particularly post-BREXIT.

Clear-sighted regulation of derivative contracts is vital to the well-being of the United States.[50]

> *"However, in many instances, we manage to simply acknowledge the obvious risk and step aside in favor of the easier solution of doing nothing, assuming that the U.S. prudential regulators will act on our behalf, or waving the **comity** [emphasis added] banner."*
>
> *" Cutting through the haze with bright line rules for identity, ownership, control, and attribution to find comfort in **comity** [emphasis added] seems to be our approach in addressing the nature of risk in the global swaps market.*
>
> *"I also cannot help but notice the Proposal seems to frequently reference **"comity"** [emphasis added] without providing supporting rationales for deferring to our fellow domestic regulators and foreign counterparts or for providing per se exemptions."*
>
> *"I do not understand how we can reach regulatory absolutes and conclusions based on **comity** [emphasis added], absent a finding that the exercise of our authority under CEA section 2(i) would be patently unreasonable under international principles. I believe that substituted compliance is generally the most workable and respectful solution, and I believe we must engage with our fellow global regulators to address matters of risk that may impact each of our jurisdictions regardless of size and nature."*
>
> *"The Proposal's stated rationale for targeting only a subset of non-U.S. subsidiary relationship focuses on comity and the application of a risk-based approach acts like a sieve on CEA section 2(i) such that only the largest entities that themselves as individual entities may pose risk to the financial system.*"

[50] Behnam, Rostin. "Statement of Dissent by Commissioner Rostin Behnam Regarding Cross-Border Application of the Regulation Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants; Proposed Rule," December 18, 2019. "[T]he Commission is now making a decision based on the most current thinking that we should retreat under a banner of ***comity*** [emphasis added] and focus only on that which can fit on the head of a pin. Oddly enough, that pin will hold only the giants of the swaps market. . . Today's Proposal suggests that we can resolve all complexities in one fell swoop if we alter our lens, abandon our longstanding and literal interpretation of CEA section 2(i), and limit ourselves to a purely *risk-based approach*. I cannot support an approach that would limit our jurisdiction and consequently oversight directly in conflict with Congressional intent, and potentially expose the U.S. to systemic risk."

"Today's Proposal withdraws the 2016 Proposal on grounds that the Commission's views have changed and evolved as a result of market and regulatory developments and "in the interest of international comity."[51]

[51] Ibid.

F. § 13.1 Petition to the Secretariat for the Commission Issue a Rule that Prohibits a Swap Dealer, Major Swap Participant, or Other Regulated Entity from Predicating a Swap Obligation on a Flip Clause, a Walk-Away, or Variable Subordination

(As stated on page 2 of this letter, following is a potentially partial submission that I may augment on March 9, 2020.)

Further below is § 13.1 in its entirety.

Green shaded text stipulates conditions that this petition must satisfy and does satisfy.
Yellow shaded text presents options that the petition can address and does address.
Grey shaded text identifies Secretariat responsibilities.
Turquoise shaded text identifies Commission responsibilities.

"§ 13.1 Petition for issuance, amendment, or repeal of a rule.

"Any person may file a petition with the Secretariat of the Commission, by mail or electronically through the Commission website, for the issuance, amendment or repeal of a rule of general application. The petition shall be directed to Secretariat, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581, and shall set forth the text of any final rule or amendment or shall specify the rule the repeal of which is sought. The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule. The Secretariat shall acknowledge receipt of the petition, refer it to the Commission for such action as the Commission deems appropriate, and notify the petitioner of the action taken by the Commission. Except in affirming a prior denial or when the denial is self-explanatory, notice of a denial in whole or in part of a petition shall be accompanied by a brief statement of the grounds of denial."[52]

The operative parts that this petition satisfies in order of appearance:

"Any person may file a petition . . ."
The stipulation includes a human being person such as me.

". . .electronically through the Commission website . . ."
Done. (The Secretariat must advise if it disagrees. My search of the CFTC site showed no petition page or instructions.)

"The petition shall be directed to Secretariat . . ."
Done.

". . . shall set forth the text of any final rule . . ."

[52] "Public Rulemaking Procedures, A Rule by the CFTC on 12/17/2019," 84 *Federal Register*, 68787, Page 68789.

Done. Here you go.

> ***"A swap dealer, major swap participant, or other regulated entity is prohibited from predicating a swap obligation on a flip clause, a walk-away, or variable subordination."***

"The petition shall further state the nature of the petitioner's interest . . ."
I am a private US citizen who wishes to permanently protect the US financial system from the mayhem that the flip clause is designed to cause, has caused, and will cause again. Such mayhem includes, but is not limited, distorted price signals, a compromised financial system, and another financial crisis.

I am also a leading, entirely disinterested, global authority on the flip clause. "*I am among the few to have continually scrutinized global use of the flip clause since June 1999, when I joined the derivatives group of Moody's Investors Service (Moody's).*"[53]

My sole interest in assessing the flip clause from all possible vantages on a fulltime basis since 1999 is to describe the flip clause as accurately as possible for the benefit of all human being persons.[54]

Factors that the petition can address and does address.

Please see the entirety of this letter.

["... may state arguments in support of the issuance, amendment or repeal of the rule." TRIPRA.[55] Sundae analogy.[56]]

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[53] "WJH Motion to File," page 12.

[54] See "WJH Motion to File" and "WJH Proposed Amicus Curiae Brief" in their respective entireties.

[55] Harrington, Bill, "Existing ABS swaps also caught in swap margin net," *Debtwire ABS*, 12 August 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)." Also, Harrington, William J., "Re: Margin and Capital Requirements for Covered Swap Entities; TRIPRA Comment to the Prudential Regulators," January 31, 2016, in its entirety. The following is on page 3. "I have read and re-read Title III of the Terrorist Risk Insurance Program Reauthorization Act TRIPRA). I have also read and re-read the Bill Summary & Status, 114th Congress (2015-2016), H.R.26, CRS Summary. Neither Title III of TRIPRA nor the CRS Summary states that, to quote from the latter, the exemption . . . applies to a swap with a flip clause or a RAC provision."

[56] See the CFTC posting of Harrington, William J., "ORDERLY RESOLUTION, SYSTEMIC STABILITY, AND SUSTAINABLE ECONOMIC GROWTH – WHY ISSUERS OF ASSET-BACKED SECURITIES MUST

> "*My 20 years of scrutiny have produced a disquieting finding. Every party that agreed to or endorsed a flip clause generated the financial crisis. None was a blindsided casualty.* II *From 2000 to 2007, US ABS issuers that entered into a swap contract almost uniformly entered into a flip-clause-swap-contract.*"[57]

Secretariat responsibilities:

"The Secretariat shall acknowledge receipt of the petition, refer it to the Commission for such action as the Commission deems appropriate, and notify the petitioner of the action taken by the Commission."

In short, the obligation of the Secretariat to provide me with a receipt of the petition strips the Commission of plausible deniability regarding the petition itself and the bigger picture, which I state again in clear, simple, and irrefutable terms.[58]

The CFTC Must Eradicate the Flip Clause.

Commission Responsibilities:

" . . . notice of a denial in whole or in part of a petition shall be accompanied by a brief statement of the grounds of denial."

The Commission's actions are clearly constrained. Firstly, the Commission must post the petition on the CFTC site.[59]

POST FULL MARGIN AGAINST ALL SWAP CONTRACTS," External Meeting for Proposed Rule 79 FR 59898 Presentation to Rule Writing Teams from the CFTC, FCA, FDIC, FHFA, FRB, and OCC, May 12, 2015. "**If a key provider of interest rate, basis rate, or currency swap contracts to ABS issuers (e.g., AIG) had entered bankruptcy, issuers in all ABS sectors would have been obligated to sell illiquid assets at fire-sale prices and ABS losses would have been larger and more widespread.** [emphasis added]" Page 2.

[57] "WJH Motion to File," page 16.

[58] Tarbert, Chair Heath M., "Tripling Down on Transparency," December 10, 2019.

[59] "Public Rulemaking Procedures, A Rule by the CFTC on 12/17/2019," 84 *Federal Register*, 68787, page 68788. "Furthermore, it will be the Commission's policy to post the petitions for rulemaking on the Commission's website. The electronic submissions of petitions will facilitate the submission of petitions for rulemaking and thereby the public's engagement in the Commission's rulemaking process."

Secondly, the Commission may propose a petitioned rule and invite public comment.[60] Or, the Commission may deny the petition and provide an on-the-record rationale for doing so.[61] Or, the Commission may delay a decision.[62] However, in this last instance of delay, the Commission would have to respond — i.e., propose a rule and invite public comment or deny the petition and provide a rationale — in the event that separate Commission rulemaking, exemption, or other action addressed the flip clause.

[60] Ibid., page 68788. "The Commission will decide on a case-by-case basis whether to solicit public comment on petitions for rulemaking, e.g., when the Commission seeks to obtain additional information or to corroborate the petitioner's information. . . Indeed, should the Commission initiate a rulemaking pursuant to a petition for rulemaking, the APA requires that it provide the public with an opportunity to participate in the rulemaking."

[61] Ibid., "In this regard, regulation § 13.1 provides that, except in affirming a prior denial or when the denial is self-explanatory, notice of a denial in whole or in part of a petition will be accompanied by a brief statement of the grounds of denial. Nevertheless, in the interest of transparency, the Commission will endeavor to include an explanation on a case-by-case basis when the petition merits it."

[62] "Public Rulemaking Procedures, A Rule by the CFTC on 12/17/2019," 84 *Federal Register*, 68787, page 68788. "Also, given resource constraints that the Commission may face at any given time and the subject matters that may be involved, the Commission will not specify a period for responding to petitions for rulemaking and will retain its discretion when to respond to a petition."

G. Comment to Global Markets Advisory Committee Subcommittee on Margin Requirements for Non-Cleared Swaps

(As stated on page 2 of this letter, following is a potentially partial submission that I may augment on March 9, 2020.)

"International comity" and "deference" are dangerously inane, fawningly fatuous parameters for the CFTC to invoke in diluting margin and capital requirements for derivative contracts.

> "*Congress deliberately placed a clear and strong limitation on the CFTC's extraterritorial reach, recognizing the need for international **comity and deference** [emphasis added] in a global swaps market.*"[63]

> "*I believe that today's proposal is an expression of respect by the CFTC for our European colleagues. If they do not believe it is necessary or appropriate to impose margin requirements on these transactions, we should, **in the interest of international comity** [emphasis added], consider adopting the same approach.*"[64]

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The CFTC must restrict "international comity and deference" to the proper spheres, e.g., when former Chair Giancarlo next attends a Downton Abbey tea party or beseeches His Holiness to beatify credit default swaps with flip clauses.[65]

Our AMERRICAN economy grows more quickly without flip-clause-swap-contracts. Our AMERRICAN financial system is infinitely safer without flip-clause-swap-contracts.

Comity and deference are particularly bad jokes given that other domiciles such as the EU are captive to NRSRO ratings, and accept flip-clause laden securitizations as eligible collateral.

Deference a joke given our pre-eminence in derivatives, particularly post-BREXIT.

Clear-sighted regulation of derivative contracts is vital to the well-being of the United States.[66]

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63 Qunintenz, Brian. "Remarks of CFTC Commissioner Brian Quintenz at 2019 ISDA Annual Japan Conference," October 25, 2019.

64 Stump, Dawn. "Statement of Commissioner Dawn D. Stump for CFTC Open Meeting, October 16, 2019."

65 CFTC Announcement, "Chairman Giancarlo to Receive Freedom of the City of London," May 30, 2019. CFTC Announcement, "CFTC Chairman J. Christopher Giancarlo Response to Bollettino," July 21, 2018.

66 Behnam, Rostin. "Statement of Dissent by Commissioner Rostin Behnam Regarding Cross-Border Application of the Regulation Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants; Proposed Rule," December 18, 2019. "[T]he Commission is now making a decision based on the most current thinking that we should retreat under a

https://www.cftc.gov/PressRoom/PressReleases/8101-20
https://www.cftc.gov/About/CFTCCommittees/GlobalMarketsAdvisory/GMAC_MarginSubcommitteeMembers.html

Respectfully,

/s/William J. Harrington

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

CC: CFTC Office of Inspector General

United States Court of Appeals for the Second Circuit (***In re Lehman Brothers Holdings Inc.*, No. 18-1079**)

Arizona Attorney General's Office

California Department of Justice

Attorney General for the State of Connecticut

Attorney General for the State of Delaware

Attorney General for the District of Columbia

Attorney General for the State of Idaho

State of Illinois

Attorney General for the State of Indiana

Attorney General for the State of Iowa

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banner of ***comity*** [emphasis added] and focus only on that which can fit on the head of a pin. Oddly enough, that pin will hold only the giants of the swaps market. . . Today's Proposal suggests that we can resolve all complexities in one fell swoop if we alter our lens, abandon our longstanding and literal interpretation of CEA section 2(i), and limit ourselves to a purely *risk-based approach*. I cannot support an approach that would limit our jurisdiction and consequently oversight directly in conflict with Congressional intent, and potentially expose the U.S. to systemic risk."

Attorney General of Kansas

Office of the Attorney General of the State of Maine

Office of the Attorney General of Maryland

Office of the Attorney General of Massachusetts

Attorney General for the State of Mississippi

Office of United States Senator Roger Wicker (Mississippi)

Missouri Attorney General

Office of United States Senator Joshua Hawley (Missouri)

New Hampshire Bureau of Securities Regulation

Attorney General of the State of New Jersey

North Carolina Attorney General

Oregon Department of Justice

Commonwealth of Pennsylvania Attorney General

Office of the Attorney General of the State of South Carolina

Attorney General of Washington

Ms. Jane Norberg, Chief of the United States Securities and Exchange Commission Whistleblower Office

Mr. Abraham Putney, New York City Branch Chief, United States Securities and Exchange Commission

Mr. Michael Heaney, Committee Chair of the United States Securities and Exchange Commission Fixed Income Market Structure Advisory Committee (FIMSAC)

Ms. Amy McGarrity, Subcommittee Chair, FIMSAC NRSRO Subcommittee

Mr. David Dimitrius, Senior Special Counsel and FIMSAC Liaison, United States Securities and Exchange Commission

Mr. Raymond McDaniel, President and CEO, Moody's Corporation

Mr. Cezary Podkul, Wall Street Journal

APPENDIX I

William J. Harrington Analyses of the Capitalization, Regulation, and NRSRO Credit Ratings of Complex Finance, Including Securitizations, Derivative Contracts, and Combinations of Both

1. "***Investors who want to fast-track sustainable fixed-income investments should inundate credit rating agencies with methodology critiques***," *Responsible Investor*, January 28, 2020. (Available at: https://www.responsible-investor.com/articles/investors-who-want-to-fast-track-sustainable-fixed-income-investments-should-inundate-credit-rating-agencies-with-methodology-critiques.)

"Bill Harrington, former Moody's SVP, urges everyone to hound credit rating agencies to embed each credit rating with an ESG upgrade, downgrade or wash.

"I am new to the ESG world but have worked to make credit rating methodologies more rigorous for 20 years. As a Moody's derivative analyst, I applied methodologies in each committee vote to assign a credit rating, developed methodology proposals, solicited and reviewed external feedback, and shepherded new methodologies to final approval and publication.

"Here's what I know. A credit rating methodology is emphatically not a mere guideline but rather the critical safe harbor that underpins credit rating agency operations. A credit rating agency preserves immunity to most legal and regulatory penalties simply by ensuring that all committees assign all ratings in a manner consistent with applicable methodologies and processes.

2. **(A)** "***Proposed Amicus Brief to the US Court of Appeals for the Second Circuit Regarding Lehman Brothers Special Financing Inc, Plaintiff-Appellant Versus Branch Banking Trust Company et al, Defendants-Appellees***," Case No. 18-1079, June 25, 2019. (Available at: http://croataninstitute.org/images/publications/20190808-Amicus-Curiae-Brief.pdf.)

"Dealmakers have always had better, albeit costlier, alternatives to a flip clause swap contract. As examples, dealmakers can accept lower debt ratings, align the payment characteristics of assets and liabilities, buy options, enter into a swap contract with two-way margin posting rather than a flip clause, increase deal resources, or let foreign currency investors such as those that buy US collateralized loan obligations (***CLOs***) mitigate exposures themselves."

"The decision by the United States Bankruptcy Court for the Southern District of New York detailed the 100% loss of contract values that Lehman Brothers Special Financing Inc. (***LBSF***) incurred under 100% of a "multitude" of in-the-money, flip-clause-swap-contracts.

"'The amount of the proceeds of the liquidation of the Collateral was insufficient to make any payment to LBSF under the Waterfall after proceeds were paid pursuant to Noteholder Priority.'"

"Under a separate, very large in-the-money contract, LBSF may have lost 67%.[1] Partly owing to outsized losses on the LBSF flip-clause-swap-contract portfolio, LBSF creditors received less viz-a-viz creditors of other Lehman entities."[2]

"Conversely, one European deal lost 34% under a flip-clause-swaps contract that was in-the-money to it and out-of-the-money to a Lehman entity.[3] Collectively, European flip-clause-swap-contracts with a variety of swap dealers undermined national economies, most notably Greece."[4]

2. **(B)** ***Motion by William J. Harrington for Leave to File Amicus Brief to the US Court of Appeals for the Second Circuit Regarding Lehman Brothers Special Financing Inc, Plaintiff-Appellant Versus Branch Banking Trust Company et al, Defendants-Appellees***," Case No. 18-1079, June 25, 2019. (Available at: http://croataninstitute.org/images/publications/WJH-Motion-to-File-Amicus-Brief.pdf.)

I have scrutinized the flip clause from the following **18** vantages: **1)** academic literature of the financial crisis; **2)** bankruptcy law of the US and other jurisdictions; **3)** byline journalism; **4)** competing exposures of the two parties to a swap contract, including the zero-sum exposure that a flip clause creates; **5)** global market practice since 1999; **6)** investigation by the US Department of Justice and attorneys general of 21 states and District of Columbia that resulted in them obtaining an $864 million settlement, including a Statement of Facts, from Moody's

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1 Moody's Announcement on Ballyrock ABS CDO 2007-1, March 4, 2010. ". . . the Issuer has just over $137MM in cash while the credit default swap termination payments due to LBSF is approximately $405MM." (https://www.moodys.com/research/Moodys-downgrades-the-ratings-of-two-classes-of-Notes-issued--PR_195797.)

2 "Creditor Recovery in Lehman's Recovery," *Federal Reserve Bank of New York,* January 14, 2019. The third chart compares recovery rates for creditors of Lehman entities, including LBSF. (https://libertystreeteconomics.newyorkfed.org/2019/01/creditor-recovery-in-lehmans-bankruptcy.html.)

3 Fitch Ratings Announcement on Eurosail-UK 2007-4BL PLC, December 17, 2014. "[P]roceeds of USD116m received by the issuer represent approximately 66% of the stipulated claim amount." (https://www.businesswire.com/news/home/20141217005430/en/Fitch-Takes-Rating-Actions-Eurosail-UK-2007-4BL-PLC.)

4 Story, Louise, Landon Thomas Jr. and Nelson D. Schwartz, "Wall St. Helped to Mask Debt Fueling Europe's Crisis," *New York Times*, February 13, 2010. (https://www.nytimes.com/2010/02/14/business/global/14debt.html?partner=MOREOVERNEWS&ei=5040.) Also, Durden, Tyler and Marla Singer, "Is Titlos PLC (Special Purpose Vehicle) the Downgrade Catalyst Trigger Which Will Destroy Greece?" *Zero Hedge*, February 15, 2010. (https://www.zerohedge.com/article/titlos-llc-special-purpose-vehicle-downgrade-catalyst-trigger-which-will-destroy-greece.)

Corporation, Moody's Analytics, and Moody's in 2017;[5] **7)** lead NRSRO credit analyst and team leader who proposed credit ratings, voted in 1500 ABS, banking, derivative, insurance, municipal, and sovereign committees, and co-developed global methodologies for derivative contracts, including both standard swap contracts and ones in which an ABS issuer referred to a flip clause in paying a swap dealer (**flip-clause-swap-contract**); **8)** lead NRSRO analyst for 50 ABS, collateralized loan obligations (**CLOs**), and collateralized debt obligations (**CDOs**), including three that defendants-appellees issued or insured; **9)** lead NRSRO analyst for ten derivative dealers, including two Lehman Brothers affiliates, that provided swap contracts both with and without a flip clause; **10)** lead NRSRO liaison with the swap trading desks at 15 financial institutions, including both the plaintiff-appellant and five defendants-appellees, regarding development and implementation of a global NRSRO methodology for flip-clause-swap-contracts; **11)** legal enforceability opinions with carve-outs; **12)** longitudinal tracking of core components of the flip-clause-swap-contract, including but not limited to the flip clause; **13)** review of NRSRO methodologies for the flip-clause-swap-contract; **14)** self-financed, public citizen advocate for responsible US finance whose advocacy against the flip-clause-swap-contract US financial regulators both cited and adopted in Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank Act**) rulemaking; 6 **15)** Structured Finance Industry Group (**SFIG**) member from May 13, 2013 to December 31, 2013 and participant on the "Derivatives in Securitization Committee," which champions the flip-clause-swap-contract, from May 15, 2013 to December 31, 2013;7 **16)** the student loan crisis; **17)** pro-bono "whistleblower" who regularly provides analysis to the SEC and the US Commodity Futures Trading Commission (**CFTC**) while explicitly opting **not** to be considered for a financial award; and **18)** the respective regulations and proposals of 14 financial regulators — Australian Prudential Regulation Authority, Bank of England, European Banking Authority, European Central Bank, European Commission, European Securities and Markets Authority, Japanese Financial Services Agency, Board of Governors of the US Federal Reserve Board System (**Federal Reserve**), US Farm Credit Administration, US Federal Deposit Insurance Corporation **(FDIC**), US Federal Housing Finance Agency, Office of the Comptroller of the Currency (collectively, the preceding five US regulators, **the prudential regulators**), the CFTC, and the SEC.

3. "***Electronic Letter to the United States 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)***,"

[5] 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," Announcement, January 13, 2017. (https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-nearly-864-million-settlement-moody-s-arising.)

November 3, 2019. (Available at: https://www.sec.gov/comments/265-30/265-30.htm.)

"My name is Bill Harrington. I registered 'Harrington Independent Flip Clause Assessments' with New York County five years ago on November 3, 2014. The second attachment to the delivering email contains the New York County Certification of 'Harrington Independent Flip Clause Assessments.'

"Per the certification, 'Harrington Independent Flip Clause Assessments' seeks to 'assess rating impact of flip clauses and derivative contracts in cash flow asset-backed securities.' The type of business is 'financial assessment,' and emphatically not 'an investment advisor or broker.' Financial assessment of the rating impact on an entity that is party to a swap contract with a flip clause is critical to the US economy because the flip clause was central to the financial crisis.[6]

"The absence of financial assessment of the rating impact on an entity that is party to a swap contract with a flip clause badly harms the US economy. The absence of financial assessment of the rating impact on an entity that is party to a swap contract with a flip clause shows that the United Securities and Exchange Commission must end the Nationally Recognized Statistical Rating Organization (NRSRO) regime."

4. ***"Commodity Futures Trading Commission 'Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants' (In the Event of No-Deal Brexit) and Prudential Regulators 'Margin and Capital Requirements for Covered Swap Entities' (In the Event of No-Deal Brexit)"*** May 31, 2019. https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2960

*The CFTC must amend the CFTC No-Deal Brexit Rule to **exclude** a swap contract with a **flip clause**, other walkaway provision, or rating agency condition / confirmation (**RAC**) that is transferred to an affiliate, branch, or other entity domiciled in the US.*

*The prudential regulators must amend the Prudential Regulators No-Deal Brexit rule to **exclude** a swap contract with a **flip clause**, other walkaway provision, or rating agency condition / confirmation (**RAC**) that is transferred to an affiliate, branch, or other entity domiciled in the US.*

[6] I estimate that between 90% -100% of both the asset-backed-security-collateralized-debt obligations and the underlying structured products such as residential-mortgage-backed-securities that Cordell, Feldberg, and Sass evaluate ("The Role of ABS CDOs in the Financial Crisis," Journal of Structured Finance, May 28, 2019) were issued by entities that were parties to one or more swap contracts with a flip clause."

In short, I live the life and produce the work that CFTC Chairman Giancarlo and CFTC Chief Economist Tuckman lauded in their letter to the "***Congregation for the Doctrine of the Faith, Dicastery for Promoting Integral Human Development, Secretary of the Vatican City, Holy See***," July 21, 2018. "We write to you as finance professionals striving to lead moral lives." (Available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarloresponsetobollettino072118.)

Chairman Giancarlo and Director of the FHFA Mark Calabria have known of my work since at least June 2, 2015. Both, along with then SEC Commissioner Michael Piwowar, spoke at "***Capital Unbound: The Cato Summit on Financial Regulation***," in New York City on June 2, 2015. (The itinerary is available at: https://www.cato.org/events/capital-unbound-cato-summit-financial-regulation.)

Luncheon Address, Commissioner Michael Piwowar, US SEC. (Available at: https://cdn.cato.org/archive-2015/cca-06-02-15-03.mp3.)

Minute 42:10 – 43:00, **William J. Harrington Question to Commissioner Piwowar**: "*Hi. Right now, the SEC, the CFTC, and the prudential regulators are working on rules for uncleared swap contracts and margin posting. Given the centrality of the securitization industry in the financial crisis, and particularly subprime mortgage securitizations, should securitization issuers post margin against uncleared swap contracts, particularly uncleared swap contracts with flip clauses?*"

Commissioner Piwowar response: "*That is a very difficult question that I'll have to think about. Honestly, it's, it's one, it's a real difficult one, I, I, I don't have an answer for you right now, but I'll certainly get back to you on that. Yah.*

Do you want to do one more? Something less technical, please."

5. "***Preserve Rigorous Policy with Respect to the ABS Sector in Making Comparability Determinations for the UK at the CFTC Open Commission Meeting of March 25, 2019***," March 22, 2019.

"The agenda for the above-titled meeting includes two new items that pertain to Brexit. I urge the Commission to draft the Brexit items so that they do not exempt flip clause swap contracts from the US swap margin rules."

"I will distribute today's letter to Ms. Allison Parent, Executive Direct of the Global Financial Markets Association. Ms. Parent was a senior policy advisor and counsel at the Bank of England from 2013 to 2015. I discussed flip clause swap contracts and the CFTC development of swap margin rules with Ms. Parent and her Bank of England colleague Mr. Michele Marzano in London on March 18, 2015. Appendix B to today's letter (pages a-h)

contains eleven emails regarding flip clause swap contracts that I exchanged with Ms. Parent and her Bank of England colleagues between March 9, 2015 and May 13, 2015."

"Of particular relevance to the CFTC Open Commission Meeting of March 25, please note the pre-Brexit regulatory priorities of the Bank of England as conveyed by Ms. Parent in her email of May 13, 2015 (Email 11, page a.)"

"The debate around cross-border regulation for all areas (tax, financial reform, accounting, etc.) will always be a complicated topic for many reasons, including political uncertainty. **Thank you for flagging the uncertainty the US regulators see related to the referendum question in regards to cross border derivatives reform** [emphasis added.]"

"Ms. Parent was replying to my email of May 12, 2015 (Email 10, pages a-b), in which I argued that US regulators could not harmonize regulations for swap margin with either the UK or the EU while the Brexit uncertainty loomed."

"Four years later, Brexit uncertainty still looms. Neither UK regulatory entities nor US swap dealers that operate in the UK have prepared for Brexit. The lack of preparedness is an embarrassment given that derivatives practitioners laud themselves often and pay themselves handsomely for the fiction that they relentlessly and continually evaluate all information in real time."

"The Commission must not compound the lapses by UK regulators and swap dealers by honoring the latter's request for a blanket exemption from the US swap margin requirements when re-booking flip clause swap contracts in the US. The US rules of both the prudential regulators and the CFTC properly classify securitization and structured product issuers as a "financial end user" that must exchange full variation margin at least daily under a swap contract entered into, or amended in any way, on or after March 1, 2017."

6. **"*Preserve Rigorous Policy with Respect to the ABS Sector in Making Comparability Determinations for Japan and Australia*,"** March 1, 2019. (Available at: https://wikirating.org/data/other/20190302_Harrington_J_William_CFTC_Open_Meeting_March7_2019_JPY&AUD_Flip_Clause_Swap_Contracts.pdf.)

"I am writing to urge the CFTC to preserve the rigorous policy with respect to the securitization sector in deciding the first two agenda items of the Open Commission Meeting of March 7, 2019, namely: (1) the amendment to the comparability determination for Japan; and (2) the comparability determination for Australia."

"Of critical importance, and in accordance with the US swap margin rules: (1) securitization issuers must exchange full variation margin daily and with a de minimus threshold under a new or amended swap, especially a flip clause swap; and (2) all non-GSE securitization debt,

i.e., private-label securitization debt, must be excluded from eligible collateral and haircut by 100% if posted."

7. **"*Helping the US SEC Answer Sen Elizabeth Warren Inquiry into Leveraged Loans, CLOs Volcker Rule, and NRSRO Credit Ratings*,"** December 4, 2018. (Available at: https://www.wikirating.org/data/other/20181205_Harrington_J_William_Sen_Elizabeth_Warren_Questions_Re_Leveraged_Loans-CLOs-Volcker_Rule-NRSRO_Credit_Ratings.pdf.)

"'A sizable number of CLO dealmakers have also been betting on a revival of flip clause swaps, as evidenced by their placing flip clauses in the priorities of payments of new deals. The deals are not yet party to flip clause swaps owing to the US swap margin rules. However, the flip clauses, which are presumably placeholders should the US bank regulators and the CFTC exempt CLO deals from the swap margin rules at a later date, represent a clear-cut choice and not happenstance. Many new CLOs have flip clauses and the remainder do not. **Moreover, no CLO deal with a flip clause can enter into a swap that complies with the swap margin rules because none of the CLO deals have the capital, legal, and operation capacities to exchange daily margin** [bold added].'"

"'Rating agencies also seem to be betting on a policy revival of flip clause swaps, as evidenced by the companies assigning top ratings to CLO notes irrespective of whether a deal has flip clauses in the priorities of payments. **The widespread rating practice may well violate SEC rules, but the SEC generally overlooks rating violations** [bold added]. With respect to Moody's, the practice may also violate the company's settlement with the US Department of Justice and the attorneys general of 21 states and the District of Columbia of January 13, 2017.'"

"'The flip clause in the priorities of payment of many US CLOs is one mechanism by which the respective CLOs can leverage any changes to the Volcker Rule that allow CLOs to securitize, among other assets, ones that are: denominated in a second currency; fixed-rate; re-securitizations; or synthetic securities. Investors will certainly have a much more difficult time assessing CLOs that securitize the above-mentioned types of assets. In contrast, each NRSRO [credit rating agency] could easily make accurate assessments, but instead will continue to inflate the associated CLO ratings in order to preserve CLO rating franchises.'"

8. "***Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker Dealers***," November 19, 2018. (Available at: https://www.sec.gov/comments/s7-08-12/s70812-4663154-176520.pdf.)

"**Flip clause swaps and swaps with walkaway provisions belong in the dustbin of failed products along with other synthetic concoctions such as aerosol sprays, asbestos tiles,**

and trans fats."

"As a refresher, flip clause swaps:
-- were integral components of pre-crisis ABS such as CDOs, RMBS, synthetic, and TRUPS deals that ignited and fueled the financial crisis;
-- were integral components of other pre-crisis ABS such as auto ABS, CLOs, and student loan ABS that would have failed but for bailouts, other direct taxpayer support, and indirect taxpayer support;
-- are integral components of most new Australian, European, and Japanese ABS such as auto ABS, CLOs, RMBS and student loan ABS;
-- integral components of what would have been characterized as security-based swaps, i.e., the 250 swaps that saddled the estate of Lehman Brothers with losses of 100% of all mark-to-market assets and which remain the source of litigation to the present date; and
-- were, along with other derivative contracts with similar walkaway provisions, a large part of the Lehman Brothers portfolio. Other of my analysis indicates that this flip clause and walkaway exposure reduced Lehman equity by at least USD 8 billion in 2008, to USD 20 billion from the USD 28-30 billion commonly cited."

9. "***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.)

"This working paper argues that some financial products labelled 'green' or 'ESG' embed features that undermine financial sustainability and are thus at odds with the sustainability principles implied in green and ESG product ratings. This paper provides a critical correction to the green and ESG sector that has been sorely needed."

"The financial sustainability scores that this working paper proposes aim to measure the impact of a financial product on what has not been measured to date, namely the marginal: improvement or distortion of price signals; reduction or buttressing of chronic economic imbalances; boosting or draining of public resources; and reduction or increase in the odds of self-induced catastrophe."

"Scoring a product on contribution to financial sustainability is both long overdue and very timely. Long overdue because the 10th anniversary of the Lehman bankruptcy looms in October 2018. Very timely because the US Administration is acting to resuscitate crisis-causing sectors such as residential-mortgage-backed securities, crisis-causing contracts such as non-margined swap contracts, and an exceptionally harmful type of the swap contract (a flip clause swap)."

10. "***S&P Violations of SEC rules in Rating US CLOs with Waterfall Flip Clauses, US SLABS with Flip Clauses, and Navient***," May 10, 2018. (Available at: https://www.wikirating.org/data/other/20180521_Harrington_J_William_S&P_Violations_of_SEC_rules_in_Rating_US_CLOs_w_Waterfall_Flip_Clauses_US_SLABS_w_Flip_Cause_Swaps_&_Navient.pdf.)

"**1.** In assigning ratings to notes of US CLO deals with waterfall flip clauses, S&P does not:
1.a. perform forward-looking analysis of the CLO deals;
1.b. review the respective CLO deals' legal opinions, including ones that carve out flip clause enforceability;
1.c. interview a CLO manager on its derivatives business plan, given that the manager can enter into a flip clause swap but cannot enter into a swap that complies with the swap margin rules because the deal lacks the necessary capital, operational, and legal capacities;
1.d. challenge a CLO manager on its competency, ethics, and compliance considering the manager's clear plan to skirt US swap margin regulations;
1.e. evaluate the trustworthiness of a CLO manager considering the above lapses in competency, ethics, and compliance;
1.f. apply rating criteria consistently to all notes of all US CLO deals, i.e., ones with and without waterfall flip clauses; or
1.g. fact check and update rating criteria, for instance with respect to the impact of LIBOR reform on CLOs, combination securities, and flip clause swaps."

11. "***William J. Harrington CFTC MRAC Nomination and Topic Submission***, March 28, 2018. (Available at: https://www.wikirating.org/data/other/20180329_Harrington_J_William_MRAC_Nomination_and_Topic_Submissions.pdf.)

"My name is Bill Harrington. I am writing to nominate myself as a member of the CFTC Market Risk Advisory Committee (MRAC). I provide biographical information further below in this letter.

"At least 30 of my colleagues, professional contacts, friends, and family have also nominated me to be a MRAC member.[7] These endorsements of my advocacy to rectify a root cause of the financial crisis — under-capitalized derivative contracts and asset-backed securities (ABS) — are deeply gratifying."

"More importantly, these endorsements demonstrate what is both best in our country and critical to its wellbeing — people who pro-actively build their futures and everyone else's. To build these futures, the MRAC must include people such as me who are dedicated to examining the financial crisis clearly, free of blinders such as professional and partisan

[7] In the end, 45 colleagues, professional contacts, and friends nominated me.

affiliations."

CODAS
A. June 22, 2018.

"Dear Mr. Harrington,
II
"Upon careful review of the nominations received and consideration of the MRAC's potential priorities over the next three years, I am writing to inform you that you were not selected for consideration for an appointment to serve as a member of the MRAC."
II
"Rostin Behnam"

B. May 30, 2019.

"CFTC's Market Risk Advisory Committee to Meet June 12 to Discuss Climate-related Financial Risk"
(Available at: https://www.cftc.gov/PressRoom/PressReleases/7931-19.)

"CFTC Commissioner Rostin Behnam is the sponsor of MRAC."

"At this meeting, the MRAC will focus on climate-related financial risks. In a series of panels, MRAC members and guests will discuss (1) the impact of climate change on the future stability of the global financial system; (2) current domestic and international initiatives addressing financial risks related to climate change; (3) financial industry approaches to the management and mitigation of such risks, including key risk management, governance, and disclosure considerations; and (4) the challenges ahead for regulators and market participants in the derivatives industry."

""The impacts of climate change affect every aspect of the American economy – from agriculture to manufacturing. Assessing climate-related market risk that could impact the stability of our nation's financial system must be a priority. It's time for the United States to take a more active leadership role and join our international counterparts in addressing this issue," said Rostin Behnam, CFTC Commissioner and MRAC sponsor."

12. "***US Financial Regulators Balk at Examining Complex Finance***," February 8, 2018. (Available at: http://www.croataninstitute.org/latest/news/us-financial-regulators-balk-at-examining-complex-finance.)

"The main US regulator for complex finance — the CFTC — intentionally got many basic features of a complex type of derivative contract exceptionally wrong in its recent No-Action

Letter from late October of last year on margin requirements for swaps used by 'special purpose vehicles.'"

"The numerous misrepresentations that underlie the CFTC's decision not to take action on these complex, undercapitalized swaps raise serious concerns regarding the CFTC's mission, competency, and trustworthiness. The same goes for other US financial regulators such as the US Department of the Treasury, the US Securities and Exchange Commission (SEC), and the National Futures Association."

"The type of complicated derivative product that the CFTC intentionally got all wrong — an 'ABS flip clause swap' — started and fueled the financial crisis. Moreover, ABS flip clause swaps remain embedded in many student loan ABS deals, as I described in a Croatan Institute 'Views' column on 18 January."

13. "***31 Misrepresentations in CFTC Letter No. 17-52***," February 2, 2018. (Available at: https://www.wikirating.org/data/other/20180203_Harrington_J_William_31_Misrepresentations_in_CFTC%20_Letter_No_17-52.pdf.)

"I am writing to urge the Commission to withdraw the CFTC Letter No. 17-52 of 27 October 2017."

"The CFTC Letter No. 17-52 was void upon issuance. As a result, neither swap dealers that are provisionally registered with the CFTC (Swap Dealers), nor investors in US and EU asset-backed securities (ABS), nor Commission staff, including those of the Division of Swap Intermediary Oversight (DSIO), can rely on the no-action position that the CFTC Letter No. 17- 52 ostensibly provides on pages 6-7."

"*DSIO will not recommend that Commission take an enforcement action against an SD for a failure to comply with the V[ariation] M[argin] Requirements as such regulations may apply to a Legacy SPV Swap*."

"My letter of today lists and corrects 31 misrepresentations that the CFTC Letter No. 17-52 cites as rationales for the no-action position. Each of the 31 misrepresentations voids either some of or the entire no-action position. The CFTC Letter No. 17-52 explains the self-voiding mechanism on page 7."

"'*Further, this letter, and the positions taken herein, is based upon the representations made to DSIO. Any different, changed, or omitted material facts or circumstances might render this no-action position void.*'"

14. "***A Welcome if Belated Victory for Financial Stability***," January 16, 2018. (Available at: http://www.croataninstitute.org/latest/news/a-welcome-if-belated-victory-for-financial-sustainability.)

"At the nexus of complex finance, poor regulatory oversight, and predatory practices regarding lending and debt servicing, inflated credit ratings played a critical role in enabling the mortgage meltdown a decade ago. With little reform of the ratings industry's embedded conflicts of interest, similar problems of overinflated ratings have largely persisted since the financial crisis. Could the recent downgrade by Moody's Investors Service (Moody's) of bonds in nine complex deals that are backed by US student loans herald a welcome change in the assessment of complexly structured asset-backed securities (ABS)? As a former industry insider, I remain skeptical, but let's hope the trend toward more sober assessments of undercapitalized ABS continues during 2018."

"The Moody's downgrades of 11 January address an extremely complicated financial contract that is embedded in each of the nine student loan ABS (SLABS) deals. This type of financial contract — 'an ABS flip clause swap' — was a key feature of many of the ABS deals that ignited and fueled the financial crisis."

15. "***PWIPC (Persistent Well-Informed Private Citizen) to CFTC: 'Deny SFIG Request for Margin Exemption for ABS Swaps,'***" July 14, 2017. (Available at: https://www.linkedin.com/pulse/pwipc-persistent-well-informed-private-citizen-tells-cftc-harrington/.)

"Unfortunately, you have not responded to a key aspect of my request."

"I requested a meeting with '***all*** CFTC staff who have had discussions with SFIG staff and members regarding an unmargined, uncleared swap with RAC provisions and a flip clause" in 2017.'"

"My tally of these CFTC staff — i.e., those copied here — may be incomplete."

"Accordingly, please provide me with the name and email of each remaining member of CFTC staff who had one or more 'discussions with SFIG staff and members regarding an unmargined, uncleared swap with RAC provisions and a flip clause' in 2017.'"

"Alternatively, please confirm that '***all*** CFTC staff who have had discussions with SFIG staff and members regarding an unmargined, uncleared swap with RAC provisions and a flip clause' in 2017 are copied here."

"Your reply will enable me to contact '***all*** CFTC staff who have had discussions with SFIG staff and members regarding an unmargined, uncleared swap with RAC provisions and a flip

clause' in 2017 and request that they meet with me.'"

"I want to offer practical insights regarding the *implementation* of the CFTC rule regarding margin posting against an uncleared swap with RAC provisions and a flip clause just as I offered practical insights during the rule making progress."

16. "***Capital Requirements for Swap Dealers and Major Swap Participants***," May 4, 2017. (Available at: https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61196&SearchText.)

"I urge the Commission to adjust the CFTC Proposal with respect to an SD or MSP that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap 'to ensure the safety and soundness' of such an entity."

"I propose this adjustment. An SD or MSP that is exposed to a flip clause, walkaway or similar provision in an uncleared swap or uncleared security-based swap must hold capital equal to the following for each such swap."
"The maximum of: [0, 100% of the 'uncleared swap margin' as defined in footnote 25 of the CFTC Proposal + 100% of the market value of the swap or security-based swap on the books of the SD or MSP]."

"**N.B.** Using the market value of the swap or security-based swap on the books of the respective SD or MSP is critical to ensuring its 'safety and soundness.' Otherwise, the second term may converge to USD 0.00 for even a deeply in-the-money swap as an SD or MSP approaches bankruptcy, insolvency, non-performing status or similar credit impairment."

"In holding the additional capital that this adjustment specifies, an SD or MSP that is party to an uncleared swap or uncleared security-based swap with a flip clause, walkaway or similar provision will fully offset the 100% loss of mark-to-market asset that the SD or MSP agreed to accept in the event of its bankruptcy, insolvency, non-performing status or similar credit impairment."

17. "***Republicans Immunize Rating Agencies from Accountability in Financial Choice Act***," May 2, 2017. (Available at: https://blog.wikirating.org/2017/05/01/republicans-immunize-rating-agencies-from-accountability-in-financial-choice-act/.)

"No government regulation will ever apply to any rating agency that the government regulates, according to the Financial Choice Act. This bill would eliminate accountability for nationally recognized statistical rating organizations (NRSROs), i.e., credit rating agencies that SEC *ostensibly* oversees."

"**Four blatant give-aways to rating agencies**"

"1. Rating numbers don't have to tally — No one at an NRSRO needs attest to the integrity of any aspect of the rating process (Section 853)."

"2. What conflict of interest? — Sales and marketing staff can *always* communicate with rating staff (Section 856)."

"3. Re-write history — Congress *never* found that the rating agencies failed big time ahead of the financial crisis. (Section 857)."

"4. Elections have consequences but bad ratings don't — Immunize NRSROs from expert liability forever. (Section 857, again)."

18. "***ABS Margin Posting – 500 Days Late and How Many USD Millions Short?***" February 12, 2017. (Available at: https://www.linkedin.com/pulse/abs-margin-posting-500-days-late-how-many-usd-short-bill-harrington?trk=portfolio_article-card_title.)

"Don't blame the swap margin rules for too much RAC and too little replacement"

"Technical modeling and legal analysis aside, commonsense dictates that ABS ratings, prices and valuations *should* assume that an issuer will 'retain its swap provider until maturity of the swap.' Commonsense also dictates that ABS ratings, prices and valuations will reflect both the credit profile of a swap provider and the risk parameters of the swap."

"However, the ABS world is very short on commonsense and dangerously long on rating arbitrages. This combination fueled the financial crisis and may also have hampered the subsequent recovery."

"ABS ratings, prices and valuations embed a long-repudiated assumption that a suite of rating provisions in a swap will fully insulate an ABS from a swap provider. This suite of assumptions incentivizes an ABS issuer to enter into an uncleared and unmargined swap rather than buy options or additional collateral."

"Hence the desperate lobbying from all corners of the ABS world to preserve the rating arbitrage for uncleared and unmargined swaps. Fitch paved the way in an announcement of 17 November 2016 that posited that the CFTC might exempt ABS issuers with legacy swaps from the swap margin rule."

"'In the U.S., a possible 'no action position' from the CFTC could, in Fitch's view, make the replacement the of legacy swaps more likely and therefore reduce replacement risk arising from the upcoming regulation.'"

19. "***Moody's DOJ Settlement Won't Stop Fake Rating Analysis & Derivatives Denial,***" January 14, 2017. (Available at: https://www.linkedin.com/pulse/moodys-doj-settlement-wont-stop-fake-rating-analysis-bill-harrington?trk=portfolio_article-card_title.)

"**The raters' dilemma – AAA cash-and-carry swaps *end* a rating arbitrage**"

"The US rules for posting swap margin do distinguish between a *new* swap contract – one that is entered from 1 March 2017 onward – and a pre-existing swap contract."

"Under a new swap contract, a financial end user such as an ABS issuer and swap provider must exchange variation margin daily so that the party that is in-the-money holds margin equal to the full mark-to-market of the contract."

"In this way, a new swap contract will be cash-and-carry. In the event of the non-performance of a swap provider, an ABS issuer can quickly close out a new swap contract and enter into a comparable one with a stronger entity."

"In other words, a new swap contract will insulate an ABS from the non-performance of a swap provider to a AAA standard, i.e., succeed where existing swap contracts have failed."

"Of course, an ABS investor that benefits from this insulation will pay for it in the form of less leverage. In closing an ABS that will be backed by a new swap contract, an ABS issuer must include the operational and financial capacity to support margin posting in the capital structure."

"Given the cost of establishing these swap capacities, an ABS issuer may buy an option or securitize additional assets rather than enter into a new swap contract. Well, that's capitalism! Accurate prices that increase choice are not necessarily convenient."

20. "***Moody's bets Germany will support Deutsche Bank derivative contracts above all else***," October 12, 2016. (Available at: https://www.debtwire.com/info/moody%E2%80%99s-bets-germany-will-support-deutsche-bank-derivatives-above-all-else-%E2%80%94-analysis.)

"Is Deutsche Bank the next Lehman Brothers or merely another Bear Stearns?"

"Given the size of Deutsche Bank, does the distinction between a possible insolvency or liquidity crunch matter? In either event, taxpayers in Germany and potentially elsewhere are already expected to bail out all or parts of the bank."

Why does this matter? The counterparty assessments and ratings allow banks such as

Deutsche Bank AG to enter into financial contracts — such as derivative trades — while postponing any penalties which may come along with the lower senior unsecured credit rating. This is already the case in the structured finance and covered bond sectors. How long before these sectors' bad practices seep into the wider financial system, again?"

"Even so, Moody's doesn't obligate itself to price just how expensive the proposition may be or even differentiate the types of counterparty obligations."

"'Our approach to government support is similar to that for determining support from an affiliate. Our assessment is designed to be qualitative and flexible in nature, enabling us to incorporate the often subtle real-world shifts that define attitudes to support for bank creditors.'"

21. "***Existing ABS swaps also caught in swap margin net***," August 12, 2016. (Available at: https://www.debtwire.com/info/existing-abs-swaps-also-caught-swap-margin-net-%E2%80%94-analysis.)

"[R]eview of the swap margin rules indicates that the margin requirements will apply to existing swaps that are amended *in any way* after the relevant compliance date — 1 March 2017 for most financial end users including ABS issuers."

"Accordingly, an ABS issuer that is party to an existing swap as of 1 March 2017 is likely to retain its swap provider until maturity of the swap so as to continue shielding it from the margin requirements. To do otherwise, i.e., change a swap provider midstream, an ABS issuer would have to either: 1. amend the existing swap; or 2. terminate it and enter into a new swap. Either course will obligate a swap provider to ensure that the swap complies with the margin requirements immediately."

"Rorschach test — maybe the margin rules are a great solution?"

"Time is running out for the ABS world writ large — issuers, investors, rating agencies, swap providers, underwriters and at least some regulators — to paint itself out of the swap margin corner."

"The ticking clock might be a boon, rather than a problem. Did ignoring the risk of a swap provider ever help investors? Why shouldn't investors distinguish between both types of swaps and providers and buy deals accordingly?"

"Won't margin posting by both an ABS issuer and a swap provider force deals to capitalize to reflect the risks to noteholders and allow them to decide whether to accept less risk and reward or vice-versa?"

"Lastly, margin posting may well consign flip clauses to where they belong — the dustbin of discredited schema that issuers used to construct deals that failed during the financial crisis. Litigation will continue for as long as flip clauses are included in ABS because a flip clause can't possibly work for both an issuer and a swap provider. One or the other will take a significant loss even before the legal fees kick in."

22. "***Efficient, commonsense actions to foster accurate credit ratings***," *Capital Markets Law Journal* 11, no. 1 (2016): 38-59 doi: 10.1093/cmlj/kmv064). Presented at the 2015 annual meeting of the American Political Science Association in San Francisco (with Norbert J. Gaillard). (Available at: https://academic.oup.com/cmlj/article-abstract/11/1/38/2366006.)

"A RAC provision enables the third-party trustee to a seasoned S[tructured] F[inance] transaction to effect a change to its structure, governing documents, or non-investor parties without obtaining noteholder consent by instead obtaining a written affirmation from an NRSRO [credit rating agency] that the change, when considered in isolation, will not result in an immediate downgrade of the rating of any class of SF debt. Non-investor parties to an SF transaction, such as a collateral manager or a derivative counterparty, can direct a trustee to submit a request to an NRSRO for a RAC with respect to one or more changes even if they unequivocally disadvantage investors. An NRSRO is never obligated to issue a RAC, but is paid out of transaction funds to do so regardless of whether the associated changes enhance investor protections, leave them intact, or unilaterally strip them away without providing offsetting compensation such as alternative investor protections, remuneration or other forms of consideration."

23. "***Margin and Capital Requirements for Covered Swap Entities; Interim Final Rule to Exempt Commercial End Users and Small Banks***," January 13, 2016. (Available at: https://www.federalreserve.gov/SECRS/2016/February/20160217/R-1415/R-1415_013116_130180_508327057758_1.pdf.)

"**'Flip clauses' and 'RAC' provisions mask capital inadequacies of ABS and covered swap entities**"

"'Flip clauses' and 'RAC' provisions are commonly placed into swaps by ABS issuers to address counterparty credit but are inadequate for this purpose."

"For a start, few if any ABS issuers have ever obtained a U.S. legal opinion with respect to the enforceability of a flip clause in a priority of payments. The inability to obtain an opinion regarding the enforceability of a flip clause is attributable in large part to the similarity of a flip clause to a walk-away provision."

"The ratcheting up of ABS risk and systemic risk that accumulates from flip clauses and RAC

provisions can by gauged both by examining the respective mechanics of flip clauses and RAC provisions and by tracking outcomes for ABS issuers that were pre-crisis counterparties to Lehman Brothers Holdings Inc. and affiliates under swaps."

"Swaps with flip clauses and RAC provisions have long underpinned the ABS sector and, in common with other practices by ABS issuers, contributed to the inadequate capitalization of ABS that was a central contributor to the financial crisis. Neither the swaps with flip clauses and RAC provisions nor the ABS that are structured with these swaps can be viewed in isolation from each other."

"But for the bailouts that prevented other counterparties from following Lehman Brothers Holdings Inc. into bankruptcy and the extraordinary measures by the U.S. government to buy ABS and other structured products, the inadequate capitalization of ABS that is attributable to a swap with a flip clause and RAC provisions would be more generally appreciated."

"Equally, but for the bailouts and other government programs, the systemic risks that accrue from covered swap entities being party to swaps with flip clauses would also be more generally appreciated. Being party to these swaps represents extremely reckless behavior on the part of covered swap entities, as well as a failure of corporate and regulatory governance, given the many attributes that a flip clause has in common with a "walk-away" provision."

24. "***CFTC Letter No. 15-21 & Rating Agency Overrides of Published Methodologies for Swap Contracts***," May 15, 2015. (Available at: https://www.wikirating.org/data/other/20180203_Harrington_J_William_31_Misrepresentations_in_CFTC%20_Letter_No_17-52.pdf, pages 94-110.)

"As my April 7 e-mail stated, the CFTC Letter No. 15-21 provides the SEC and the U.S. Department of Justice with grounds to bring enforcement actions against Fitch, Moody's, and S&P. From 2006 onward, each of these credit rating agencies ignored its respective Delinking Criteria in assigning ratings to debt issued by SPVs that were party to swap contracts. These swap contracts are the same Legacy SPV Swap contracts that are the subject of the CFTC Letter No. 15-21."

"The CFTC Letter No. 15-21 also provides ESMA with grounds to bring enforcement actions against Fitch, Moody's, and S&P. From 2006 onward, each of these credit rating agencies ignored its respective Delinking Criteria in assigning and subsequently monitoring ratings to debt issued by SPVs in the EU that were party to swap contracts."

"Ignoring published criteria to assign and monitor the ratings of SPV debt is a violation of the respective procedures of each credit rating agency and the regulatory rules of both the SEC and ESMA."

25. "***Orderly Resolution, Systemic Stability, and Sustainable Economic Growth—Why Issuers of ABS Must Post Full Margin Against All Swap Contracts***," May 12, 2015. (Available at: https://www.cftc.gov/node/157371.)

CFTC Staff Summary
"Commenters argue against an exemption from margin requirements for issuers of asset backed securities. Commenters believe ABS issuers' current practice for dealing with counterparty credit risk is inadequate by construction and presents a systemic risk. See attached presentation.~~~ ~~~Conference call was joint with staff of Prudential Regulators."

Accompanying Presentation. (Available at: https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/dfsubmission/dfsubmission_051215_2376_0.pdf.)

"No swap contract between an ABS issuer and a financial counterparty that references an interest rate, basis rate, or currency is 'plain vanilla.'"

"Forget financial engineering and just read the swap contract and governing documents of an ABS, particularly its priority of payments, to evaluate the undercapitalization of ABS when an issuer is party to a swap contract."

"A swap contract with a flip clause between an ABS issuer and a financial counterparty is more akin to a huge banana split that has somewhere beneath the maraschino cherries, whipped cream, caramel sauce, melted chocolate, chopped nuts, bananas, pineapples, jimmies, strawberry ice cream, and chocolate ice cream, a dollop of vanilla ice cream."

"Requiring ABS issuers to post full margin against all swap contracts that reference interest rates, basis rates, and currencies will simplify these contracts, provided that eligible collateral does not include other ABS."

26. "***SEC — Teleconference of Staff of Commissioner Kara Stein and Office of Credit Ratings with William J. Harrington***," December 2, 2014. (Available at: https://www.sec.gov/comments/s7-08-10/s70810-310.pdf.)

"On December 2, 2014, Michael Spratt, Allison Lee, Michelle Stasny, and Harriet Orol had a teleconference with William J. Harrington. The parties discussed, among other things, rules concerning Asset-Backed Securities Disclosure and Registration, and Nationally Recognized Statistical Rating Organizations."

"1. Introduction for briefing for staff of SEC Commissioner Kara Stein on unenforceable,

walkaway flip clauses in asset-backed security (ABS) waterfalls by William J. Harrington, former Senior Vice President, Derivatives Group of Moody's Investors Services
a. My credentials available
b. SEC unlikely to find a more knowledgeable analyst of "uncleared swap contracts with unenforceable, walkaway flip clauses and no margin posting." These swap contracts, which may reference currencies, interest rates, or basis rates underpin most ABS sectors worldwide
(i) Big picture take-away: walkaway flip clause cannot be risk managed by either ABS issuers or their counterparties
c. From outset in 2002, my Moody's publications with respect to derivative contracts, ABS, and derivative counterparties made top ratings for ABS and derivative counterparties harder to obtain
d. Work of last four years--correct bogus post-mortem of rating failure, ABS failure, and systemic failure
e. SEC work on ABS/NRSROs equivalent to "GM Nod," VA wait times, & flawed 2013 roll-out of Affordable Care Act
(i) Exhibit Number 1 = No-Action Letter to Ford Motor Credit Company LLC
(ii) My May 29, 2014 comment letter on derivative disclosures by ABS issuers and proposed rules for NRSROs details my 2011-2014 outreach to SEC staff in all divisions"

"5. One enabler of rating inflation of ABS and other sectors is deficient assessment of derivative contracts. All NRSROs uniformly assume that derivative contracts deliver benefits to issuers without exposing them to any counterparty risk
a. i.e., misrating is real-world concern that conceals real world losses, not ivory tower musings
b. Rating inflation most egregious for ABS
c. Again, derivative contract is a contract, not an asset
d. No empirical data to show that derivative contracts make life better; like evolution, just a theory
e. Cross-border capital flows = cross-currency swap = riskiest of contract."

"7. ABS rating inflation extends credit too cheaply
a. Financing by ABS should cost more
b. No free lunch; too cheap financing today = bailouts tomorrow
c. D-F preamble: "To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ''too big to fail'', ***to protect the American taxpayer by ending bailouts***, to protect consumers from abusive financial services practices, and for other purposes"

"9. Who in ABS industry (defined at its widest?) will speak on record regarding unenforceable, walkaway flip clauses, let alone defend them?
(i) Mr. Abe Losice, Assistant Director of the SEC? After discussing these issues, and other limitation of swap contracts used by ABS issuers, Mr. Losice replied these insights weren't news to the SEC."

"11. Reviving RMBS with "uncleared, balance-guaranteed, interest rate swap contracts with unenforceable, walkaway flip clauses and no margin posting" will be a systemic disaster.
a. I undertook my self-appointed, self-funded work four years ago in part to be ready to counter RMBS lobbying when it materialized
b. Moody's would not have paid me to critique the basic guts of most ABS, particularly the highly tainted sector of RMBS
c. Fortunately, Treasury efforts to revive RMBS seem to be going nowhere for many reasons"

"12. Ask experts in housing finance, securitization, credit risk management, investing, or regulation about RMBS and "uncleared, balance-guaranteed interest rate swap contracts with unenforceable, walkaway flip clauses and no margin posting"
a. None will defend these swap contract, though they underpin securitizations of all pre-payable, fixed rate mortgages of all tenors, including 30-years
b. Effectively, "uncleared, balance-guaranteed interest rate swap contracts with unenforceable, walkaway flip clauses and no margin posting" are a jerry-rigged construct of the ABS industry that would have failed spectacularly in 2008 but for the bail-outs
(i) WJH experience in evaluating major providers of these contracts that were saved only by 2008 financial consolidation & bail-outs"

"14. Nightmare template for one-world financial regulation
a. EU regulators don't understand flip clauses either
b. In UK, a flip clause has been upheld against Lehman Brothers, i.e., UK banks at grace risk of write-offs
c. Flip clauses a problem of poor risk management both by ABS issuers and their counterparties; harmonization of international l law with respect to flip clauses a side show"

27. "***SEC — Teleconference of Paul Gumagay (Office of Commissioner Luis A. Aguilar) and William J. Harrington***," June 30, 2014. (Available at: https://www.sec.gov/comments/s7-08-10/s70810-304.pdf.)

"On June 30, 2014, Paul A. Gumagay, Counsel to the Commissioner, had a teleconference with William J. Harrington. Mr. Harrington discussed, among other things, the Commission's Reproposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment (Release Nos. 33-9244; 34-71611; File No. S7-08-10); Proposed Rules for Nationally Recognized Statistical Rating Organizations (Release No. 34-64514; File No. S7- 18-11); and his comment letter dated May 29, 2014. He also provided the attached document."

"1. Most ABS carry inflated ratings from all NRSROs; widespread downgrades should have already occurred

- Derivative contracts (i.e., real world risk and not ivory-tower, theoretical concerns) drive inflated ratings
- ABS dodged the bullet of counterparty risk thanks to the 2008 bailouts
- Derivatives contracts are contracts that impose new obligations on counterparties such as ABS issuers; derivative contracts are not outright assets that 'transform' cashflows
- Cross-border capital flows occur via cross-currency swap contracts; these swap contracts are among the riskiest of derivative contracts."

"2. Alesco Preferred Funding Series I-XVI are cases in point for significant derivative risk that is ignored in ratings
- These TruPS CDOs have self-referencing, nested counterparty risk in which one Merrill Lynch/BoA entity (MLDP) assumes the guarantee of a second Merrill Lynch/BoA entity (ML & Co.) with respect to the payment, posting & replacement/guarantee obligations of a third Merrill Lynch/BoA entity (MLIB)
- Effectively, the guarantee is bogus and does not mitigate counterparty risk of Merrill Lynch/BoA, particularly with respect to swap termination payments & nullification of flip clauses
- Even so, Moody's upgraded Alesco Preferred Funding V, VI, VIII, IX, X, & XVI on June 26, 2014."

"4. Commissioner Piwowar's statements on Reg AB disclosures are flat out wrong
- Reg AB must address nascent revival of PLS RMBS as well as larger ABS sectors such as student loans, auto loans, CLOs and CMBS.
- Private-label RMBS has riskiest derivative contracts of all—balance-guaranteed swaps with flip clauses that offset both interest rate risk and prepayments
- U.S. Treasury request for comment of June 26, 2014 indicates administration support for revival of private-label RMBS?"

"8. Discuss pp. 1-2 of my May 29, 2014 comment letter to the SEC proposing new rules for NRSROs
- To date, the SEC has enabled NRSROs to assign inaccurate ratings with impunity
- Ford Motor Credit Company No-Action Letter nullifies Dodd-Frank penalties for inflating ABS ratings
- 2011 proposed rules for NRSROs would empower NRSROs to continue rating across all sectors— municipal, state, sovereign, supra-national, corporate, financial, as well as ABS."

28. "***Request for Securities and Exchange Commission Re-proposal Relating to Nationally Recognized Statistical Rating Organizations***," May 29, 2014. (Available at: https://www.sec.gov/comments/s7-18-11/s71811-84.pdf.)

"Of particular concern, the proposed rules would enable NRSROs to continue awarding credits to both parties to a derivative contract (e.g., an ABS issuer and a large bank). By not

applying any derivative debits at all, let alone balancing derivative debits and credits, NRSROs appease issuers and exploit earnings franchises, particularly in the ABS and financial sectors."

"**Unenforceable flip clauses prop up AAA ratings of ABS 'liar loans'**"

"NRSROs have known since at least January 2010 that their derivative assessments for ABS are wildly inaccurate but still treat a derivative contract as 100.00% risk-free in assigning AAA ratings to new ABS; to do otherwise, for instance by applying even a minuscule rating debit of 0.01% to an ABS, places a AAA rating out of reach. Most flagrantly, NRSROs apply a rating debit of 0.00% to a swap contract with a 'flip clause,' even though a flip clause exposes one of the two parties (i.e., either a derivative provider or an ABS issuer) to 100.00% loss of contract value should the derivative provider become insolvent."

"A swap contract with a flip clause is an NRSRO construct that underpins AAA ratings in most ABS sectors worldwide and has no analog among mainstream derivative contracts. Since the ABS industry's inception, issuers have jerry-rigged flip clauses into swap contracts as a means of keeping issuance costs artificially low. On its own, a swap contract generally costs nothing to enter and, to make a good thing even better, adding a flip clause ostensibly insulates ABS against the risk that an insolvent swap counterparty will claim a termination payment and siphon funds from an ABS."

"**Flip side of a flip clause: A derivative provider's rating should be debited twice**"

"With respect to the rating of a derivative provider, an NRSRO should apply two (non-zero) debits to the swap contract: a first debit that reflects the credit profile of an ABS issuer and a second, much larger debit that reflects the punitive losses that a derivative provider inflicts upon itself in the event of insolvency. As an alternative to incurring the second derivative debit, a derivative provider can set aside significant reserves that must be augmented upon being downgraded."

"In their present form, ABS and NRSRO rule proposals would codify longstanding practice by ABS issuers, underwriters, NRSROs, auditors, and counsel, as well as by the Commission itself, to conceal risks under derivative contracts with respect to individual ABS, counterparties, and the ABS sector as a whole. As a result, no investor or other interested parties—be they bank regulators, corporate risk managers, ABS analysts, bank analysts, valuation consultants, independent researchers, financial journalists, private U.S. citizens, or the Commission itself— will have enough information to price ABS accurately, to measure bank capital accurately, to track systemic risks accurately, or to gauge the scale of the next bailout accurately."

29. "***SEC — Teleconference of Office of Structured Finance and Division of Corporate Finance with Marc Joffee and William J. Harrington,***" April 30, 2014. (Available at: https://www.sec.gov/comments/s7-08-10/s70810-301.pdf.)

"On April 30, 2014, Kathy Hsu, Robert Errett, Hughes Bates, Michelle Stasny, and Kayla Florio of the Division of Corporation Finance and Igor Kozhanov of the Division of Economic and Risk Analysis had a teleconference with William Harrington and Marc Joffe. The participants discussed topics relating to the Commission's April 7, 2010 proposing release regarding asset-backed securities and related releases. Mr. Harrington provided the attached memorandum."

"But for the 2008 bailouts, large counterparties such as AIG might well have been cautionary tales for ABS exposure to derivative risk and, correspondingly, counterparty exposure to ABS issuers. For instance, had AIG not been propped up, issuers in all ABS sectors would have found that a flip clause did not nullify obligations to accelerate swap payments owed to AIG, losses in all ABS sectors would have been larger, ABS in all sectors would have been downgraded more steeply, and the financial crisis would have been more severe."

"In other words, disclosure of derivative assets such as options and swap contracts with flip clauses is, to use the standard of Commissioner Piwowar: 'necessary for investors to independently perform due diligence.' Moreover, not only investors, but also third-party evaluators, regulators, and other interested parties track ABS risk."

"The disclosures serve a key aim of Regulation AB, namely that of facilitating independent scrutiny of ABS, both on an individual basis and in aggregate by issuer, sector, counterparty, counterparty guarantor, and industry as a whole."

"Moreover, an issuer can make the disclosures, and update them, at minimal cost and without raising gatekeeping or privacy concerns."

30. "***Entire Financial System Needs Commonsense Review of Derivative Contracts. Let's Start with ABS***," March 1, 2014. (Available at: https://wikirating.org/data/other/20140301_Harrington_J_William_Entire_Financial_System_Needs_Commonsense_Review.pdf.)

"Derivative overload will periodically erupt into more fiascos that will later be portrayed by the principals involved as having been 'unforeseeable.' Fiascos aside, mispriced derivative contracts continually distort market signals and, in doing so, wreak havoc on investment decisions. Future generations will marvel at our proliferation of derivatives and wonder, as we do at the follies of previous generations, 'What were they thinking?'"

"As with most bilateral contracts, a derivative contract engenders highly wishful thinking on

the part of both parties. From initial negotiation to final payment, an issuer and a counterparty each price a derivative contract under the assumption that it will deliver finely honed benefits that will cure what ails without imposing unforeseen costs or losses."

"Industry practice of treating a derivative contract as a low-cost panacea, rather than, first and foremost, a binding contract with trade-offs, is justifiable only under the assumption that the parties will not exit the contract ahead of schedule. Derivative contracts specify significant costs for early exit, regardless of whether the exit is voluntary or involuntary (e.g., after one party has become insolvent)."

"Nonetheless, analysts, regulators, policy makers, and rating agencies egg on issuers and counterparties in wishfully thinking that entering into a derivative contract is always beneficial, both for the parties themselves and for the wider economy as a whole. With every new derivative contract, a sovereign entity taps more markets, a corporation smooths earnings, a municipality reduces borrowing costs, an ABS issuer securitizes more assets, and, in win-win fashion, a counterparty books a profit up front."

31. "***Reg AB Disclosures for Securitization Swaps and Other Derivative Contracts***," February 17, 2014. (Available at: https://wikirating.org/data/other/20140217_Harrington_J_William_Reg_AB_Disclosures_for_Securitization_Swaps_and_Other_Derivative_Contracts.pdf.)

"**Disclosure of derivative assets and liabilities under Regulation AB**"

"ABS issuers make few disclosures with respect to derivative contracts, counterparties, or counterparty guarantors, even though the parameters of a derivative contract and the credit profiles of a counterparty and guarantor underpin the likelihood that an can pay ABS interest and principal."

"A sophisticated, institutional investor can form an independent assessment of ABS exposure to counterparty insolvency with the following disclosures.
1. Type of derivative contract
2. Notional amount of contract
3. Legal final maturity of contract
4. Upfront payment paid or received by ABS issuer
5. Counterparty to contract
6. Guarantor of counterparty to contract
7. Mark-to-market of contract on counterparty books and records
8. Collateral posted by counterparty to issuer
9. Presence of flip clause in contract or in priority of payments
10. Provisions that enable a counterparty to modify the contract without obtaining consent of ABS investors (often termed "RAC" provisions, shorthand for obtaining rating agency

confirmation/satisfying rating agency condition)
11. RAC provisions obtained to-date"

32. "***Securitization Swaps and the CFTC Clearing Mandate for Interest Rate Swaps***," February 3, 2014. Available at: https://www.sec.gov/comments/s7-08-10/s70810-256.pdf, HTML pages 23-31.)

"**Big Picture** – A securitization swap is much less effective than a cleared swap (or a non-cleared swap with two-way collateral posting) in mitigating counterparty exposure for either a swap provider or an ABS issuer."

"Although both an ABS issuer and a swap provider are linked until maturity of a securitization swap, neither holds reserves against the other's non-performance. Moreover, a swap provider does not reserve against its own insolvency, a risk posed by a 'flip clause' in the ABS priority of payments."

"A flip clause, a linchpin of securitization swaps since their inception, encourages an ABS issuer and a swap provider to ignore insolvency risk altogether by masking unresolved issues of law, risk management, and governance. The 2008 bail-outs propped up providers of securitization swaps, such as AIG, and in so doing left flip clauses dormant (and other deficiencies of securitization swaps unexamined). In the absence of bail-outs, ABS losses and downgrades would have been worse."

"A swap provider incorrectly treats a securitization swap as plain-vanilla, i.e., as having a robust secondary market and minimal counterparty exposure, and marks-to-market accordingly. (The assessment of minimal exposure to an ABS issuer is validated by reference to the rating of senior ABS, which represents circular reasoning, given that the ABS rating itself rests on a bedrock assumption that the ABS are not exposed to insolvency of a swap provider.) No counterweight offsets the optimistic mark-to-market of a securitization swap by a provider; an ABS issuer doesn't mark a securitization swap to-market at all."

33. "***Questions for SEC Open Meeting of February 5, 2014***," February 2, 2014. (Available at: https://www.sec.gov/comments/s7-08-10/s70810-256.pdf.)

"I have several questions regarding the Open Meeting that will be held on February 5, 2014 at 3:00 PM by the Securities and Exchange Commission."

"3. Will securitization swaps, a key component of most cash-flow, asset-backed securities, be examined as the Commission considers whether to adopt rules revising the disclosure, reporting, and offering process for asset-backed securities? In particular, will an issuer be required to disclose the presence of a "flip clause" in a securitization swap, given that such a

clause was held to be unenforceable against Lehman Brothers in 2010?"

"On two separate occasions in 2013, I briefed the SEC on the risks that securitization swaps (and, in particular, flip clauses) posed to investors in asset-backed securities, as well as to the financial system as a whole. On October 16, 2013, I met with staff from the Office of Credit Ratings and, on November 12, 2013, I met with staff from the Division of Trading and Markets. (http://www.sec.gov/comments/s7-18-11/s71811-76.pdf.)"

"In the latter briefing, I recommended that flip clauses, lynchpins to almost all securitization swaps, be counted prominently among 'any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the ABS will pay interest and principal according to its terms and conditions.' When a flip clause is not upheld against an insolvent counterparty, as occurred with respect to Lehman Brothers, an ABS issuer must divert funds that had been earmarked for timely payment of interest and principal towards paying a lump-sum termination amount to the insolvent counterparty, instead."

"Fortunately, Lehman Brothers provided very few securitization swaps to issuers of cash-flow, asset-backed securities. AIG, however, provided such swaps to many, many issuers who, but for the 2008 bail-outs, would have been obligated to pay large, lump-sum termination amounts to AIG, rather than pay "interest and principal according to its terms and conditions.'"

34. "***SEC — Meeting of Division of Trading and Markets and Office of Credit Ratings with William J. Harrington***," November 12, 2013. (Available at: https://www.sec.gov/comments/s7-18-11/s71811-76.pdf.)

"On November 12, 2013, representatives from the Securities and Exchange Commission ("Commission") met with William J. Harrington to discuss the Commission's proposed rules and rule amendments in accordance with Title IX, Subtitle C of the Dodd-Rank Wall Street Reform and Consumer Protection Act (Release No. 34- 64514). Participating on behalf of the Commission were Randall Roy, Mark Attar and Rachel Yura, from the Division of Trading and Markets; and Harriet Orol, from the Office of Credit Ratings."

35. "***Inaccurate ABS & DPC Ratings Attributable to Securitization Swaps***," October 20, 2013. (Available at: https://wikirating.org/data/other/20131020_Harrington_J_William_Email_Inaccurate_ABS&DPC_Ratings_Attributable_to_Securization_Swaps.pdf.)

"The third attachment contains two Moody's announcements of no-downgrade letters that were issued to counterparties of securitization swaps that opted not to fulfill contractual obligations to ABS issuers. The first Moody's announcement impacts 11 CDOs whose issuers

remained counterparty to Goldman Sachs after it obtained Moody's permission not to replace itself after having been downgraded to a replacement trigger. As a result, each of the 11 CDOs faces increased risk of making a termination payment in the event of a Goldman insolvency. The second Moody's announcement details a no-downgrade letter issued to Bank of America N.A. (BANA) that allows BANA to obtain a guarantee of its obligations under a securitization swap from MLDP, a DPC that, in circular fashion, is itself guaranteed by BANA."

36. "***Losses Attributable to Securitization Swaps***," September 11, 2013. (Available at: https://wikirating.org/data/other/20130911_Harrington_J_William_ABS_Losses_Attributable_to_Securitization_Swaps.pdf.)

"In the U.S., the ABS industry pitches the indispensability to housing finance reform of reviving residential mortgage-backed securities (RMBS) and ignores the highly idiosyncratic risks of 'balance guarantee' securitization swaps that underpin the whole sector. In Europe, the industry hinges economic revival upon increased securitization of corporate receivables and reduced capital penalties for ABS, glossing over outsized market risk of ubiquitous securitization swaps that hedge depreciation of asset pools attributable to currency mismatches."

"**Breaking bad ABS math apart**"

"An insolvent counterparty will deplete an ABS issuer's cash by either failing to make hedge payments (when an asset pool has depreciated) or claiming a lump-sum termination amount (when an asset pool has appreciated). Additionally, the estate of an insolvent counterparty will saddle an ABS issuer with litigation expenses and lengthy operational uncertainties, e.g., by contesting the validity of securitization swaps that do not conform to local regulations."

"An ABS priority of payments locks in ABS losses when cash runs short or assets are written down, and the impact may be magnified in the wake of a major counterparty becoming insolvent. Interest proceeds that have been depleted by a relative depreciation of the asset pool or springing legal fees may divert principal proceeds to pay senior ABS coupons, leaving senior principal outstanding and junior ABS with cashless, in-kind coupons. Funding a termination payment can force an ABS issuer to liquidate assets at fire sale prices (other ABS issuers will be liquidating similar assets for the same reason), eroding support for all tranches irreversibly."

"Moreover, an ABS issuer with an in-the-money securitization swap may never receive collateral, leaving ABS fully exposed to relative depreciation of an asset pool after a counterparty becomes insolvent. Following an industry-wide downgrade of banks in 2012, counterparties unilaterally deferred posting collateral to ABS issuers or voided the obligation to do so altogether by again obtaining no-downgrade letters from Moody's."

"**Sometimes, saying nothing is saying something**"

"Clearing houses are rejecting securitization swaps without comment."

37. "***Comment on the Securities and Exchange Commission Credit Ratings Roundtable for ABS***," June 3, 2013. (Available at: https://www.sec.gov/comments/4-661/4661-28.pdf.)

"In a particularly egregious instance, NRSRO methodologies specify that the same individual derivative contract be modeled in one manner for an asset-backed security and in a second, mutually exclusive manner for a Derivative Product Company. Without the double-counting, NRSROs would be obligated both to downgrade most asset-backed securities worldwide and to allow the Derivative Product Company sector to fade away."

"Bank bail-outs kept upright the ABS domino of event risk from failure of a counterparty to an ABS issuer. Event risk is sizable given the few derivative providers to ABS issuers, the failure of the 'replacement' market and the non-enforceability of 'flip clauses' under U.S. bankruptcy law."

Non-enforceability of 'flip clauses' will obligate ABS issuers to pay unscheduled termination payments on a senior basis to FDIC-insured bank counterparties. Had a major hedge provider entered bankruptcy in 2008 (Lehman was not a major hedge provider to cashflow ABS issuers), senior RMBS debt that fell to $0.30 would have fallen further to $0.10 or less."

38. "***Moody's Approach to Rating Derivative Product Companies***," April 1, 2013. (Available at: https://www.sec.gov/comments/4-661/4661-28.pdf, HTML pages 16-99.)

"For two decades, Moody's has based the (sf) rating of ABS upon an assessment that no expected losses accrue where an ABS issuer adheres to a Moody's protocol for entering into derivative contracts. Effectively, Moody's treats a counterparty to an ABS issuer as being rated better than Aaa. One eligible counterparty is as reliably excellent as another and none bring an additional loss of even a single basis point to any ABS anywhere in the world."

"In fact, Moody's ABS models don't register counterparties on an individual basis at all but simply record scheduled payments under a derivative contract as flowing to and from a generic placeholder. Given that generic placeholders rarely file for bankruptcy or otherwise warrant a downgrade, Moody's models the placeholder as never obligating an ABS issuer to pay an unscheduled amount such as a termination payment or a re-hedging fee."

"In the real world, downgraded banks are balking at 'replacing' themselves as counterparties to ABS issuers. Essentially, a 'replacing' bank is a distressed liquidator that books an

irreversible loss on each contract that is 'replaced' and retains remaining contracts that cannot be 'replaced' at any price. Where "replacement" does not occur (the majority of cases), back-up provisions obligate a downgraded counterparty to post collateral to an ABS issuer or alternatively to terminate at costs that range from unfavorable to prohibitive."

"Under a derivative contract that is subject to a 'flip clause,' a D[erivative] P[products] C[ompany] is exposed chiefly to its own credit risk rather than that of an ABS issuer. Prime examples are counterparties to issuers of CDOs that have been downgraded to Caa but continue to receive derivative payments on schedule. Bail-outs kept banks solvent and let sleeping 'flip clauses' lie dormant."

"'Flip clauses' are the most onerous termination provisions and, where valid, obligate a DPC to write-off 100% of mark-to-market assets with ABS issuers. Where the validity of 'flip clauses' has not been established, a DPC must do still more and not only write-off 100% of mark-to-market assets with ABS issuers but also hold additional reserves to pay legal fees. 'Flip clauses' have been upheld under U.K. law, struck down under U.S. law and have unclear status in other domiciles such as Switzerland and France."

"The presence of 'flip clauses' in derivative contracts clouds the determination of whether a DPC is solvent or insolvent in the first place, inviting still more legal inquiry. Crediting mark-to-market assets that are subject to 'flip clauses' as money-good receivables may suggest that a DPC is solvent whereas writing-off the same assets may suggest that the DPC is insolvent and thus entitled to relief under the relevant bankruptcy code."

39. "***Comment on Securities and Exchange Commission Proposed Rules for Nationally Statistical Rating Organizations***," August 8, 2011. (Available at: https://www.sec.gov/comments/s7-18-11/s71811-33.pdf.)

"**Financial Institutions Mismanaged Risk All By Themselves, Can't Pin That on NRSROs**"

"Commissioner Shapiro is not entirely correct that rating agencies contributed 'significantly to the mismanagement of risks by financial institutions.' The financial institutions that issued structured finance transactions mismanaged their risks entirely on their own. On one hand these large financial institutions rewarded employees (and outside counsel) to obtain ever more worthless opinions from the rating agencies and, on the other hand, their treasury and risk management functions treated the same worthless opinions at full face value. The CEO of a bank holding company did not need deep knowledge of synthetic CDOs to discern this tendency."

APPENDIX II

"31 Misrepresentations in CFTC Letter No. 17-52" *William J Harrington Electronic Letter to the CFTC* *February 2, 2018*

(Also, available at:
https://www.wikirating.org/data/other/20180203_Harrington_J_William_31_Misrepresentations_in_CFTC%20_Letter_No_17-52.pdf.)

William J. Harrington
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New York, NY 10003
212-620-8139
wjharrington@yahoo.com

February 2, 2018

VIA ELECTRONIC MAIL

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodities Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

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")**

Dear Mr. Kirkpatrick,

My name is Bill Harrington. I am writing to urge the Commission to withdraw the CFTC Letter No. 17-52 of 27 October 2017.

The CFTC Letter No. 17-52 was void upon issuance. As a result, neither swap dealers that are provisionally registered with the CFTC (Swap Dealers), nor investors in US and EU asset-backed securities (ABS), nor Commission staff, including those of the Division of Swap Intermediary Oversight (DSIO), can rely on the no-action position that the CFTC Letter No. 17-52 *ostensibly* provides on pages 6-7.

"DSIO will not recommend that Commission take an enforcement action against an SD for a failure to comply with the V[ariation] M[argin] Requirements as such regulations may apply to a Legacy SPV Swap."

My letter of today lists and corrects 31 misrepresentations that the CFTC Letter No. 17-52 cites as rationales for the no-action position. Each of the 31 misrepresentations voids either some of or the entire no-action position. The CFTC Letter No. 17-52 explains the self-voiding mechanism on page 7.

"Further, this letter, and the positions taken herein, is based upon the representations made to DSIO. Any different, changed, or omitted material facts or circumstances might render this no-action position void."

By withdrawing the CFTC Letter No. 17-52 immediately, the CFTC will end the disruption that the DSIO has created for Swap Dealers, investors in at least 60 US and EU ABS, CFTC staff, the US financial system, and the US economy.

60 ABS Deals and Respective Swap Providers Voided by CFTC Letter No. 17-52

- ***Shading denotes a Swap Dealer provisionally registered with the CFTC***
- ***"*" denotes a Navient-sponsored ABS deals***
- ***"(MHF Applies)" denotes a deal with Moody's Hedge Framework of 26 May 2006 to 12 November 2013 as applicable Delinking Criteria***
- ***Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.***

1. * SLM Private Credit Student Loan Trust 2003-A – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. Citibank, N.A.
2. * SLM Private Credit Student Loan Trust 2003-B – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. Citibank, N.A.
3. * SLM Private Credit Student Loan Trust 2003-C – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. JPMorgan Chase Bank National Association
4. * SLM Student Loan Trust 2003-2 – CDC IXIS Capital Markets (Euro 121mm / USD 131mm)
5. * SLM Student Loan Trust 2003-5 – CDC IXIS Capital Markets (Euro 199mm / USD 228mm)
6. * SLM Student Loan Trust 2003-7 – CDC IXIS Capital Markets (Euro 431mm / USD 489mm)
7. * SLM Student Loan Trust 2003-10 – CDC IXIS Capital Markets (GBP 500mm / USD 826bn)
8. * SLM Student Loan Trust 2003-12 – Citibank (GBP 396mm / USD 669mm)
9. * SLM Private Credit Student Loan Trust 2004-A – JPMorgan Chase Bank NA
10. * SLM Private Credit Student Loan Trust 2004-B – JPMorgan Chase Bank NA
11. * SLM Student Loan Trust 2004-2 – CDC IXIS Capital Markets (Euro 713mm / USD 898mm)
12. * SLM Student Loan Trust 2004-5 – Swiss Re Financial Products (Euro 760mm / USD 929mm)
13. * SLM Student Loan Trust 2004-10 – AIG Financial Products Corp. (Euro 408mm / USD 501mm)
14. * SLM Private Credit Student Loan Trust 2005-A – Morgan Stanley Capital Services
15. * SLM Private Credit Student Loan Trust 2005-B – Royal Bank of Scotland
16. GE Business Loan Trust 2005-2 – Swap Dealer not identified
17. Signum Verde Limited, 2006-02 – Swap Dealer not identified
18. Goal Capital Funding Trust 2006-1 – Swap Dealer not identified (MHF Applies)

19. Latam Walkers Cayman Trust 2006-100 – Swap Dealer not identified
20. Latam Walkers Cayman Trust 2006-101 – Swap Dealer not identified
21. GE Business Loan Trust 2006-2 – Swap Dealer not identified
22. * SLM Private Credit Student Loan Trust 2006-A – Deutsche Bank New York
23. * SLM Private Credit Student Loan Trust 2006-B – Deutsche Bank New York (MHF Applies)
24. * SLM Private Credit Student Loan Trust 2006-C – Bank of America NA (MHF Applies)
25. * SLM Student Loan Trust 2006-4 – 2 Counterparties: 1. Credit Suisse First Boston International (Euro 416mm / USD 505mm); and 2. Banque Nationale De Paris (Euro 416mm / USD 505mm)
26. * SLM Student Loan Trust 2006-10 – Barclays Capital Markets (Euro 208mm / USD 266mm) (MHF Applies)
27. Latam Trust 2007-108 – Swap Dealer not identified
28. Cloverie PLC 2007-52 – Swap Dealer not identified
29. Cloverie PLC 2007-53 – Swap Dealer not identified
30. * SLM Private Credit Student Loan Trust 2007-A – Credit Suisse First Boston International (MHF Applies)
31. Signum Verde Limited, 2007-04 – Swap Dealer not identified
32. * SLM Student Loan Trust 2007-4 – Barclays Capital (Euro 205mm / USD 274mm) (MHF Applies)
33. Jupiter Finance Limited Series No: 2008-003 – Swap Dealer not identified
34. Latam Trust 2008-102 – Swap Dealer not identified
35. Latam Trust 2008-101 – Swap Dealer not identified
36. * SLC Student Loan Trust 2008-01 – Credit Suisse First Boston International (euro 115mm / USD 178mm) (MHF Applies)
37. New Mexico Educational Assistance Foundation - Education Loan Bonds (2010 Indenture) – Swap Dealer not identified (MHF Applies)
38. * SLM Private Education Student Loan Trust 2010-C – Royal Bank of Scotland (MHF Applies)
39. Iowa Student Loan Liquidity Corporation 2011A – Swap Dealer not identified
40. * SLM Private Education Student Loan Trust 2011-C – Royal Bank of Canada, Toronto (MHF Applies)
41. * SLM Private Education Student Loan Trust 2012-A – GSMMDP (MHF Applies)
42. * SLM Private Education Student Loan Trust 2012-B – Bank of New York (MHF Applies)
43. * SLM Private Education Student Loan Trust 2012-C – Bank of New York (MHF Applies)
44. * SLM Private Education Student Loan Trust 2012-D – Royal Bank of Canada, Toronto (MHF Applies)
45. * SLM Private Education Student Loan Trust 2012-E – Bank of New York (MHF Applies)
46. * SLM Private Education Student Loan Trust 2013-A – Bank of New York (MHF Applies)

47. * SLM Private Education Student Loan Trust 2013-B – Bank of New York (MHF Applies)
48. * SLM Private Education Student Loan Trust 2013-C – Bank of New York
49. OSCAR US 2014-1 – BNP Paribas
50. * SLM Private Education Student Loan Trust 2014-A – Bank of New York
51. * Navient Private Education Loan Trust 2014-A – Bank of New York
52. * Navient Private Education Student Loan Trust 2014-CT – JPMorgan Chase NA
53. OSCAR US 2015-1 – BNP Paribas
54. * Navient Private Education Loan Trust 2015-A – Royal Bank of Canada
55. * Navient Private Education Loan Trust 2015-B – Wells Fargo Bank
56. * Navient Private Education Loan Trust 2015-C – JPMorgan Chase Bank NA
57. OSCAR US 2016-1 – BNP Paribas
58. OSCAR US 2016-2 – BNP Paribas
59. * Navient Private Education Loan Trust 2016-A – JPMorgan Chase Bank NA
60. Emblem Finance Company No. 2 – Swap Dealer not identified

Is the CFTC captive to a single company, namely Navient?

Navient, the large student loan company that sponsors 40 of the ABS deals listed above, and the Structured Finance Industry Group (SFIG) made many of the 31 misrepresentations that my letter of today lists and corrects. Moreover, Navient and SFIG staff and members may have made additional misrepresentations in written and spoken communications with DSIO staff.

The CFTC must publish all written materials that Navient and SFIG submitted regarding the no-action position, including the respective requests for the no-action position that CFTC Letter No. 17-52 cites in footnote 1.[1]

The signatory to the CFTC Letter No. 17-52 DSIO Director Mr. Matthew B. Kulkin also made some of the 31 misrepresentations. The additional contact whom the CFTC Letter No. 17-52 identifies, DSIO Chief Counsel Mr. Frank Fisanich, may have helped Mr. Kulkin make the misrepresentations. Accordingly, Mr. Kulkin and Mr. Fisanich have voided the CFTC Letter No. 17-52 with respect to the entire CFTC, as Mr. Kulkin explained on page 7 of the letter.

"This letter, and the positions taken herein, represent the views of DSIO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission."

Organization of "31 Misrepresentations in CFTC Letter No. 17-52"

[1] "Navient Solutions, LLC, Request for Relief from Variation Margin Requirements (Feb. 24, 2017); Structured Finance Industry Group, Request for Temporary Relief from March 1, 2017 Variation Margin Compliance Date (Feb. 6, 2017); Orient Corporation, Request for No-Action Relief from CFTC Regulations 23.152-161 in Connection with OSCAR US Funding Trust, et al. (July 13, 2017)"

Pages 11-79 of this letter list and correct the 31 misrepresentations in the order that CFTC Letter No. 17-52 presents them.

My letter of today uses the following format to address each of the 31 misrepresentations.

Each misrepresentation is:
- numbered;
- identified by page of appearance in CFTC Letter No. 17-52;
- summarized;
- quoted;
- examined for the systemic harm created; and
- corrected.

The following entry for Misrepresentation #26 (page 68 of his letter) provides an example.

Misrepresentation #26 page 6: Sponsors Navient and SFIG provide information that is accurate and actionable.

"Based on the foregoing, DSIO believes that a no-action position is warranted."

Systemic Harm: Misrepresentation #26 harms Swap Dealers, current investors, and future investors by endorsing lobbying catchphrases that serve a single company — Navient.

Corrective to Misrepresentation #26: *The DSIO disregards all representations that Sponsors Navient and SFIG have made and concludes that a no-action position is NOT warranted.*

Appendices to "31 Misrepresentations in CFTC Letter No. 17-52"

My letter of today has four appendices. Each contains material that corroborates the designation of many of the misrepresentations in the CFTC Letter No. 17-52 as such and supports many of the corrections.

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. This 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 repeatedly.
2. The Fitch public call for the CFTC to issue a no-action position.

Appendix B, pages 92-93, contains my email "CFTC Letter No. 15-21 & Inaccurate Representations of Delinking Criteria" of 7 April 2015, which was sent to Acting Director DSIO Mr. Thomas Smith and DSIO Chief Counsel Mr. Fisanich. The CFTC site links the CFTC Letter No. 15-21 of 31 March 2015 and the CFTC Letter No. 17-52 of 27 October 2017. SFIG lobbied actively to obtain both no-action positions.

Appendix C, pages 94-110, contains my "Letter No. 15-21 & Rating Agency Overrides of Published Methodologies for Swap Contracts" of 15 May 2015, addressed to Acting Director DSIO Mr. Thomas Smith, Ms. Harriet Orol of the U.S. Securities and Exchange Commission Office of Credit Ratings, and Mr. Felix Flinterman, who heads the European Securities and Markets Authority department that oversees credit rating agencies.

My letter of 15 May 2015 itemized and corrected 14 misrepresentations that the CFTC Letter No. 15-21 of 31 March 2015 cited as rationales for the no-action position contained therein. SFIG staff and members made each of the 14 misrepresentations, 13 of which are also cited in CFTC Letter No. 17-52.

My former Moody's colleague Mr. Rick Michalek and I discussed the 14 SFIG misrepresentations in CFTC Letter No. 15-21 of 31 March 2015 with the signatory DSIO Acting Director Mr. Thomas Smith and the additional contact DSIO Chief Counsel Mr. Frank Fisanich in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Appendix D, pages 111-116, contains my email correspondence with CFTC staff — including the CFTC Secretary, Office of Inspector General, and several DSIO staff — of 17 July 2017 to 3 August 2017. This email correspondence addressed two topics.

1. My four unanswered meeting requests to discuss the benefits of margin posting under an ABS flip clause swap — the "Legacy SPV Swap" that the CFTC Letter No. 17-52 addresses — with staff of the respective CFTC commissioners and the DSIO.
2. Seven SFIG meetings in which SFIG staff and members lobbied CFTC staff to exempt ABS flip clause swaps from margin posting.

Moody's Hedge Framework as Best Practice for ABS Flip Clause Swaps

My email that delivered this letter also attached the Moody's methodology "Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions" of 18 October 2010 (Moody's Hedge Framework). This methodology, which obtained globally from 26 May 2006 to 12 November 2013 and covered at least 17 of the 60 ABS deals listed earlier, is a "Delinking Criteria" that the CFTC Letter No. 17-52 misrepresents repeatedly. As the material in the appendices does, Moody's Hedge Framework corroborates the designation of many of the misrepresentations in CFTC Letter No. 17-52 as such and supports many of the corrections.

I was a co-author and lead developer of Moody's Hedge Framework. I was also the co-author and lead developer of three related methodologies:

1. a forerunner to Moody's Hedge Framework that applied to US collateralized debt obligations;[2]
2. a criterion for application in assigning and monitoring ratings of credit-linked note transactions and other financial asset repackage transactions;[3] and
3. a methodology for application in assigning and monitoring the ratings of structured Swap Dealers such as Goldman Sachs Mitsui Marine Derivative Products LP and Nomura Derivative Products Inc.[4]

In developing Moody's Hedge Framework, my U.S. and EU colleagues and I actively solicited the input of SDs by meeting with individual SDs[5] and their regulators[6] and by issuing several comment requests.[7] We also announced the key provisions of the Delinking Criteria in succinct press releases and worked closely with SDs, SPVs, and their respective counsels in incorporating the Delinking Criteria into what have become the Legacy SPV Swap contracts.

Our team had a big-picture goal of approving a standard swap contract with each SD as an efficient means to codifying several best practices for the benefit of investors, SDs, and Moody's. Investors in all types of SPV debt would benefit from the same protections. Rating teams could focus most of their analysis on the assets being securitized. SDs could accurately price the costs of Remedial Actions. And all SDs would face a level playing field.

Can One Private Citizen Describe ABS Flip Clause Swaps More Accurately than the Entire CFTC?

I have a similar big-picture goal, which my biography as a Senior Fellow at the Croatan Institute describes.

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[2] Moody's Approach for Rating Thresholds of Hedge Counterparties in CDO Transactions." *Moody's Investors Service Guidelines* (23 October 2002).

[3] "Capping Hedge Termination Payments in Moody's Rated Structured Notes Following Default of the Underlying Debt Instrument." *Moody's Investors Service Special Report* (17 September 2004).

[4] "Mitigating Voluntary Bankruptcy Risk of U.S.-Domiciled Termination Derivative Product Companies and Assessing the Effectiveness of Continuation Derivative Product Companies." *Moody's Investors Service Methodology* (16 July 2009).

[5] Moody's U.S. and EU teams met with the following SDs: Bank of America, Bank of New York, Barclays Bank, Bear Stearns and Bear Stearns Financial Products, CSFB, Deutsche Bank, Lehman Brothers and the two Lehman Brothers Derivative Product Companies, Merrill Lynch Derivative Products, Nomura Derivative Products Inc., Royal Bank of Scotland, SwissRe, Wachovia, and UBS. From 2004 to 2006, Moody's teams were rebuffed in their repeated offers to meet with Goldman Sachs. Three years later, in 2009, as SD downgrades loomed and Remedial Actions were being activated, Goldman Sachs offered to discuss the Delinking Criteria.

[6] In 2006, I discussed Moody's Hedge Framework with Paul Tucker of the Bank of England during his visit to Moody's offices in New York.

[7] "Moody's Requests Comments on Proposals for Swaps in Highly-Rated Structured Finance Cash-flow Transactions" (December 7, 2005).

My work centers on boosting the sustainability of the world financial system with the dual aims of rationalizing economic decision-making and avoiding bailouts. I focus on the capitalization and regulation of derivative contracts and structured finance.

I have engaged in a fulltime effort to alert regulators, market participants, the media and credit rating agencies to the respective undercapitalization of both parties to an "ABS flip clause swap." My biography on the Croatan site lists my work and links to much of it.

The 18-year takeaway, which I have shared with the CFTC repeatedly?

An ABS flip clause is deficient in design and construction and exposes both a swap provider and investors to outsize losses.[8]

Please share this letter with staff of Chairman Giancarlo, Commissioner Behnam, and Commissioner Quintenz.

I look forward to implementing the corrective to Misrepresentation #31 (pages 78-79 of this letter.)

"The CFTC will speak with Mr. William J. Harrington regarding his letter of 2 February 2018 in an open forum. This meeting and the information that Mr. Harrington conveys will:

1. *help the CFTC adopt policies that ensure the safety and soundness of both Swap Dealers and the financial system;*
2. *help the CFTC adopt policies that help the US economy by encouraging optimal investment and by decreasing bailout risk; and*
3. *redress the failure of the CFTC to speak with Mr. Harrington regarding SFIG misrepresentations of ABS flip clause swaps, despite Mr. Harrington having contacted CFTC staff on at least* ***ELEVEN*** *occasions since January 2017."*

Sincerely yours,

William J. Harrington
Senior Fellow, Croatan Institute
www.croataninstitute.org
Experts Board, Wikirating.org — Key Expert, Structured Finance Topics
www.wikirating.org
917-680-1465

[8] CFTC intake call with Bill Harrington and Rick Michalek of 12 May 2015. "Commenters believe ABS issuers' current practice for dealing with counterparty credit risk is inadequate by construction and presents a systemic risk." The CFTC notice of this intake call and accompanying presentation by the commenters is available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/dfmeeting_051215_2376.

cc: CFTC Office of Inspector General
Mr. Matthew B. Tulkin, Director, Division of Swap Dealer Oversight, CFTC
Mr. Frank Fisanich, Division of Swap Dealer and Intermediary Oversight, CFTC
Mr. Thomas Smith, Division of Swap Dealer and Intermediary Oversight, CFTC
Ms. Regina Thoele, Compliance, National Futures Association, Chicago
Ms. Jamila A. Piracci, OTC Derivatives, National Futures Association, New York
Ms. Harriet Orol, Office of Credit Ratings, US Securities and Exchange Commission (SEC), New York
Mr. Abraham Putney, Branch Chief, SEC, New York
Ms. Diane Audino, Office of Credit Ratings, SEC, New York
Ms. Verena Ross, Executive Director, European Securities and Markets Authority (ESMA), Paris, France
Mr. Felix Flinterman, Head of Supervision—Credit Rating Agencies and Trade Repositories, ESMA, Paris, France
Mr. Gwénaël Pover, Senior Supervision Officer, ESMA, Paris, France
Ms. Elisabeth van Laere, Team Leader—Monitoring and Strategy, ESMA, Paris, France
Ms. Valentina Mejdahl, Supervision Officer—Monitoring and Strategy, ESMA, Paris, France
Direct Supervision Mailbox, Monitoring and Strategy, ESMA
Mr. Evert Van Walsum, Head—Investors and Issuers, ESMA, Paris, France
Mr. Andy Haldane, Bank of England, London, UK
Mr. Richard Johns, Executive Director, Structured Finance Industry Group, Washington, D.C.
Ms. Alyssa Acevedo, Manager, ABS Policy, Structured Finance Industry Group, Washington, D.C.
Mr. Michael Tarkan, Director of Research/Senior Analyst, Compass Point Research and Trading, Washington, D.C.
Ms. Meghan Neenan, Managing Director, Fitch Ratings, New York
Mr. Michael Taiano, Director, Fitch Ratings, New York
Ms. Arlene Pascarella, Compliance Administrator, Fitch Ratings, New York
Mr. Kevin Duignan, Global Group Head—Financial Institutions, New York
Ms. Marjan van der Weijden, Global Group Head—Structured Finance and Covered Bonds, Fitch Ratings, London, UK
Ms. Tuuli Krane, Senior Director, Fitch Ratings, Frankfurt, Germany
Ms. Tracy Wan, Senior Director, Fitch Ratings, New York
Mr. Warren Kornfeld, Senior Vice President, Moody's Investors Service, New York
Mr. Ray McDaniel, CEO, Moody's Corporation, New York
Mr. Michel Madelain, Vice Chairman, Moody's Investors Service, Paris, France
Mr. Robert Fauber, President, Moody's Investors Service, New York

Mr. Richard Cantor, Chief Risk, Officer Moody's Corporation and Chief Credit Officer, Moody's Investors Service, New York
Mr. Nicolas S. Weill, Chief Credit Officer – Global Structured Finance, Moody's Investors Services, New York
Mr. Edward Manchester, Senior Vice President, Moody's Investors Service, London, UK
Mr. Matthew Carroll, Senior Director, S&P Global Ratings, New York
Mr. Matthew Albrecht, Senior Director, S&P Global Ratings, New York
Ms. Belinda Ghetti, Managing Director, S&P Global Ratings, New York
Mr. Felix E. Herrera, Chief Credit Officer—Global Structured Finance, S&P Global Ratings, New York
Mr. Andrew O'Neill, Senior Director, S&P Global Ratings, London, UK
Ms. Christina Piluzo, Managing Director, S&P Global Ratings, New York
Mr. Jon Riber, Senior Vice President, DBRS, New York
Ms. Patricia Christel, Vice President, Corporate Communications, Navient, Wilmington, DE

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Misrepresentation #1, page 1: Orient Corporation (aka Mizuho Securities) was one of three entities with an open request for a no-action position on 27 October 2017.

"This letter is in response to requests to the Division of Swap Dealer and Intermediary Oversight ("DSIO") of the U.S. Commodity Futures Trading Commission ("Commission") for a no-action position from multiple entities, [Footnote] 1."
"[Footnote] 1 Navient Solutions, LLC, Request for Relief from Variation Margin Requirements (Feb. 24, 2017); Structured Finance Industry Group, Request for Temporary Relief from March 1, 2017 Variation Margin Compliance Date (Feb. 6, 2017); *Orient Corporation, Request for No-Action Relief from CFTC Regulations 23.152-161 in Connection with OSCAR US Funding Trust, et al. (July 13, 2017)* [italics added]."

Systemic Harm: Misrepresentation #1 masks both the primary beneficiary and the main losers under the no-action position. Navient is the primary beneficiary. The investors in 40 Navient-sponsored, under-capitalized student loan ABS (SLABS) deals with an ABS flip clause swap and the associated swap dealers are the main losers.

The CFTC Letter No. 17-52 enables Navient to avoid following the lead of Mizuho Securities by adding resources to the 40 SLABS deals and thereby curing the respective degrees of under-capitalization. In total, the 40 deals securitize an estimated USD 28bn of student loans and are counterparty to USD 15bn of ABS flip clause swaps, including USD 6bn of currency swaps.

Corrective to Misrepresentation #1: *This letter is in response to repeated requests to the DSIO and the Commission for a no-action position from **TWO** entities — Navient and its lobbyist SFIG, [Footnote] 1. Unfortunately, the CFTC is subject to regulatory capture by Navient and SFIG.*

[Footnote] 1 Navient Solutions, LLC, Request for Relief from Variation Margin Requirements (Feb. 24, 2017); and Structured Finance Industry Group, Request for Temporary Relief from March 1, 2017 Variation Margin Compliance Date (Feb. 6, 2017).

Mizuho Securities, a third entity that had requested a no-action position on 13 July 2017 — Orient Corporation, Request for No-Action Relief from CFTC Regulations 23.152-161 in Connection with OSCAR US Funding Trust, et al. (July 13, 2017) — rendered its request moot by completing certain remedial actions on behalf of the respective OSCAR deals on 30 August 2017, according to a Moody's announcement of the same date. The remedial actions prompted Moody's to "confirm the Aaa (sf) ratings on 10 classes of notes from four ABS transactions backed by auto loans issued by OSCAR US Funding Trust, OSCAR US Funding Trust II, OSCAR US Funding Trust IV, and OSCAR US Funding Trust V."

Moody's had placed these 10 classes of notes on watch on 27 July 2017, owing to a reduced "likelihood of swap replacement" that the rating agency attributed to the variation margin requirements. Further, Moody's advised that the scale of downgrades could be two-to-three notches, i.e., downgrades to Aa2 or Aa3 from Aaa. "In the absence of any restructuring of the abovementioned transactions or without any factor that would positively affect the likelihood of swap replacement, the ratings of the notes will likely be downgraded by two to three notches."

Accordingly, the subsequent remedial actions that Mizuho Securities quickly effectuated on behalf of the Oscar transactions with tranches on negative watch — "the execution of amended documents and the entrustment of additional cash" — constituted AAA mitigation against the low likelihood of swap replacement, according to the Moody's announcement of 30 August 2017.

"The additional cash entrustment serves as credit enhancement to the [OSCAR] notes to cover potential losses arising from the transaction becoming unhedged. The amended waterfall also enables any excess spread and principal collections available to the Subordinated Beneficial Interest to cover losses when that scenario arises.

"Moody's believes these additional credit enhancements are sufficient to mitigate the risks -- from the reduced likelihood of entering into a replacement swap -- to a level satisfactory to maintain the Aaa (sf) ratings."

In short, Mizuho Securities, and by extension Navient, did not need the CFTC to issue a no-action position. Instead, Mizuho Securities effectuated an obvious, private sector fix to rectify an obvious private sector problem: The company added resources to its undercapitalized ABS deals. Navient could easily have done the same.

Following are two tables with 28 and 12, respectively, Navient-sponsored, under-capitalized SLABS deals with ABS flip clause swaps. Navient could have protected the investors in the 40 deals' SLABS, and the associated tranches' ratings, by following the lead of Mizuho Securities and adding resources to each of the 40 SLABS deals. Similarly, Navient could have amended the waterfall of each deal to enable any excess spread and principal collections available to Navient as beneficial owner to instead cover swap-related losses.

Twenty-Eight Navient and Navient-Sponsored Private Student Loan Securitizations with Balance-Guaranteed, ABS Flip Clause Swaps that Reference Prime Rate/LIBOR and Respective Swap Providers (Shading denotes a Swap Dealer provisionally registered with the CFTC.)
Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.

1. *SLM Private Credit Student Loan Trust 2003-A – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. Citibank, N.A.*
2. *SLM Private Credit Student Loan Trust 2003-B – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. Citibank, N.A.*
3. *SLM Private Credit Student Loan Trust 2003-C – 2 Counterparties: 1. Merrill Lynch Derivative Products AG; & 2. JPMorgan Chase Bank National Association*
4. *SLM Private Credit Student Loan Trust 2004-A – JPMorgan Chase Bank NA*
5. *SLM Private Credit Student Loan Trust 2004-B – JPMorgan Chase Bank NA*
6. *SLM Private Credit Student Loan Trust 2005-A – Morgan Stanley Capital Services*
7. *SLM Private Credit Student Loan Trust 2005-B – Royal Bank of Scotland*
8. *SLM Private Credit Student Loan Trust 2006-A – Deutsche Bank New York*
9. *SLM Private Credit Student Loan Trust 2006-B – Deutsche Bank New York*
10. *SLM Private Credit Student Loan Trust 2006-C – Bank of America NA*

11. *SLM Private Credit Student Loan Trust 2007-A – Credit Suisse First Boston International*
12. *SLM Private Education Student Loan Trust 2010-C – Royal Bank of Scotland*
13. *SLM Private Education Student Loan Trust 2011-C – Royal Bank of Canada, Toronto*
14. *SLM Private Education Student Loan Trust 2012-A – GSMMDP*
15. *SLM Private Education Student Loan Trust 2012-B – Bank of New York*
16. *SLM Private Education Student Loan Trust 2012-C – Bank of New York*
17. *SLM Private Education Student Loan Trust 2012-D – Royal Bank of Canada, Toronto*
18. *SLM Private Education Student Loan Trust 2012-E – Bank of New York*
19. *SLM Private Education Student Loan Trust 2013-A – Bank of New York*
20. *SLM Private Education Student Loan Trust 2013-B – Bank of New York*
21. *SLM Private Education Student Loan Trust 2013-C – Bank of New York*
22. *SLM Private Education Student Loan Trust 2014-A – Bank of New York*
23. *Navient Private Education Loan Trust 2014-A – Bank of New York*
24. *Navient Private Education Student Loan Trust 2014-CT – JPMorgan Chase NA*
25. *Navient Private Education Loan Trust 2015-A – Royal Bank of Canada*
26. *Navient Private Education Loan Trust 2015-B – Wells Fargo Bank*
27. *Navient Private Education Loan Trust 2015-C – JPMorgan Chase Bank NA*
28. *Navient Private Education Loan Trust 2016-A – JPMorgan Chase Bank NA*

Twelve Navient and Navient-Sponsored FFELP Student Loan Securitizations with Balance-Guaranteed, ABS Flip Clause Swaps that Reference Currencies/USD and Respective Swap Providers (Shading denotes a Swap Dealer provisionally registered with the CFTC.)
Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.

1. *SLM Student Loan Trust 2003-2 – CDC IXIS Capital Markets (Euro 121mm / USD 131mm)*
2. *SLM Student Loan Trust 2003-5 – CDC IXIS Capital Markets (Euro 199mm / USD 228mm)*
3. *SLM Student Loan Trust 2003-7 – CDC IXIS Capital Markets (Euro 431mm / USD 489mm)*
4. *SLM Student Loan Trust 2003-10 – CDC IXIS Capital Markets (GBP 500mm / USD 826bn)*
5. *SLM Student Loan Trust 2003-12 – Citibank (GBP 396mm / USD 669mm)*
6. *SLM Student Loan Trust 2004-2 – CDC IXIS Capital Markets (Euro 713mm / USD 898mm)*
7. *SLM Student Loan Trust 2004-5 – Swiss Re Financial Products (Euro 760mm / USD 929mm)*
8. *SLM Student Loan Trust 2004-10 – AIG Financial Products Corp. (Euro 408mm / USD 501mm)*
9. *SLM Student Loan Trust 2006-4 – 2 Counterparties: 1. Credit Suisse First Boston International (Euro 416mm / USD 505mm); and 2. Banque Nationale De Paris (Euro 416mm / USD 505mm)*
10. *SLM Student Loan Trust 2006-10 – Barclays Capital Markets (Euro 208mm / USD 266mm)*
11. *SLM Student Loan Trust 2007-4 – Barclays Capital (Euro 205mm / USD 274mm)*
12. *SLC Student Loan Trust 2008-01 – Credit Suisse First Boston International (euro 115mm / USD 178mm)*

N.B. As a coda, the CFTC Letter No.17-52 proved not only redundant but also disruptive to Mizuho Securities and to investors in tranches of the respective OSCAR deals.

Moody's cited CFTC Letter No. 17-52 in issuing RAC on 25 December 2017 ***to allow Mizuho Securities to withdraw cash from the deals' reserve accounts, i.e., to partially reverse the AAA mitigation against***

the low probability of counterparty replacement that Mizuho Securities had put in place just four months earlier on 30 August 2017.

“*RATINGS RATIONALE*

“Today's affirmation follows the withdrawal of cash [underlining added] from the FX Reserve Account. The cash reserve in the FX Reserve Account is used to cover the risks related to swaps subject to new two-way margining requirements.

“Following the cash withdrawals, for each transaction, Moody's believes the current credit enhancements and, when applicable, the cash in the FX Reserve Account are sufficient to mitigate the risks of potential losses arising from the transaction becoming unhedged to a level satisfactory to maintain the Aaa (sf) ratings.

“On 27 October 2017, the US Commodity Futures Trading Commission announced their no-action position with respect to variation margin requirements applicable to legacy swaps with SPVs. Moody's believes the announcement increases the likelihood that a downgraded counterparty will procure a novation to a replacement counterparty [underlining added].”

Misrepresentation #2, page 1: The Navient and SFIG requests for a no-action position were *urgent*.

"The Sponsors state that the request for a no-action position is *urgent* [italics added] because Moody's and Fitch have each issued reports indicating that various rated tranches of SPV-issued notes are under review and could be subject to future negative credit rating changes..."

Systemic Harm: Misrepresentation #2 indicates that rating agencies maintain accurate ratings and moreover, do so in large part by compiling and resolving watchlists in a timely and objective manner. In fact, Sponsor Navient and lobbyist SFIG previously worked in tandem to delay Fitch and Moody's in resolving respective watchlists of FFELP ABS for more than a year in 2015-2016.

Corrective to Misrepresentation #2: *The CFTC has determined that Sponsor Navient and industry lobbyist SFIG will convince rating agencies Fitch and Moody's to refrain from resolving various rated tranches of SPV-issued notes that are under review for as long as is convenient to Navient.*

Sponsor Navient and industry lobbyist SFIG did exactly this — convinced Fitch and Moody's to refrain from resolving various rated tranches of SPV-issued notes that were backed by FFELP student loans — for more than 18 months in 2015-16. For instance, Moody's placed the Aaa-rated, Class A-3 notes of SLC Student Loan Trust 2008-2 on negative watch on 8 April 2015 and kept the notes on watch for more than 18 months before downgrading them by twelve notches to Ba3 on 1 November 2016

During this 18-month period, Navient and SFIG submitted detailed rebuttals to the Moody's plans to re-rate FFELP ABS. Navient submitted its rebuttal to Moody's on 19 October 2015 and SFIG submitted a very similar rebuttal to Moody's on 30 October 2015.

Also during this 18-month period, Navient and SFIG submitted similar rebuttals to a Fitch proposal to downgrade FFELP ABS. Navient submitted its rebuttal to Fitch on 18 November 2015 and updated it on 30 December 2015 and SFIG submitted a very similar rebuttal to Fitch during the same period in late 2015.

Misrepresentation #3, page 1: The CFTC "recently" adopted the margin rules for uncleared swaps.

"…subject to the Commission's *recently* [italics added] adopted margin requirements for uncleared swaps."

Systemic Harm (1): Misrepresentation #3 masks the failure by major financial entities such as JPMorgan Chase and Navient to comply with the variation margin requirement despite having had almost two years to do so.

Systemic Harm (2): Misrepresentation #3 also masks the failure of nationally recognized statistical rating organizations (NRSROs) DBRS, Fitch, Moody's and S&P Global to update methodologies for ABS flip clause swaps and adjust ABS ratings accordingly.

Corrective to Misrepresentation #3: *…subject to the Commission's margin rules for uncleared swaps, which the Commission approved and published on 16 December 2015 (i.e., 22 months before issuing Letter No. 17-52.)*

Moreover, US bank regulators had signaled the content of the CFTC margin rules in adopting a parallel set of margin rules for uncleared swaps two months earlier in October 2015 (i.e., two years before the CFTC issued Letter No. 17-52.) The CFTC margin rules are "practically identical to the rules of the United States banking regulators," stated then CFTC Commissioner Massad in voting to approve the CFTC rule on 16 December 2015.

On 4 February 2016, the private sector entities Navient, SFIG, JPMorgan Chase, Fitch and Moody's each disregarded the respective variation margin requirements of the CFTC and the US banking regulators. This represents a failure of the private sector.

Specifically, Navient arranged for JPMorgan Chase to provide a balance-guaranteed ABS flip clause swap to Navient Private Education Loan Trust 2016-A, a SLABS deal that closed on 4 February 2016. Navient did not establish a reserve account or provide other resources to enable Navient 2016-A to comply with the parallel variation margin requirements that the US banking regulators and the CFTC had announced three months earlier and six weeks earlier, respectively.

Likewise, JPMorgan Chase did not discharge the explicit responsibility that both sets of margin rules assign to a swap provider prior to entering into any uncleared swap — let alone a balance-guaranteed ABS flip clause swap — with a financial entity such as Navient 2016-A, namely to ensure the swap will comply with the variation margin requirements.

Fitch and Moody's each opted to ignore the variation margin requirements of both the CFTC and US banking regulators in assigning ratings to four classes of notes that Navient 2016-A issued.

Following are the respective announcements from Fitch and Moody's:
"Fitch assigned a AAA rating to the three senior most classes and a AA rating to the fourth, subordinated class;

and
"Moody's assigned a Aaa rating to the three senior most classes and a Aa3 rating to the fourth, subordinated class.

The Moody's announcement described the balance-guaranteed ABS flip clause swap but did not mention the variation margin rules that had been recently adopted.

"Basis Swap Mitigates Prime/LIBOR Basis Risk

"'The trust has entered into a basis swap at closing to mitigate the basis risk that exists because the index for 65.6% of the trust student loans is the Prime rate, while the index for the Class A-1 and A-2B is one-month LIBOR. The trust will pay the Prime rate minus 3% to the swap counterparty in exchange for one-month LIBOR. ***Because the swap terminates 8 to 10 years after closing, and the notional balance of the swap will be reduced by 50% after the swap step-down event, the transaction will be exposed to Prime/LIBOR basis risk in the tail-end of the transaction*** *[bold added to identify the balance-guarantee component of the ABS flip clause swap]. The transaction structure is, in our view, consistent with Aaa ratings because it can withstand Prime equal to one-month LIBOR + 1.50% until the Class A notes are paid in full in our Aaa cash flow analysis."*

Misrepresentation #4, pages 1-2: The variation margin requirements were the first rather than the last nail in the "replacement" coffin.

"…solely because the Commission's recently adopted margin requirements for uncleared swaps have reduced the likelihood that the SPV's SD swap counterparty could be replaced in the event that it suffers a credit rating downgrade that threatens the credit rating of the SPV's issued notes. [Footnote] 3."

"[Footnote] 3. See Moody's places four auto loan ABS under review for downgrade after updating its approach to counterparty risks (July 27, 2017), available at: https://www.moodys.com/research/Moodys-places-four-autoloan-ABS-under-review-for-downgrade--PR_370302, and Fitch Places 38 US ABS Tranches with Currency Swaps on RWN (Sept. 29 (sic), 2017), available at: https://www.fitchratings.com/site/pr/1028608. Moody's and Fitch had previously announced that the VM Requirements would cause them to reconsider ratings of certain SPV obligations. See Moody's updates its approach to assessing counterparty risks in structured finance (July 26, 2017), available at: https://www.moodys.com/research/Moodys-updates-itsapproach-to-assessing-counterparty-risks-in-structured--PR_368938, and Fitch: Pending US Swap Rules Could Impact Structured Finance Transactions (Nov. 17, 2016), available at: https://www.fitchratings.com/site/pr/1014938."

Systemic Harm: Misrepresentation #4 indicates that replacement is a valid market mechanic and rating assumption. In fact, all NRSRO rating agencies (including DBRS, Fitch, Moody's, and S&P Global), and all US regulators (including the CFTC), have had firsthand knowledge since 2008 that the replacement mechanic does not work. For more, see Appendix A to this letter.

Corrective to Misrepresentation #4: *Market realities reduced the likelihood that an SPV's SD swap counterparty could be replaced as far back as 2008. Rating agencies should have downgraded all notes where an SPV is party to an ABS flip clause swap in 2008. Since 2008, additional market, regulatory, legal and UK political developments have further reduced the likelihood of timely replacement to almost zero. [Footnote] 3.*

[Footnote] 3. See submission to the CFTC from William J. Harrington regarding "Capital Requirements for Swap Dealers and Major Swap Participants" of 4 May 2017 on cftc.gov.
This submission forms one of two parts of the comment dated 16 May 2017 that Mr. Harrington submitted to Moody's in response to "Moody's Proposes Revisions to Its Approach to Assessing Counterparty Risks in Structured Finance." Moody's reviewed the entirety of Mr. Harrington's comment of 16 May 2017 and posted it under the erroneous name of "Jeremiah Chase." See https://www.moodys.com/RFC/response/ViewComments/UEJTXzEwNzU3OTE=. Moody's also misrepresented the content of Mr. Harrington's comment in summarizing it and the three other comments received regarding the proposal. See https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1075791.

Mr. Harrington's CFTC submission of 4 May 2017 also forms the basis of — "Fitch Ratings Review of Navient Solvency & Swap Losses on USD 5 Billion of SLABS Residuals" — a letter that Mr. Harrington

submitted to the Fitch analyst for Navient Ms. Meghan Neenan, 12 of her colleagues, Navient staff, SFIG staff, SEC staff, ESMA staff and CFTC staff on 20 September 2017.

Appendix A of Mr. Harrington's submission to the CFTC of 4 May 2017 contains the correspondence between Mr. Harrington and Fitch Managing Director for Corporate Communications Mr. Daniel Noonan in which Mr. Harrington questions the replacement assumptions that Fitch cited in the announcement "Pending US Swap Rules Could Impact Structured Finance Transactions" of 17 November 2016, available at: https://www.fitchratings.com/site/pr/1014938."

Finally, the CFTC Letter No. 17-52 itself both forges and drives a new nail into the replacement coffin — the difficulty of replacing a defaulting counterparty. Moody's identified this new nail in the rationale for downgrading tranches in nine SLABS deals with ABS flip clause swaps on 11 January 2018.

*"*On 27 October 2017, the US Commodity Futures Trading Commission (CFTC) announced a no-action position with respect to variation margin requirements applicable to legacy swaps with special purpose vehicles (SPVs)….in our view, it does not materially increase the likelihood that, *if a counterparty defaults, the SPV will enter into a new swap with a replacement counterparty [underline added].* Moreover, the relief does not affect initial margin requirements."

Misrepresentation #5, page 1: Fitch issued a watchlist of ABS notes with exposure to ABS flip clause swaps on 29 September 2017, rather than 1 September 2017.

"[Footnote] 3… Fitch Places 38 US ABS Tranches with Currency Swaps on RWN (Sept. 29, 2017), available at: https://www.fitchratings.com/site/pr/1028608."

Systemic Harm: Misrepresentation #5 undermines the CFTC reputation for accuracy and integrity.

Corrective to Misrepresentation #5: *"[Footnote] 3… Fitch Places 38 US ABS Tranches with Currency Swaps on RWN (Sept. 1, 2017), available at: https://www.fitchratings.com/site/pr/1028608."*

Misrepresentation #6, page 2: The CFTC mission is to prop up inaccurate ABS ratings prices for as long as possible.

"Moody's indicated that the SPVs' notes will likely be downgraded by two to three notches. A downgrade of the securities issued by an SPV will, of course, affect its market value, thereby harming current holders of such obligations. Thus, the Commission's uncleared swap margin requirements as applied in this limited circumstance risks posing a serious threat to the price stability of these instruments…"

Systemic Harm (1): Misrepresentation #6 indicates that the CFTC endorses both inaccurate ABS ratings and inaccurate ABS rating guidance. Inaccurate ratings of ABS, including ABS where a trust was party to an ABS flip clause swap, started and fueled the financial crisis. Inaccurate ABS ratings also impede price discovery pertaining to ABS notes, direct capital to suboptimal uses, and disadvantage new ABS investors. In short, inaccurate ABS ratings and propped up ABS prices thwart capitalism.

Systemic Harm (2): Misrepresentation #6 indicates that the CFTC endorses inaccurate ratings, inaccurate rating guidance and inflated prices of NON-US ABS, such as EU ABS. The Moody's watchlist of 26 July 2017 and the Fitch watchlist of 1 September 2017 both were 100% comprised of SLABS tranches denominated in either euros or sterling. These ABS fall under the purview of EU regulators such as the ESMA and not the CFTC.

Systemic Harm (3): Misrepresentation #6 indicates that the CFTC engages in a fool's errand of predicting rating actions. In fact, Moody's downgraded 26 tranches in nine SLABS deals with ABS flip clause swaps on 11 January 2018. The Moody's announcement cited the CFTC Letter No. 17-52 as one driver of the downgrades.

"On 27 October 2017, the US Commodity Futures Trading Commission (CFTC) announced a no-action position with respect to variation margin requirements applicable to legacy swaps with special purpose vehicles (SPVs)….in our view, it does not materially increase the likelihood that, if a counterparty defaults, the SPV will enter into a new swap with a replacement counterparty [underline added]. Moreover, the relief does not affect initial margin requirements."

Corrective to Misrepresentation #6: *The CFTC should rescind the Letter No. 17-52 and disavow the policy of propping up ABS ratings and market prices, particularly the ratings and prices of EU ABS. Doing so will help convince rating agencies to assign accurate ratings to ABS notes where an SPV is party to an ABS flip clause swap. Timely downgrades indicate that a financial system is operating optimally. Conversely, stale and inaccurate ABS ratings indicate that special interests have captured the CFTC and distorted the basic workings of the financial system.*

The CFTC should disavow the policy of endorsing rating guidance as accurate. Moody's undercut its earlier rating guidance of 27 July 2017 — "the SPVs' notes will likely be downgraded by two to three notches" — on 30 August 2017. On that date, Moody's announced that it confirmed the Aaa (sf)

ratings on 10 classes of notes from four ABS transactions backed by auto loans issued by OSCAR US Funding Trust, OSCAR US Funding Trust II, OSCAR US Funding Trust IV, and OSCAR US Funding Trust V.

Mizuho Securities had completed certain remedial actions on behalf of the respective OSCAR deals — actions that pre-dated and did not require the CFTC no-action position, according to the Moody's announcement. The remedial actions — "the execution of amended documents and the entrustment of additional cash" — constituted AAA mitigation against the low likelihood of swap replacement.

"The additional cash entrustment serves as credit enhancement to the [OSCAR] notes to cover potential losses arising from the transaction becoming unhedged. The amended waterfall also enables any excess spread and principal collections available to the Subordinated Beneficial Interest to cover losses when that scenario arises.

"Moody's believes these additional credit enhancements are sufficient to mitigate the risks -- from the reduced likelihood of entering into a replacement swap -- to a level satisfactory to maintain the Aaa (sf) ratings."

Misrepresentation #7, page 2: The CFTC cannot assess counterparty exposure.

"…despite the fact that replacing the S[wap] D[ealer] counterparty to an SPV swap will not change the material economic terms [Footnote] 5 of the swap itself and has no effect on risk to the SPV, the noteholders, or the financial system."
"[Footnote] 5. As represented by the Sponsors, for the purposes hereof, 'material economic terms means the pricing and other economic terms typically documented in a transaction confirmation that establish the amount and timing of the SPV's obligations."

Systemic Harm: Misrepresentation #7 indicates that the CFTC cannot fulfil its mission ("to foster open, transparent, competitive, and financially sound markets") or perform a basic competency — (assess the counterparty exposure for investors in ABS notes where a trust is party to a balance-guaranteed ABS flip clause swap.)

Corrective to Misrepresentation #7: *The CFTC rejects all SFIG or Sponsor Navient representations and withdraws Letter No. 17-52. Some SFIG and Navient representations are patently nonsensical and the remainder intentionally obscure the undercapitalization of both parties — an SPV on one hand and a swap dealer on the other hand — to an ABS flip clause swap.*

The following is an example of a representation by SFIG and Sponsor Navient that is patent nonsense: "[R]eplacing the S[wap] D[ealer] counterparty to an SPV swap will not change the material economic terms of the swap itself and has no effect on risk to the SPV, the noteholders, or the financial system." In fact, rudimentary analysis of counterparty exposure starts with the understanding that replacing one SD counterparty (e.g., GOLDMAN SACHS MITSUI MARINE DERIVATIVE PRODUCTS LP) with a second SD counterparty (e.g., MORGAN STANLEY MUFG SECURITIES CO LTD) changes a fundamental economic term of a swap and thus has pronounced effect on risk to an SPV, noteholders, the Swap Dealer itself (by exposing itself to flip clause losses) and the financial system.

In turn, this nonsense obscures the market reality that in the limited instances where a second swap dealer has replaced an initial swap dealer, the new swap dealer has also excluded or amended economic terms that were present in the initial transaction.

Moreover, the CFTC operates under the maxim of "Fool the CFTC once, shame on SFIG. Fool the CFTC twice, shame on the CFTC." The CFTC cited 14 SFIG misrepresentations regarding ABS flip clause swaps, rating methodologies and ABS operating capabilities in a 2015 no-action letter — the CFTC Letter No. 15-21 of 31 March 2015.

Mr. William J. Harrington and Mr. Rick Michalek discussed the SFIG misrepresentations with the signatories to CFTC Letter No. 15-21, DSIO Acting Director Mr. Tom Smith and DSIO Chief Counsel Mr. Frank Fisanich, in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Mr. Harrington had previously itemized the SFIG misrepresentations in a letter of 15 May 2015 addressed to Mr. Smith, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

Mr. Harrington first informed Mr. Smith and Mr. Fisanich that the Letter No. 15-21 cited many SFIG misrepresentation in an email of 7 April 2015, an excerpt of which follows.

The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.

…

"For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

Misrepresentation #8, page 2: An earlier CFTC no-action letter that also pertained to ABS flip clause swaps — CFTC Letter No. 15-21 of 31 March 2015 — does *not* contain at least 14 SFIG misrepresentations.

"DSIO believes that no-action relief is necessary and appropriate within the limited circumstances described herein to maintain stability and price certainty for SPV-issued notes that were issued prior to the implementation of the Commission's uncleared swap margin requirements. [Footnote] 6"
"[Footnote] 6. DSIO has previously recognized the significant operational difficulties that may arise if compliance with the Commission's swap regulations was required of existing SPVs. See, e.g., CFTC Letter No. 15-21 (providing relief from compliance with certain business conduct and documentation requirements in connection with Legacy SPV Swaps, as defined therein); and CFTC Letter No. 12-45 (providing relief from "commodity pool" status to certain securitization vehicles formed prior to October 12, 2012)."

Systemic Harm: Misrepresentation #8 indicates that the CFTC cannot fulfil its mission ("to foster open, transparent, competitive, and financially sound markets") and demonstrates full regulatory capture with respect to Navient and SFIG.

Corrective to Misrepresentation #8: *The CFTC has rescinded Letter No. 15-21 of 31 March 2015 and Letter No. 17-52 of 27 October 2017.*

The CFTC operates under the maxim of "Fool the CFTC once, shame on SFIG. Fool the CFTC twice, shame on the CFTC." The CFTC cited 14 SFIG misrepresentations regarding ABS flip clause swaps, rating methodologies and ABS operating capabilities in a 2015 no-action letter — the CFTC Letter No. 15-21 of 31 March 2015.

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The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.

…
"For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

Misrepresentation #9 page 2: Swap dealers, originators of ABS trusts, and NRSRO rating agencies had *NO* responsibility to incorporate the margin rules for uncleared swaps into policy after the CFTC voted to adopt the rules on 16 December 2015.

”…in response to certain credit rating agency-related actions in respect of one or more Legacy SPV Swaps. [Footnote] 8.”
“[Footnote] 8. For purposes of this letter, ‘Legacy SPV Swap' means a swap executed prior to March 1, 2017.”

Systemic Harm (1): Misrepresentation #9 abets the private sector failure by swap dealers and ABS originators that entered into ABS flip clause swaps after the US banking regulators and the CFTC adopted the largely parallel sets of margin rules for uncleared swaps on 22 October 2015 and 16 December 2015, respectively.

Systemic Harm (2): Misrepresentation #9 also masks the failure of nationally recognized statistical rating organizations (NRSROs) DBRS, Fitch, Moody’s and S&P Global to update methodologies for ABS flip clause swaps and adjust ABS ratings soon after 16 December 2015.

The NRSRO actions in respect of one or more legacy SPV swaps were both incomplete and long overdue.

Only Moody’s issued a watchlist prior to the compliance date of 1 September 2017. Fitch issued a watchlist belatedly on 29 September 2017. Further, the Fitch and Moody’s watchlists contained only tranches of SPVs that are party to ABS flip clause swaps that reference currencies, rather than tranches of all SPVS that are party to any type of ABS flip clause swaps.

Neither DBRS nor S&P Global issued any watch lists.

Corrective to Misrepresentation #9: *For purposes of this letter, ‘Legacy SPV Swap’ means a swap executed prior to 16 December 2015, the date that the CFTC voted to adopt the margin rules for uncleared swaps (i.e., 22 months before issuing Letter No. 17-52.)*

The margin rules clearly state that: 1) it is the swap dealer that must ensure that a new swap with a financial entity complies with the variation margin requirement; 2) a new swap is one with a financial entity that is entered into or amended in any way from 1 March 2017 onward; and 3) the category of financial entity includes ABS trusts.

Moreover, US bank regulators had signaled the content of the CFTC margin rules in adopting a parallel set of margin rules for uncleared swaps two months earlier in October 2015 (i.e., two years before the CFTC issued Letter No. 17-52.) The CFTC margin rules are “practically identical to the rules of the United States banking regulators,” stated then CFTC Commissioner Massad in voting to approve the CFTC rule on 16 December 2015.

On 4 February 2016, the private sector entities Navient, SFIG, JPMorgan Chase, Fitch and Moody's each disregarded the respective variation margin requirements of the CFTC and the US banking regulators. This represents a failure of the private sector.

Specifically, Navient arranged for JPMorgan Chase to provide a balance-guaranteed ABS flip clause swap to Navient Private Education Loan Trust 2016-A, a SLABS deal that closed on 4 February 2016. Navient did not establish a reserve account or provide other resources to enable Navient 2016-A to comply with the parallel variation margin requirements that the US banking regulators and the CFTC had announced three months earlier and six weeks earlier, respectively.

Likewise, JPMorgan Chase did not discharge the explicit responsibility that both sets of margin rules assign to a swap provider prior to entering into any uncleared swap — let alone a balance-guaranteed ABS flip clause swap — with a financial entity such as Navient 2016-A, namely to ensure the swap will comply with the variation margin requirements.

Fitch and Moody's each opted to ignore the variation margin requirements of both the CFTC and US banking regulators in assigning ratings to four classes of notes that Navient 2016-A issued.

Following are the respective announcements from Fitch and Moody's:
"Fitch assigned a AAA rating to the three senior most classes and a AA rating to the fourth, subordinated class;
and
"Moody's assigned a Aaa rating to the three senior most classes and a Aa3 rating to the fourth, subordinated class.

The Moody's announcement described the balance-guaranteed ABS flip clause swap but did not mention the variation margin rules that had been recently adopted.

"Basis Swap Mitigates Prime/LIBOR Basis Risk

"'The trust has entered into a basis swap at closing to mitigate the basis risk that exists because the index for 65.6% of the trust student loans is the Prime rate, while the index for the Class A-1 and A-2B is one-month LIBOR. The trust will pay the Prime rate minus 3% to the swap counterparty in exchange for one-month LIBOR. ***Because the swap terminates 8 to 10 years after closing, and the notional balance of the swap will be reduced by 50% after the swap step-down event, the transaction will be exposed to Prime/LIBOR basis risk in the tail-end of the transaction*** *[bold added to identify the balance-guarantee component of the ABS flip clause swap]. The transaction structure is, in our view, consistent with Aaa ratings because it can withstand Prime equal to one-month LIBOR + 1.50% until the Class A notes are paid in full in our Aaa cash flow analysis."*

Misrepresentation #10 pages 2-3: The respective ABS ratings and the respective methodologies for ABS flip clause swaps of NRSRO rating agencies Fitch, Moody's and S&P serve the public.

"[Footnote] 8. For purposes of this letter, "Legacy SPV Swap" means a swap… between an SPV whose obligations currently have a credit rating from at least one of Moody's, Standard and Poor's Ratings Services ("S&P"), or Fitch and a counterparty that, at the time the swap was executed, had a credit rating from at least one of Moody's, S&P, or Fitch."

Systemic Harm: Misrepresentation #10 masks the harm that the ABS ratings and the methodologies for ABS flip clause swaps of NRSROs Fitch, Moody's and S&P create for the US economy, the US financial system and the international financial system. Fitch, Moody's and S&P base ABS ratings and methodologies for ABS flip clause swaps on a common assumption that governments will bailout or otherwise support ABS and ABS flip clause swaps.

See the section entitled "The 800-page gorilla—rating methodologies are protected speech" in my article "Moody's DoJ Settlement Won't Stop Fake Rating Analysis & Derivative Denial" of 14 January 2017.

Senior managers and staff at Fitch, Moody's and S&P, as well as other nationally recognized statistical rating organizations such as DBRS, KBRA and Morningstar, know that the respective ABS ratings are inaccurate and the respective methodologies for ABS flip clause swaps enable both parties to under-capitalize the respective exposures.

With respect to Moody's staff and managers, see my report to the Moody's Integrity Hotline, the SEC Office of Credit Ratings and the European Securities and Markets Authority regarding the "erroneous and knowingly inflated ratings of all parties to an uncleared swap with a flip clause around the world of 8 August 2017. This report cites Moody's Corp. CEO Mr. Ray McDaniel and four other Moody's senior managers as the employees responsible for the erroneous ratings.

With respect to Fitch staff and managers, please see Appendix A to this letter.

With respect to all rating agency staff and managers, please see my letter "Fitch Ratings Review of Navient Solvency & Swap Losses on USD 5B of SLABS Residuals" of 20 September 2017.

Corrective to Misrepresentation #10: *Remove all references to nationally recognized statistical rating organizations Fitch, Moody's and S&P as specified by the clear language of Title IX of the Dodd-Frank Act.*

Misrepresentation #11 page 3: An ABS SPV cannot take adaptive actions such as ones to comply with a new regulation.

"The Sponsors state that an SD would not be able to comply with Commission Regulation 23.153 because restrictions in SPVs' governing documentation may prevent an SPV from taking certain actions required by the SD to comply with such regulation."

Systemic Harm (1): Misrepresentation #11 ignores the capacity of an ABS SPV to quickly change fundamental components such as waterfall provisions, reserve accounts, legal final maturities and cleanup calls.

For one set of notable examples, see **Misrepresentation #1,** earlier in this letter. Mizuho Securities amended the waterfalls of four ABS SPVs to trap cash in reserve accounts for the benefit of investors on 30 August 2017, then withdrew cash from the reserve accounts to pay itself rather than investors on 25 December 2017. Moody's issued RAC with respect to both sets of actions by Mizuho Securities, i.e., the waterfall amendments that benefited investors of 30 August 2017 and the withdrawals from the new reserve accounts that harmed investors of 25 December 2017.

Systemic Harm (2): Misrepresentation #11 indicates that the CFTC is the dupe of Sponsor Navient. The company publicized its having acted to effectuate 80-plus changes to the legal final maturities and other material features of 50-plus FFELP ABS SPVs in an 18-month period from 2015 to 2017. With respect to the adjusted legal final maturities, amendments that Navient extended note maturities to as far in the future as 2083.

Corrective to Misrepresentation #11: *Most ABS SPVs have the ability to change fundamental components such as waterfall provisions, reserve accounts, legal final maturities and cleanup calls in a very timely manner.*

For instance, Mizuho Securities amended the waterfalls of four ABS SPVs on 30 August 2017, i.e., five weeks after Moody's had placed 10 notes in the four deals on negative watch on 27 July 2017. The respective amendments trapped cash in reserve accounts to insulate investors from exposure to ABS flip clause swaps if a swap dealer did not replace itself. By effectuating the waterfall amendments in such a timely manner, Mizuho Securities demonstrated that the private sector did not require the no-action position that CFTC provided in Letter No. 17-52 of 27 October 2017.

In fact, Letter No. 17-52 facilitated Mizuho Securities in subsequently harming investors in the same four SPVs. The company removed cash from the reserve accounts upon obtaining Moody's RAC to do so on 25 December 2017, i.e., less than two months after the CFTC issued Letter No. 17-52. Moody's cited CFTC Letter No. 17-52 as rationale: The letter "increases the likelihood that a downgraded counterparty will procure a novation to a replacement counterparty."

Similarly, Navient facilitated the effectuation of amendments to the legal final maturities of at least 50 classes of notes in 31 FFELP ABS SPVs in a 14-month period between 7 December 2015 and 8 February

2017. In total, USD 10bn of notes were amended with new legal final maturities that ranged from 2045 to 2083.

Navient announced each amendment promptly. See the first 15 announcements below, which are listed in reverse chronological order starting with the most recent. In turn, the first series of amendments, which Navient announced on 7 December 2015, was effectuated within three months of the company having established a system to facilitate these types of amendments on 16 September 2015. See the 16th and 17th announcements, further below.

Navient Announcements of Amendments that Extended the Legal Final Maturities of FFELP ABS Notes (reverse chronological order, starting with the most recent)

1. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $10 billion", **8 February 2017**. "Navient (Nasdaq:NAVI), the nation's leading loan management, servicing and asset recovery company, today announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $190 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Feb. 7, 2017, and extended the legal final maturity date on the B tranches of SLM Student Loan Trust 2008-8 to **2075**, SLM Student Loan Trust 2008-5 to **2073**, and SLM Student Loan Trust 2007-8 to **2083**."*
2. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to nearly $9.8 billion", **29 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $512 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 28, 2016, and extended the legal final maturity date on the A6 tranche of SLC Student Loan Trust 2006-1 and the B tranche of SLM Student Loan Trust 2005-4 to **2055**."*
3. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $9.3 billion", **13 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $170 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 12, 2016, and extended the legal final maturity date on the B tranches of SLC Student Loan Trust 2005-3, SLC Student Loan Trust 2006-1, and SLM Student Loan Trust 2005-8 to **2055** and the B tranche of SLM Student Loan Trust 2006-7 to **2056.**"*
4. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $9.1 billion", **5 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $706 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 2, 2016, and extended the legal final maturity date on the SLM Student Loan Trust 2013-3 A3 tranche to **2055** and the B tranche to **2076** and the B tranche of SLM Student Loan Trust 2012-5 to **2075**."*

5. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $8.4 billion", **29 November 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization totaling $573 million of bonds backed by federally guaranteed student loans. The amendment was effective as of Nov. 29, 2016, and extended the legal final maturity date on the SLM Student Loan Trust 2013-1 A3 tranche to **2055** and the B tranche to **2070.**"*
6. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $7.8 billion", **15 November 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization totaling $469 million of bonds backed by federally guaranteed student loans. The amendment was effective as of Nov. 14, 2016, and extended the legal final maturity date to **2049** on the A3 tranche of Navient Trust 2014-8.*
7. *"Navient announces $509 million FFELP ABS legal final maturity date extension, bringing total bonds extended to $7.3 billion", **4 October 2016.** "Navient…announced an amendment extending the final maturity date of $509 million in bonds issued by a Navient-sponsored securitization backed by federally guaranteed student loans. The amendment was effective as of Oct. 4, 2016, and extended the legal final maturity date to June 27, **2044**, on the Class A3 Notes issued by SLM Student Loan Trust 2013-5."*
8. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $6.8 billion", **13 June 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $800 million of bonds backed by federally guaranteed student loans. The amendment was effective as of June 13, 2016 and extended the legal final maturity date to **2043** on the senior tranche of SLM Trust 2013-2.*
9. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $6 billion", **6 June 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $1.1 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of June 6, 2016, and extend the legal final maturity date on SLM Trust 2003-14 A7 and B tranches to **2065**, SLM Trust 2004-3 A6 and B tranches to **2064**, and the subordinate tranche of SLM Trust 2014-1 to **2068**."*
10. *"Navient announces extension of legal final maturity date on $61 million in FFELP ABS", **22 April 2016.** "Navient…announced the amendment of the transaction agreement for SLC Student Loan Trust 2008-2, totaling $61 million of bonds backed by federally guaranteed student loans. The amendment was effective as of April 20, 2016, and extends the legal final maturity date on the subordinate tranche to **2066**."*
11. *"Navient announces extension of legal final maturity date of FFELP ABS, bringing total bonds extended to $4.8 billion", **18 April 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $1.2 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of April 18, 2016, and*

*extend the legal final maturity date on: SLM Student Loan Trust 2013-6 A3 tranche to **2055** and B tranche to **2083**; SLM Student Loan Trust 2014-2 A3 tranche to **2055** and B tranche to **2072**; and subordinate tranches of SLM Student Loan Trust 2008-7 and SLM Student Loan 2008-9 to **2083**."*

12. *"Navient announces extension of legal final maturity date of 6 FFELP bonds",**7 April 2016.** "Navient…announced the amendment of transaction agreements for six Navient-sponsored securitizations totaling $281 million of bonds backed by federally guaranteed student loans. The amendments were effective as of April 6, 2016, and extend the legal final maturity date on the subordinate tranches of SLM Student Loan Trust 2007-7 to **2070**, SLM Student Loan Trust 2008-2 to 2083, SLM Student Loan Trust 2008-3 to **2083**, SLM Student Loan Trust 2008-6 to **2083**, SLM Student Loan Trust 2012-2 to **2072** and SLM Student Loan Trust 2012-3 to **2072**."*
13. *"Navient announces extension of legal final maturity date of FFELP ABS", **8 March 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization trust totaling $150 million of bonds backed by federally guaranteed student loans. The amendments were effective as of March 7, 2016, and extend the legal final maturity date to **2055** on the senior tranche of SLC Student Loan Trust 2009-1." 'Navient is committed to supporting a well-functioning, transparent, and efficient market for our investors,' said Somsak Chivavibul, chief financial officer, Navient. 'We encourage all of our ABS bondholders to visit Navient's online investor communication forum at www.dealvector.com/navient to discuss requested legal final maturity date amendments with fellow investors or contact Navient directly.'"*
14. *"Navient announces extension of legal final maturity dates on two FFELP ABS trusts", **16 February 2016.** "Navient…announced the amendment of transaction agreements for two Navient-sponsored securitization trusts totaling $2 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of Feb. 16, 2016 and extend the legal final maturity date to **2045** on the senior tranche of SLM Student Trust 2012-4 and to **2070** on both the senior and subordinated tranches of SLM Student Trust 2012-8.*
15. *"Navient announces extension of legal final maturity dates on six FFELP ABS trusts", **7 December 2015.** "Navient…announced the amendment of transaction agreements for six Navient-sponsored securitization trusts totaling $1.1 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 2, 2015 and extend the legal final maturity date to **2083** on both the senior and subordinated tranches. The six trusts affected by today's amendments are Navient Student Loan Trusts 2014-2, 2014-3, 2014-4, 2014-5, 2014-6 and 2014-7."*

Navient Announcements of Actions to Facilitate Amendments to FFELP ABS SPVs

16. *"Navient announces online investor forum to facilitate communication with ABS bondholders", **16 September 2015.** "Navient…announced the launch of a new online investor forum designed to facilitate communication with bondholders of securities backed by federally guaranteed student*

loans. The forum is provided by Navient through DealVector.
"Through the new online investor forum, ABS investors can register to receive notifications regarding their bonds and can also communicate with Navient and directly with other bondholders through identity-protected messages.
"'As the largest issuer of student loan backed securities, Navient is committed to supporting a well-functioning, transparent, and efficient market for our investors,'" said Somsak Chivavibul, chief financial officer, Navient. 'To that end, we have adopted an innovative technology solution, and we encourage all of our ABS investors to register on DealVector's website.'
"To participate, bondholders can visit www.dealvector.com/navient or they can access the new online forum through a link at www.navient.com/abs."

17. *"Navient announces transaction agreement amendment for 16 ABS trusts"*, ***16 September 2015.***
"*Navient…announced the amendment of transaction agreements for 16 Navient-sponsored securitization trusts backed by federally guaranteed student loans. The amendments give Navient the option to purchase trust student loans aggregating up to 10 percent of the trust's initial pool balance as well as to provide loans to the trust under a revolving credit agreement at Navient's discretion.*
"The 16 trusts affected by today's amendments are SLM Student Loan Trusts 2003-1, 2003-4, 2003-5, 2003-7, 2003-11, 2003-14, 2004-1, 2004-3, 2004-10, 2005-4, 2005-5, 2005-10, 2006-1, 2007-6, 2007-8 and 2012-3.
"In December 2014, the servicing agreements for 17 Navient-sponsored securitization trusts backed by federally guaranteed student loans were similarly amended to give Navient the option to purchase trust student loans aggregating up to 10 percent of the trust's initial pool balance. The trusts affected by the December 2014 amendments were: SLM Student Loan Trusts 2002-1, 2002-7, 2003-2, 2003-3, 2006-3, 2007-2, 2007-3, 2007-7, 2008-1, 2008-2, 2008-3, 2008-4, 2008-5, 2008-6, 2008-7, 2008-8, and 2008-9."

Misrepresentation #12 page 3: The CFTC first announced the margin rules for uncleared swaps in 2016.

"The Commission published final margin requirements for such SDs in January 2016 (the 'Final Margin Rule'). [Footnote] 11"
"[Footnote] 11 See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The Final Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations. See §§ 23.150-159, 161."

Systemic Harm: Systemic Harm (1): Misrepresentation #12 masks the failure by major financial entities such as JPMorgan Chase and Navient to comply with the variation margin requirement despite having had almost two years to do so.

Systemic Harm (2): Misrepresentation #12 also masks the failure of nationally recognized statistical rating organizations (NRSROs) DBRS, Fitch, Moody's and S&P Global to update methodologies for ABS flip clause swaps and adjust ABS ratings accordingly.

Corrective to Misrepresentation #12: *…subject to the Commission's margin rules for uncleared swaps, which the Commission approved and published on 16 December 2015 (i.e., 22 months before issuing Letter No. 17-52.)*

Moreover, US bank regulators had signaled the content of the CFTC margin rules in adopting a parallel set of margin rules for uncleared swaps two months earlier in October 2015 (i.e., two years before the CFTC issued Letter No. 17-52.) The CFTC margin rules are "practically identical to the rules of the United States banking regulators," stated then CFTC Commissioner Massad in voting to approve the CFTC rule on 16 December 2015.

On 4 February 2016, the private sector entities Navient, SFIG, JPMorgan Chase, Fitch and Moody's each disregarded the respective variation margin requirements of the CFTC and the US banking regulators. This represents a failure of the private sector.

Specifically, Navient arranged for JPMorgan Chase to provide a balance-guaranteed ABS flip clause swap to Navient Private Education Loan Trust 2016-A, a SLABS deal that closed on 4 February 2016. Navient did not establish a reserve account or provide other resources to enable Navient 2016-A to comply with the parallel variation margin requirements that the US banking regulators and the CFTC had announced three months earlier and six weeks earlier, respectively.

Likewise, JPMorgan Chase did not discharge the explicit responsibility that both sets of margin rules assign to a swap provider prior to entering into any uncleared swap — let alone a balance-guaranteed ABS flip clause swap — with a financial entity such as Navient 2016-A, namely to ensure the swap will comply with the variation margin requirements.

Fitch and Moody's each opted to ignore the variation margin requirements of both the CFTC and US banking regulators in assigning ratings to four classes of notes that Navient 2016-A issued.

Following are the respective announcements from Fitch and Moody's:
"Fitch assigned a AAA rating to the three senior most classes and a AA rating to the fourth, subordinated class;
and
"Moody's assigned a Aaa rating to the three senior most classes and a Aa3 rating to the fourth, subordinated class.

The Moody's announcement described the balance-guaranteed ABS flip clause swap but did not mention the variation margin rules that had been recently adopted.

"Basis Swap Mitigates Prime/LIBOR Basis Risk

"'The trust has entered into a basis swap at closing to mitigate the basis risk that exists because the index for 65.6% of the trust student loans is the Prime rate, while the index for the Class A-1 and A-2B is one-month LIBOR. The trust will pay the Prime rate minus 3% to the swap counterparty in exchange for one-month LIBOR. ***Because the swap terminates 8 to 10 years after closing, and the notional balance of the swap will be reduced by 50% after the swap step-down event, the transaction will be exposed to Prime/LIBOR basis risk in the tail-end of the transaction*** *[bold added to identify the balance-guarantee component of the ABS flip clause swap]. The transaction structure is, in our view, consistent with Aaa ratings because it can withstand Prime equal to one-month LIBOR + 1.50% until the Class A notes are paid in full in our Aaa cash flow analysis."*

Misrepresentation #13 page 4: NRSRO rating agencies Fitch, Moody's and S&P develop Delinking Criteria to protect *investors* in notes of ABS SVPs that are parties to ABS flip clause swaps.

"By entering into a swap with an SD, the SPV takes on SD credit risk (i.e., the risk of nonperformance by the SD). The Sponsors represent that, *in order to minimize the impact of SD credit risk on the risk profile of the obligations issued by the SPV* [italics added], the rating agencies have developed criteria designed to isolate the credit risk of the SD (the "Delinking Criteria") so that the rating agencies may assign a credit rating to the obligations issued by the SPV based on the quality of the underlying assets of the SPV and the structural features of the SPV and with limited exposure to the credit quality of the SD."

Systemic Harm: Misrepresentation # 13 ignores the 19-year practice of NRSROS ratings agencies Fitch, Moody's and S&P to protect the *sponsors of ABS SPVs* in evaluating ABS flip clause swaps. This practice helped start and fuel the financial crisis.

Corrective to Misrepresentation #13: *To placate the sponsors of ABS SPVs, Fitch, S&P and Moody's preserve deficient criteria so as to continue assigning AAA-ratings and other top ratings to notes issued by an ABS SPV that is party to an ABS flip clause swap.*

See a Fitch announcement and S&P note, both published in response to CFTC Letter No. 17-52 of 27 October 2017:

1. *The announcement: Fitch Affirms 36 US ABS Classes; Removes Negative Watch following CFTCs No-Action Position of 7 November 2017.*
   "Fitch Ratings has affirmed 36 U.S. ABS tranches with currency swaps and removed the ratings from Negative Watch. The tranches were placed on Negative Watch on Sept. 1, 2017. This rating action is purely event driven following Commodity Futures Trading Commission's (CFTC) No-Action Position exempting novated or transferred legacy SPV swaps from variation margin posting. Full transaction level analysis was not reflected in this rating action."

2. *S&P Note: "CFTC No-Action Letter Reduces Concerns On Legacy Swap Replacements In U.S. Structured Finance Transactions" (17 November 2017.)*
   "On Oct. 27, 2017, the CFTC issued a "no action" letter that addresses the topic of legacy swaps in structured finance transactions. Based on this "no action" letter, we now understand that an SPE would not be required to post a margin, following the transfer of a swap to a new counterparty…As a result, we no longer consider that the CFTC margin rules potentially affect our view regarding the replaceability of legacy swaps in U.S. structured finance transactions. Accordingly, we are not proceeding with a review of the approximately 50 U.S. structured finance transactions, previously described in our Oct. 20 publication."

Also, see two articles by Bill Harrington:

1. *"Fitch Ratings Review of Navient Solvency & Swap Losses on USD 5B of SLABS Residuals," self-published on Linked.com, 20 September 2017;*
   and
2. *"Moody's bets Germany will support Deutsche Bank derivatives above all else," Debtwire ABS, 12 October 2016.*

Misrepresentation #14 page 4: A swap dealer or other provider of an ABS flip clause swap "can easily be replaced."

"Specifically, the Sponsors represent that rating agency criteria assume that the current SD can easily be replaced with a higher rated SD in the event the current SD is downgraded below a certain threshold (typically below a 'A' rating in the case of a transaction rated 'AAA'). In this manner, exposure to any single SD's credit risk is believed to be significantly diminished."

Systemic Harm (1): Misrepresentation #14 indicates that replacement is a valid market mechanic and rating assumption. In fact, all NRSRO rating agencies (including DBRS, Fitch, Moody's, and S&P Global), and all US regulators (including the CFTC), have had firsthand knowledge since 2008 that the replacement mechanic does not work. For more, see Appendix A to this letter.

Systemic Harm (2): Misrepresentation #14 indicates that the CFTC is the dupe of Sponsor Navient. The company has a long history of pressuring DBRS, Fitch, Moody's and S&P to dilute rating methodologies for ABS, including methodologies for ABS flip clause swaps.

Corrective to Misrepresentation #14: *Market realities reduced the likelihood that an SPV's SD swap counterparty could be replaced as far back as 2008. Rating agencies should have downgraded all notes where an SPV is party to an ABS flip clause swap in 2008. Since 2008, additional market, regulatory, legal and UK political developments have further reduced the likelihood of timely replacement to almost zero. [Footnote] 3.*

[Footnote] 3. See submission to the CFTC from William J. Harrington regarding "Capital Requirements for Swap Dealers and Major Swap Participants" of 4 May 2017 on cftc.gov.
This submission forms one of two parts of the comment dated 16 May 2017 that Mr. Harrington submitted to Moody's in response to "Moody's Proposes Revisions to Its Approach to Assessing Counterparty Risks in Structured Finance." Moody's reviewed the entirety of Mr. Harrington's comment of 16 May 2017 and posted it under the erroneous name of "Jeremiah Chase." See https://www.moodys.com/RFC/response/ViewComments/UEJTXzEwNzU3OTE=. Moody's also misrepresented the content of Mr. Harrington's comment in summarizing it and the three other comments received regarding the proposal. See https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1075791.

Mr. Harrington's CFTC submission of 4 May 2017 also forms the basis of — "Fitch Ratings Review of Navient Solvency & Swap Losses on USD 5 Billion of SLABS Residuals" — a letter that Mr. Harrington submitted to the Fitch analyst for Navient Ms. Meghan Neenan, 12 of her colleagues, Navient staff, SFIG staff, SEC staff, ESMA staff and CFTC staff on 20 September 2017.

Appendix A of Mr. Harrington's submission to the CFTC of 4 May 2017 contains the correspondence between Mr. Harrington and Fitch Managing Director for Corporate Communications Mr. Daniel Noonan in which Mr. Harrington questions the replacement assumptions that Fitch cited in the announcement

"Pending US Swap Rules Could Impact Structured Finance Transactions" of 17 November 2016, available at: https://www.fitchratings.com/site/pr/1014938."

Finally, the CFTC Letter No. 17-52 itself both forges and drives a new nail into the replacement coffin — the difficulty of replacing a defaulting counterparty. Moody's identified this new nail in the rationale for downgrading tranches in nine SLABS deals with ABS flip clause swaps on 11 January 2018.

"On 27 October 2017, the US Commodity Futures Trading Commission (CFTC) announced a no-action position with respect to variation margin requirements applicable to legacy swaps with special purpose vehicles (SPVs)….[I]n our view, it does not materially increase the likelihood that, *if a counterparty defaults, the SPV will enter into a new swap with a replacement counterparty [underline added].* Moreover, the relief does not affect initial margin requirements."

Misrepresentation #15 pages 4-5: The Navient and SFIG requests for a no-action position were *urgent* and might be needed in *as soon as 30 days*.

"The Sponsors explain that under the Delinking Criteria, certain provisions of the documents governing the Legacy SPV Swap (the "Legacy SPV Swap Documentation") require the SD to take one or more Remedial Actions (as defined below) within designated time periods (in many cases, 30 days or less) following the withdrawal, qualification, and/or downgrade of the SD's credit ratings below certain specified thresholds. The purpose of any Remedial Action is to quickly insulate the investors in obligations issued by the SPV from the credit risk of the SD."

Systemic Harm: Misrepresentation #15 indicates that holders of notes from an ABS SPV that is party to an ABS flip clause swap have recourse if a swap dealer does not "take one more Remedial Actions" within periods of as short as 30 days.

In fact, the holders of notes have little to no recourse, particularly when the swap dealer does not replace itself with a higher-rated swap dealer. Moreover, NRSRO rating agencies Fitch, Moody's and S&P have not downgraded notes even in instances when a swap dealer has failed to replace itself or take other remedial actions for years, let alone 30 days.

Corrective to Misrepresentation #15: *The Remedial Actions have few teeth. Failure of a swap dealer to perform a Remedial Action does not typically give rise to a termination event or default event on terms that benefit the ABS SPV.*

Moreover, NRSROs Fitch, Moody's and S&P typically ignore the failure of a swap dealer to replace itself or take other Remedial actions on behalf of investors in notes from an ABS SPV that is party to an ABS flip clause swap. Rather than downgrade the notes, Fitch, Moody's and S&P dilute the respective Delinking Criteria to facilitate a downgraded swap dealer in taking NO Remedial Actions.

A real world example has been playing out since 28 September 2017, when Fitch downgraded Deutsche Bank to BBB+. This rating triggered Remedial Actions such as collateralization or replacement under the Fitch Delinking Criteria, as Fitch was reported to have communicated to Deutsche Bank.

However, Deutsche Bank remained the provider of non-remediated ABS flip clause swaps to many ABS SPVs — including two that are Navient-sponsored, SLM Private Credit Student Loan Trust 2006-A and SLM Private Credit Student Loan Trust 2006-B — at the time of this writing. Even so, Fitch did not downgrade or watch list tranches in the two deals to reflect the increased exposure to Deutsche Bank that arises from its failure to perform remedial actions.

In short, Deutsche Bank took no remedial actions "to quickly insulate the investors in obligations issued by" the ABS SPVs within four-plus months, let alone 30 days. Fitch was fine with this failure of Deutsche Bank to take remedial actions on behalf of the deals.

Similarly, Deutsche Bank remained the provider of a currency ABS flip clause swap to a third Navient-sponsored SLABS — SLM Student Loan Trust 2005-9 — until 25 January 2018, i.e., almost four months after the Fitch downgrade of Deutsche Bank. The bank took no remedial actions "to quickly insulate the investors in obligations issued by the SPV" during this four-month period, let alone within 30 days. Fitch was also fine with this failure of Deutsche Bank to take remedial actions on behalf of the deal.

*Finally, Fitch Ratings waited more than four months for Deutsche Bank to **begin** remediating a much more basic exposure — that of 18 EU ABS SPVs to Deutsche Bank as an account bank, i.e., not as a swap counterparty. See the Fitch announcement: "Remedial Actions Underway for DB SF Account Bank Exposure" of 1 February 2018. "[R]emedial actions are being taken to remedy the counterparty risk following DB's recent downgrade."*

Misrepresentation #16 page 5: The CFTC cannot assess counterparty exposure.

"The taking of any Remedial Action will not affect the material economic terms of the Legacy SPV Swap."

Systemic Harm: Misrepresentation #16 indicates that the CFTC cannot fulfil its mission ("to foster open, transparent, competitive, and financially sound markets") or perform a basic competency — (assess the counterparty exposure for investors in ABS notes where a trust is party to a balance-guaranteed ABS flip clause swap.)

Corrective to Misrepresentation #16: *The CFTC rejects all SFIG or Sponsor Navient representations and withdraws Letter No. 17-52. Some SFIG and Navient representations are patently nonsensical and the remainder intentionally obscure the undercapitalization of both parties — an SPV on one hand and a swap dealer on the other hand — to an ABS flip clause swap.*

The following is an example of a representation by SFIG and Sponsor Navient that is patent nonsense: "[R]eplacing the S[wap] D[ealer] counterparty to an SPV swap will not change the material economic terms of the swap itself and has no effect on risk to the SPV, the noteholders, or the financial system." In fact, rudimentary analysis of counterparty exposure starts with the understanding that replacing one SD counterparty (e.g., GOLDMAN SACHS MITSUI MARINE DERIVATIVE PRODUCTS LP) with a second SD counterparty (e.g., MORGAN STANLEY MUFG SECURITIES CO LTD) changes a fundamental economic term of a swap and thus has pronounced effect on risk to an SPV, noteholders, the Swap Dealer itself (by exposing itself to flip clause losses) and the financial system.

In turn, this nonsense obscures the market reality that in the limited instances where a second swap dealer has replaced an initial swap dealer, the new swap dealer has also excluded or amended economic terms that were present in the initial transaction.

Moreover, the CFTC operates under the maxim of "Fool the CFTC once, shame on SFIG. Fool the CFTC twice, shame on the CFTC." The CFTC cited 14 SFIG misrepresentations regarding ABS flip clause swaps, rating methodologies and ABS operating capabilities in a 2015 no-action letter — the CFTC Letter No. 15-21 of 31 March 2015.

Mr. William J. Harrington and Mr. Rick Michalek discussed the SFIG misrepresentations with the signatories to CFTC Letter No. 15-21, DSIO Acting Director Mr. Tom Smith and DSIO Chief Counsel Mr. Frank Fisanich, in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Mr. Harrington had previously itemized the SFIG misrepresentations in a letter of 15 May 2015 addressed to Mr. Smith, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

Mr. Harrington first informed Mr. Smith and Mr. Fisanich that the Letter No. 15-21 cited many SFIG misrepresentation in an email of 7 April 2015, an excerpt of which follows.

The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.

…

"For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

Misrepresentation #17 page 5: Moody's Delinking Criteria allows a downgraded Swap Dealer and Moody's to negotiate post-closing changes in collateral agreements and other ABS flip clause swap documents.

"The Remedial Actions required to be taken by SDs and SPVs may include amending a Legacy SPV Swap or novating the obligations of the SD under a Legacy SPV Swap to a third party or an affiliate of the SD. [Footnote[16"

"[Footnote] 16 The Sponsors represent that "Remedial Action" means: (1) posting of collateral by the SD, which may require the SD and the SPV to enter into a collateral agreement **and amend the Legacy SPV Swap Documentation in order to give effect thereto** [bold added]; (2) replacing the downgraded SD with an entity who satisfies (or whose guarantor satisfies) the applicable credit rating requirements of the Legacy SPV Swap **(which may require making certain technical amendments to the Legacy SPV Swap Documentation)** [bold added]; (3) obtaining a guaranty of the SD's obligations under the Legacy SPV Swap from a guarantor that satisfies the requisite credit ratings; **or (4) taking any other action as agreed with each relevant rating agency through procedures that are specified in the Legacy SPV Swap Documentation** [bold added]."

Systemic Harm (1): Misrepresentation #17 encourages a downgraded Swap Dealer to believe that it can renege on posting collateral, arranging replacement, or obtaining a guarantee, i.e., to avoid fulfilling the very obligations that the Delinking Criteria specify for neutralizing the impact of increased exposure to a downgraded Swap Dealer on ABS investors.

Systemic Harm (2): Misrepresentation #17 encourages a downgraded Swap Dealer to renege on posting collateral, arranging replacement, or obtaining a guarantee, i.e., to avoid fulfilling the very obligations that the Delinking Criteria specify for neutralizing the impact of increased exposure to a downgraded Swap Dealer on ABS investors.

Corrective to Misrepresentation #17: *The Moody's Delinking Criteria that obtained globally from 26 May 2006 to 12 November 2013 ("Framework for De-Linking Counterparty Risks from Global Structured Finance Cashflow Transactions or Moody's Hedge Framework) explicitly excluded post-closing amendments such as amendments to collateral agreements, "technical amendments to the Legacy SPV Swap Documentation," or "taking any other action as agreed with" Moody's.*

Instead, Moody's Hedge Framework prescribed a comprehensive suite of contractual provisions that were to be in place when a Swap Dealer and ABS SPV entered into an ABS flip clause swap.

Accordingly, a Swap Dealer may not rely on the no-action position contained in CFTC Letter No. 17-52 of 27 October 2017 with respect to an ABS flip clause swap that an SPV with Moody's-rated debt entered between 26 May 2006 and 12 November 2013.

a. *An ABS SPV with Moody's-rated debt that complied with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12*

November 2013 will not need to amend the swap. In short, a Swap Dealer will never be required to invoke the no-action position in the first place.

b. *An ABS SPV that did **not** comply with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 did not use the applicable Moody's "Delinking Criteria." This failure disqualifies a Swap Dealer from treating the ABS flip clause swap as one that is covered by the no-action position.*

The following is a partial list of seventeen ABS deals with Moody's rated debt that entered into an ABS flip clause swap between 26 May 2006 and 12 November 2013.

17 Student Loan Securitizations with ABS Flip Clause Swaps Subject to Moody's Hedge Framework (Shading denotes a Swap Dealer provisionally registered with the CFTC.)
Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.

1. *Goal Capital Funding Trust 2006-1 – Swap Dealer not identified*
2. *SLM Private Credit Student Loan Trust 2006-B – Deutsche Bank New York*
3. *SLM Private Credit Student Loan Trust 2006-C – Bank of America NA*
4. *SLM Student Loan Trust 2006-10 – Barclays Capital Markets (Euro 208mm / USD 266mm)*
5. *SLM Private Credit Student Loan Trust 2007-A – Credit Suisse First Boston International*
6. *SLM Student Loan Trust 2007-4 – Barclays Capital (Euro 205mm / USD 274mm)*
7. *SLC Student Loan Trust 2008-01 – Credit Suisse First Boston International (euro 115mm / USD 178mm)*
8. *SLM Private Education Student Loan Trust 2010-C – Royal Bank of Scotland*
9. *New Mexico Educational Assistance Foundation - Education Loan Bonds (2010 Indenture) – Swap Dealer not identified*
10. *SLM Private Education Student Loan Trust 2011-C – Royal Bank of Canada, Toronto*
11. *SLM Private Education Student Loan Trust 2012-A – GSMMDP*
12. *SLM Private Education Student Loan Trust 2012-B – Bank of New York*
13. *SLM Private Education Student Loan Trust 2012-C – Bank of New York*
14. *SLM Private Education Student Loan Trust 2012-D – Royal Bank of Canada, Toronto*
15. *SLM Private Education Student Loan Trust 2012-E – Bank of New York*
16. *SLM Private Education Student Loan Trust 2013-A – Bank of New York*
17. *SLM Private Education Student Loan Trust 2013-B – Bank of New York*

William J. Harrington, a co-author and lead developer of Moody's Hedge Framework, described its content to DSIO staff in an email dated 7 April 2015 and in a letter of 15 May 2015 addressed to DSIO staff, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

Mr. Harrington and former Moody's colleague Mr. Rick Michalek discussed the content of Moody's Hedge Framework and the corresponding SFIG misrepresentations with the signatories to CFTC Letter No. 15-21, DSIO Acting Director Mr. Tom Smith and DSIO Chief Counsel Mr. Frank Fisanich, in a

teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Mr. Harrington cited the following provisions of Moody's Hedge Framework that explicitly excluded post-closing amendments.

1. *"In general, where a hedge counterparty (a "Counterparty") agrees at the outset to adhere to rating triggers and remedies that are of a nature substantially as specified in this Framework, Moody's opinion is that that this would substantially mitigate the impact of Counterparty exposure on the expected loss of the cashflow transaction." See page 1, second paragraph.*
2. *Moody's Hedge Framework "specifies Counterparty obligations upfront and does not contemplate their being supplanted in the future by 'other such remedies as may be agreed at a later date.' Alternatives to this framework will be considered at closing where the relevant provisions are already in place, rather than being left open-ended for future specification." See page 4, last paragraph.*
3. *"Tables 2A & 2B list the Counterparty obligations associated with each [rating] category. Upon entering a hedge, a Counterparty would execute agreements necessary for it to perform its obligations, including those activated upon its rating reaching either the First Trigger or Second Trigger, such as a Schedule to Master incorporating provisions consistent with this framework, a credit support annex, and, where necessary to support the Counterparty's rating above the First Trigger at time of closing, letters of credit or guarantees [footnote] 7. None of these obligations may be contingent upon issuance of Rating Agency Confirmation by Moody's prior to being activated." See page 6, last paragraph.*
4. *"Timing for CSA [—] Closing." See Table 2A "Counterparty Obligations, SPV Remedies and Timing," first line, page 15.*

Mr. Harrington cited the entirety of Moody's Hedge Framework with respect to the comprehensive suite of contractual provisions that were to be in place when a Swap Dealer and ABS SPV entered into an ABS flip clause swap.

Misrepresentation #18 page 5: A Swap Dealer that has been downgraded does not pose additional risk to ABS investors or to itself.

"Although any such action will not…increase the risks to the SPV or its noteholders."

Systemic Harm (1): Misrepresentation #18, which has enabled downgraded Swap Dealers to renege on posting collateral, arranging replacement, or obtaining guarantees under the guise of "taking no action constitutes an action," *does* "increase the risks to the SPV" and "its noteholders."

1. Structured Credit Investor (SCI) reported on Swap Dealers having reneged on obligations to post collateral, arrange replacement, or obtain guarantees viz-a-viz an estimated 150 ABS transactions in the period 2010-2013. The SCI article "Counterparty conundrums" of 2 August 2013 describes these Swap Dealer "taking no action actions" in detail. See "Questions for the SEC Open Meeting of 5 February 2014," submitted by William J. Harrington, (HTML pages 19-21.)

   "Nevertheless, research undertaken by ex-Moody's svp William Harrington shows that the agency has issued 96 rating agency confirmations (RACs) covering 177 ABS transactions…For at least 78 of the RACs, the swap counterparty successfully petitioned Moody's to be allowed to amend an existing derivative contract with an ABS transaction so as to avoid posting collateral and/or finding a replacement counterparty [underline added]."

2. Moody's issued RACs with respect to 11 separate decisions by Goldman Sachs to renege on obligations to replace itself as counterparty to ABS deals on 20 July 2012.

   "Moody's has determined that no downgrade or withdrawal of the current Moody's ratings of the notes (the "Notes") issued by any of the 11 SF CDO transactions listed below (the "Issuers") will result solely due to Goldman Sachs International (the "Swap Counterparty") neither (A) transferring [underline added] all of its rights and obligations under the applicable swap agreements the ("Agreements") between it and the corresponding Issuer to another entity which has the required minimum ratings set forth in the Agreements nor (B) causing an entity with such required ratings to guarantee or provide an indemnity [underline added] in respect of the Swap Counterparty or its Credit Support Provider's obligations under the Agreement."

Systemic Harm (12): Misrepresentation #18 subjects a Swap Dealer to the self-referencing exposure of its own credit profile under an ABS flip clause swap. By "taking no action, which

constitutes an action," a Swap Dealer increases the likelihood that a flip clause will be activated against it.

Mr. William J. Harrington submitted a detailed evaluation of the risks that ABS flip clause swaps pose to Swap Dealers in a submission to the CFTC dated 4 May 2017.

"The bankruptcy of Lehman Brothers provided a real-world example of a bankrupt swap provider that received USD 0.00 per USD 1.00 owed under 100% of in-the-money, uncleared swaps that contained flip clauses with 44 securitization issuers. United States Bankruptcy Judge Shelley C. Chapman detailed these "payments" of USD 0.00 in a ruling on *Lehman Brothers Special Financing Inc. vs. Bank of America National Association et al of 28 June 2016." (Page 10.)*

Corrective to Misrepresentation #18: *A downgraded Swap Dealer that is party to an ABS flip clause swap poses additional risk to both ABS investors and itself. Accordingly, a downgraded Swap Dealer must fulfill contractual obligation to post collateral, arrange replacement or obtain a guarantee. In plain language, a downgraded Swap Dealer must not characterize reneging on obligations, i.e., taking no action, as an "action" that has been agreed with a credit rating agency.*

Misrepresentation #19 page 5: Swap dealers, originators of ABS trusts, and NRSRO rating agencies had *NO* responsibility to incorporate the margin rules for uncleared swaps into policy after the CFTC voted to adopt the rules on 16 December 2015.

"This is significant because, as discussed above, the Legacy SPV Swap may not previously have been subject to or affected by the VM Requirements because it was entered into prior to the compliance date of such regulations."

Systemic Harm (1): Misrepresentation #19 abets the private sector failure by swap dealers and ABS originators that entered into ABS flip clause swaps after the US banking regulators and the CFTC adopted the largely parallel sets of margin rules for uncleared swaps on 22 October 2015 and 16 December 2015, respectively.

Systemic Harm (2): Misrepresentation #19 also masks the failure of nationally recognized statistical rating organizations (NRSROs) DBRS, Fitch, Moody's and S&P Global to update methodologies for ABS flip clause swaps and adjust ABS ratings soon after 16 December 2015.

The NRSRO actions in respect of one or more legacy SPV swaps were both incomplete and long overdue.

Only Moody's issued a watchlist prior to the compliance date of 1 September 2017. Fitch issued a watchlist belatedly on 29 September 2017. Further, the Fitch and Moody's watchlists contained only tranches of SPVs that are party to ABS flip clause swaps that reference currencies, rather than tranches of all SPVS that are party to any type of ABS flip clause swaps.

Neither DBRS nor S&P Global issued any watch lists.

Corrective to Misrepresentation #19: *For purposes of this letter, 'Legacy SPV Swap' means a swap executed prior to 16 December 2015, the date that the CFTC voted to adopt the margin rules for uncleared swaps (i.e., 22 months before issuing Letter No. 17-52.)*

The margin rules clearly state that: 1) it is the swap dealer that must ensure that a new swap with a financial entity complies with the variation margin requirement; 2) a new swap is one with a financial entity that is entered into or amended in any way from 1 March 2017 onward; and 3) the category of financial entity includes ABS trusts.

Moreover, US bank regulators had signaled the content of the CFTC margin rules in adopting a parallel set of margin rules for uncleared swaps two months earlier in October 2015 (i.e., two years before the CFTC issued Letter No. 17-52.) The CFTC margin rules are "practically identical to the rules of the United States banking regulators," stated then CFTC Commissioner Massad in voting to approve the CFTC rule on 16 December 2015.

On 4 February 2016, the private sector entities Navient, SFIG, JPMorgan Chase, Fitch and Moody's each disregarded the respective variation margin requirements of the CFTC and the US banking regulators. This represents a failure of the private sector.

Specifically, Navient arranged for JPMorgan Chase to provide a balance-guaranteed ABS flip clause swap to Navient Private Education Loan Trust 2016-A, a SLABS deal that closed on 4 February 2016. Navient did not establish a reserve account or provide other resources to enable Navient 2016-A to comply with the parallel variation margin requirements that the US banking regulators and the CFTC had announced three months earlier and six weeks earlier, respectively.

Likewise, JPMorgan Chase did not discharge the explicit responsibility that both sets of margin rules assign to a swap provider prior to entering into any uncleared swap — let alone a balance-guaranteed ABS flip clause swap — with a financial entity such as Navient 2016-A, namely to ensure the swap will comply with the variation margin requirements.

Fitch and Moody's each opted to ignore the variation margin requirements of both the CFTC and US banking regulators in assigning ratings to four classes of notes that Navient 2016-A issued.

Following are the respective announcements from Fitch and Moody's:
"Fitch assigned a AAA rating to the three senior most classes and a AA rating to the fourth, subordinated class;
and
"Moody's assigned a Aaa rating to the three senior most classes and a Aa3 rating to the fourth, subordinated class.

The Moody's announcement described the balance-guaranteed ABS flip clause swap but did not mention the variation margin rules that had been recently adopted.

"Basis Swap Mitigates Prime/LIBOR Basis Risk

"'The trust has entered into a basis swap at closing to mitigate the basis risk that exists because the index for 65.6% of the trust student loans is the Prime rate, while the index for the Class A-1 and A-2B is one-month LIBOR. The trust will pay the Prime rate minus 3% to the swap counterparty in exchange for one-month LIBOR. ***Because the swap terminates 8 to 10 years after closing, and the notional balance of the swap will be reduced by 50% after the swap step-down event, the transaction will be exposed to Prime/LIBOR basis risk in the tail-end of the transaction*** *[bold added to identify the balance-guarantee component of the ABS flip clause swap]. The transaction structure is, in our view, consistent with Aaa ratings because it can withstand Prime equal to one-month LIBOR + 1.50% until the Class A notes are paid in full in our Aaa cash flow analysis."*

Misrepresentation #20 page 5: An ABS SPV must take action in order to hold collateral that a Swap Dealer posts or to benefit from a guarantee that the Swap Dealer obtains.

"As described above, certain of the Remedial Actions require action to be taken by both the SD and the SPV that are party to a Legacy SPV Swap."

Systemic Harm: Misrepresentation #20 undermines the contractual provisions in an ABS flip clause swap that obligate a Swap Dealer to undertake actions on behalf of an SPV.

Corrective to Misrepresentation #20: *Few if any Remedial Actions by a Swap Dealer, such as posting collateral, arranging replacement or obtaining a guarantee, require action to be taken by an SPV with Moody's-rated debt that entered into an ABS flip clause swap between 26 May 2006 and 12 November 2013.*

The Moody's Delinking Criteria that obtained globally from 26 May 2006 to 12 November 2013 ("Framework for De-Linking Counterparty Risks from Global Structured Finance Cashflow Transactions or Moody's Hedge Framework) specified that an ABS SPV complete all swap documentation, including that for a credit support annex, upon entering into an ABS flip clause swap. Moreover, Moody's Hedge Framework assigns many of the housekeeping tasks associated with the Remedial Actions to an SD in recognition of the limited capabilities of an SPV.

Accordingly, a Swap Dealer may not rely on the no-action position contained in CFTC Letter No. 17-52 of 27 October 2017 with respect to an ABS flip clause swap that an SPV with Moody's-rated debt entered between 26 May 2006 and 12 November 2013.

a. *An ABS SPV with Moody's-rated debt that complied with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 will not need to amend the swap. In short, a Swap Dealer will never be required to invoke the no-action position in the first place.*
b. *An ABS SPV that did **not** comply with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 did not use the applicable Moody's "Delinking Criteria." This failure disqualifies a Swap Dealer from treating the ABS flip clause swap as one that is covered by the no-action position.*

The following is a partial list of seventeen ABS deals with Moody's rated debt that entered into an ABS flip clause swap between 26 May 2006 and 12 November 2013.

17 Student Loan Securitizations with ABS Flip Clause Swaps Subject to Moody's Hedge Framework (Shading denotes a Swap Dealer provisionally registered with the CFTC.)
Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.

1. *Goal Capital Funding Trust 2006-1 – Swap Dealer not identified*
2. *SLM Private Credit Student Loan Trust 2006-B – Deutsche Bank New York*
3. *SLM Private Credit Student Loan Trust 2006-C – Bank of America NA*

4. *SLM Student Loan Trust 2006-10 – Barclays Capital Markets (Euro 208mm / USD 266mm)*
5. *SLM Private Credit Student Loan Trust 2007-A – Credit Suisse First Boston International*
6. *SLM Student Loan Trust 2007-4 – Barclays Capital (Euro 205mm / USD 274mm)*
7. *SLC Student Loan Trust 2008-01 – Credit Suisse First Boston International (euro 115mm / USD 178mm)*
8. *SLM Private Education Student Loan Trust 2010-C – Royal Bank of Scotland*
9. *New Mexico Educational Assistance Foundation - Education Loan Bonds (2010 Indenture) – Swap Dealer not identified*
10. *SLM Private Education Student Loan Trust 2011-C – Royal Bank of Canada, Toronto*
11. *SLM Private Education Student Loan Trust 2012-A – GSMMDP*
12. *SLM Private Education Student Loan Trust 2012-B – Bank of New York*
13. *SLM Private Education Student Loan Trust 2012-C – Bank of New York*
14. *SLM Private Education Student Loan Trust 2012-D – Royal Bank of Canada, Toronto*
15. *SLM Private Education Student Loan Trust 2012-E – Bank of New York*
16. *SLM Private Education Student Loan Trust 2013-A – Bank of New York*
17. *SLM Private Education Student Loan Trust 2013-B – Bank of New York*

Following are pertinent excerpts from Moody's Hedge Framework, i.e., excerpts that specify that an ABS SPV complete all swap documentation, including that for a credit support annex, upon entering into an ABS flip clause swap.

"SPVs do not typically have the resources or capacity to carry out many of their rights and obligations unassisted under these hedge agreements. Further, the agents of these SPVS and their debtholders (such as trustees) may not always have the mandate or resources to fully protect the interests of the cashflow transaction under the hedges. Therefore, 'market standard' contractual terms in hedges involving institutional market parties are not always appropriate for hedges with cashflow transactions. The framework uses market standards wherever possible and adjusts them where necessary to address the limited capacities of an SPV [underlining added]. The principal adjustment occurs with respect to a Counterparty paying for its own replacement; several others follow from the potential time needed for replacement to occur and reliance on the Counterparty to discharge this and certain other tasks."
See page 5, first paragraph.

"An SPV or its arranger should establish a separate collateral account at closing [underlining added], secured to its Trustee, for the sole purpose of holding collateral that may be posted at a later date, should the ratings of the Counterparty be downgraded to one of the triggers in this framework."
See page 7, sixth paragraph.

"As the cashflow transaction does not have the capacity to make calculations [underlining added] of the hedge mid-market valuation, DV01, etc., the Counterparty should usually be required to calculate collateral requirements. For the same reasons, demand for collateral should be 'deemed' to occur [underlining added] either daily or weekly, consistent with the Collateral Amounts and Valuations specified in the CSA."
See page 7, last paragraph.

"The ISDA agreement is designed for hedges between large institutions that are able to look after their own interests. Such institutions have the resources to provide timely notices, monitor Counterparty circumstances and calculations and to terminate the hedge when it is advisable to do so. However, when one of the parties to a hedge is an SPV in a cashflow transaction, the SPV may [underlining added] not have adequate capital resources to do these things, but instead rely upon the Counterparty's calculations, notices and goodwill. It is therefore necessary to amend certain of the Events of Default and Termination Events accordingly to reflect these realities [underlining added]."
Page 9, first full paragraph.

Misrepresentation #21 page 5: An SPV sponsor such as Navient cannot induce an SPV to approve an adaptive action such as an amendment to governing documents.

"However, the Sponsors represent that, due to their limited purpose nature, it is very difficult to cause SPVs to take any action not explicitly contemplated by the Legacy SPV Swap Documentation…The permitted activities of SPVs, therefore, are significantly limited through covenants contained in their constitutive documents and transaction agreements, and generally do not include entering into new arrangements or modifications of the kind that may be required to enable an SD to comply with its regulatory obligations under the VM Requirements.

Systemic Harm (1): Misrepresentation #21 ignores the capacity of an ABS SPV to quickly change fundamental components such as waterfall provisions, reserve accounts, legal final maturities and cleanup calls.

For one set of notable examples, see **Misrepresentation #1,** earlier in this letter. Mizuho Securities amended the waterfalls of four ABS SPVs to trap cash in reserve accounts for the benefit of investors on 30 August 2017, then withdrew cash from the reserve accounts to pay itself rather than investors on 25 December 2017. Moody's issued RAC with respect to both sets of actions by Mizuho Securities, i.e., the waterfall amendments that benefited investors of 30 August 2017 and the withdrawals from the new reserve accounts that harmed investors of 25 December 2017.

Systemic Harm (2): Misrepresentation #21 indicates that the CFTC is the dupe of Sponsor Navient. The company publicized its having acted to effectuate 80-plus changes to the legal final maturities and other material features of 50-plus FFELP ABS SPVs in an 18-month period from 2015 to 2017. With respect to the adjusted legal final maturities, amendments that Navient extended note maturities to as far in the future as 2083.

Corrective to Misrepresentation #21: *The Sponsor Navient and the former Sponsor Mizuho Securities can easily induce their respective sponsored SPVs to take many actions, including those not explicitly contemplated by the Legacy SPV Swap Documentation.*

Sponsor Navient has had great success in inducing its sponsored SPVs to enter into new arrangements and modifications that legal final maturities and cleanup calls in a very timely manner. Former Sponsor Mizuho has had great success in inducing its sponsored SPVs to enter into new arrangements with respect to waterfall provisions and reserve accounts.

For instance, Mizuho Securities amended the waterfalls of four ABS SPVs on 30 August 2017, i.e., five weeks after Moody's had placed 10 notes in the four deals on negative watch on 27 July 2017. The respective amendments trapped cash in reserve accounts to insulate investors from exposure to ABS flip clause swaps if a swap dealer did not replace itself. By effectuating the waterfall amendments in such a timely manner, Mizuho Securities demonstrated that the private sector did not require the no-action position that CFTC provided in Letter No. 17-52 of 27 October 2017.

In fact, Letter No. 17-52 facilitated Mizuho Securities in subsequently harming investors in the same four SPVs. The company removed cash from the reserve accounts upon obtaining Moody's RAC to do so on 25 December 2017, i.e., less than two months after the CFTC issued Letter No. 17-52. Moody's cited CFTC Letter No. 17-52 as rationale: The letter "increases the likelihood that a downgraded counterparty will procure a novation to a replacement counterparty."

Similarly, Navient facilitated the effectuation of amendments to the legal final maturities of at least 50 classes of notes in 31 FFELP ABS SPVs in a 14-month period between 7 December 2015 and 8 February 2017. In total, USD 10bn of notes were amended with new legal final maturities that ranged from 2045 to 2083.

Navient announced each amendment promptly. See the first 15 announcements below, which are listed in reverse chronological order starting with the most recent. In turn, the first series of amendments, which Navient announced on 7 December 2015, was effectuated within three months of the company having established a system to facilitate these types of amendments on 16 September 2015. See the 16th and 17th announcements, further below.

Navient Announcements of Amendments that Extended the Legal Final Maturities of FFELP ABS Notes (reverse chronological order, starting with the most recent)

1. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $10 billion", **8 February 2017**. "Navient (Nasdaq:NAVI), the nation's leading loan management, servicing and asset recovery company, today announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $190 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Feb. 7, 2017, and extended the legal final maturity date on the B tranches of SLM Student Loan Trust 2008-8 to **2075**, SLM Student Loan Trust 2008-5 to **2073**, and SLM Student Loan Trust 2007-8 to **2083**."*
2. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to nearly $9.8 billion", **29 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $512 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 28, 2016, and extended the legal final maturity date on the A6 tranche of SLC Student Loan Trust 2006-1 and the B tranche of SLM Student Loan Trust 2005-4 to **2055**."*
3. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $9.3 billion", **13 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $170 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 12, 2016, and extended the legal final maturity date on the B tranches of SLC Student Loan Trust 2005-3, SLC Student Loan Trust 2006-1, and SLM Student Loan Trust 2005-8 to **2055** and the B tranche of SLM Student Loan Trust 2006-7 to **2056.**"*

4. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $9.1 billion"**, 5 December 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $706 million of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 2, 2016, and extended the legal final maturity date on the SLM Student Loan Trust 2013-3 A3 tranche to **2055** and the B tranche to **2076** and the B tranche of SLM Student Loan Trust 2012-5 to **2075**."*
5. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $8.4 billion"**, 29 November 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization totaling $573 million of bonds backed by federally guaranteed student loans. The amendment was effective as of Nov. 29, 2016, and extended the legal final maturity date on the SLM Student Loan Trust 2013-1 A3 tranche to **2055** and the B tranche to **2070.**"*
6. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $7.8 billion"**, 15 November 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization totaling $469 million of bonds backed by federally guaranteed student loans. The amendment was effective as of Nov. 14, 2016, and extended the legal final maturity date to **2049** on the A3 tranche of Navient Trust 2014-8.*
7. *"Navient announces $509 million FFELP ABS legal final maturity date extension, bringing total bonds extended to $7.3 billion"**, 4 October 2016.** "Navient…announced an amendment extending the final maturity date of $509 million in bonds issued by a Navient-sponsored securitization backed by federally guaranteed student loans. The amendment was effective as of Oct. 4, 2016, and extended the legal final maturity date to June 27, **2044**, on the Class A3 Notes issued by SLM Student Loan Trust 2013-5."*
8. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $6.8 billion"**, 13 June 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $800 million of bonds backed by federally guaranteed student loans. The amendment was effective as of June 13, 2016 and extended the legal final maturity date to **2043** on the senior tranche of SLM Trust 2013-2.*
9. *"Navient announces extension of legal final maturity dates of FFELP ABS, bringing total bonds extended to $6 billion"**, 6 June 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $1.1 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of June 6, 2016, and extend the legal final maturity date on SLM Trust 2003-14 A7 and B tranches to **2065**, SLM Trust 2004-3 A6 and B tranches to **2064**, and the subordinate tranche of SLM Trust 2014-1 to **2068**."*
10. *"Navient announces extension of legal final maturity date on $61 million in FFELP ABS"**, 22 April 2016.** "Navient…announced the amendment of the transaction agreement for SLC Student Loan*

*Trust 2008-2, totaling $61 million of bonds backed by federally guaranteed student loans. The amendment was effective as of April 20, 2016, and extends the legal final maturity date on the subordinate tranche to **2066**."*

11. *"Navient announces extension of legal final maturity date of FFELP ABS, bringing total bonds extended to $4.8 billion"**, 18 April 2016.** "Navient…announced the amendment of transaction agreements for Navient-sponsored securitizations totaling $1.2 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of April 18, 2016, and extend the legal final maturity date on: SLM Student Loan Trust 2013-6 A3 tranche to **2055** and B tranche to **2083**; SLM Student Loan Trust 2014-2 A3 tranche to **2055** and B tranche to **2072**; and subordinate tranches of SLM Student Loan Trust 2008-7 and SLM Student Loan 2008-9 to **2083**."*
12. *"Navient announces extension of legal final maturity date of 6 FFELP bonds"**,7 April 2016.** "Navient…announced the amendment of transaction agreements for six Navient-sponsored securitizations totaling $281 million of bonds backed by federally guaranteed student loans. The amendments were effective as of April 6, 2016, and extend the legal final maturity date on the subordinate tranches of SLM Student Loan Trust 2007-7 to **2070**, SLM Student Loan Trust 2008-2 to 2083, SLM Student Loan Trust 2008-3 to **2083**, SLM Student Loan Trust 2008-6 to **2083**, SLM Student Loan Trust 2012-2 to **2072** and SLM Student Loan Trust 2012-3 to **2072**."*
13. *"Navient announces extension of legal final maturity date of FFELP ABS"**, 8 March 2016.** "Navient…announced the amendment of transaction agreements for a Navient-sponsored securitization trust totaling $150 million of bonds backed by federally guaranteed student loans. The amendments were effective as of March 7, 2016, and extend the legal final maturity date to **2055** on the senior tranche of SLC Student Loan Trust 2009-1." 'Navient is committed to supporting a well-functioning, transparent, and efficient market for our investors,' said Somsak Chivavibul, chief financial officer, Navient. 'We encourage all of our ABS bondholders to visit Navient's online investor communication forum at www.dealvector.com/navient to discuss requested legal final maturity date amendments with fellow investors or contact Navient directly.'"*
14. *"Navient announces extension of legal final maturity dates on two FFELP ABS trusts"**, 16 February 2016.** "Navient…announced the amendment of transaction agreements for two Navient-sponsored securitization trusts totaling $2 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of Feb. 16, 2016 and extend the legal final maturity date to **2045** on the senior tranche of SLM Student Trust 2012-4 and to **2070** on both the senior and subordinated tranches of SLM Student Trust 2012-8.*
15. *"Navient announces extension of legal final maturity dates on six FFELP ABS trusts"**, 7 December 2015.** "Navient…announced the amendment of transaction agreements for six Navient-sponsored securitization trusts totaling $1.1 billion of bonds backed by federally guaranteed student loans. The amendments were effective as of Dec. 2, 2015 and extend the legal final maturity date to **2083** on both the senior and subordinated tranches. The six trusts affected by*

today's amendments are Navient Student Loan Trusts 2014-2, 2014-3, 2014-4, 2014-5, 2014-6 and 2014-7."

Navient Announcements of Actions to Facilitate Amendments to FFELP ABS SPVs

16. *"Navient announces online investor forum to facilitate communication with ABS bondholders"*, ***16 September 2015.*** *"Navient…announced the launch of a new online investor forum designed to facilitate communication with bondholders of securities backed by federally guaranteed student loans. The forum is provided by Navient through DealVector.*
"Through the new online investor forum, ABS investors can register to receive notifications regarding their bonds and can also communicate with Navient and directly with other bondholders through identity-protected messages.
"'As the largest issuer of student loan backed securities, Navient is committed to supporting a well-functioning, transparent, and efficient market for our investors,'" said Somsak Chivavibul, chief financial officer, Navient. 'To that end, we have adopted an innovative technology solution, and we encourage all of our ABS investors to register on DealVector's website.'
"To participate, bondholders can visit www.dealvector.com/navient or they can access the new online forum through a link at www.navient.com/abs."
17. *"Navient announces transaction agreement amendment for 16 ABS trusts"*, ***16 September 2015.*** ***"****Navient…announced the amendment of transaction agreements for 16 Navient-sponsored securitization trusts backed by federally guaranteed student loans. The amendments give Navient the option to purchase trust student loans aggregating up to 10 percent of the trust's initial pool balance as well as to provide loans to the trust under a revolving credit agreement at Navient's discretion.*
"The 16 trusts affected by today's amendments are SLM Student Loan Trusts 2003-1, 2003-4, 2003-5, 2003-7, 2003-11, 2003-14, 2004-1, 2004-3, 2004-10, 2005-4, 2005-5, 2005-10, 2006-1, 2007-6, 2007-8 and 2012-3.
"In December 2014, the servicing agreements for 17 Navient-sponsored securitization trusts backed by federally guaranteed student loans were similarly amended to give Navient the option to purchase trust student loans aggregating up to 10 percent of the trust's initial pool balance. The trusts affected by the December 2014 amendments were: SLM Student Loan Trusts 2002-1, 2002-7, 2003-2, 2003-3, 2006-3, 2007-2, 2007-3, 2007-7, 2008-1, 2008-2, 2008-3, 2008-4, 2008-5, 2008-6, 2008-7, 2008-8, and 2008-9."

Misrepresentation #22 page 6: Swap dealers, originators of ABS trusts, and NRSRO rating agencies had *NO* responsibility to incorporate the margin rules for uncleared swaps into policy after the CFTC voted to adopt the rules on 16 December 2015.

"Furthermore, at the time these agreements were put in place, being required to comply with the VM Requirements was not contemplated and, therefore, not addressed under the Legacy SPV Swap Documentation and related structured finance transaction agreements."

Systemic Harm (1): Misrepresentation #22 abets the private sector failure by swap dealers and ABS originators that entered into ABS flip clause swaps after the US banking regulators and the CFTC adopted the largely parallel sets of margin rules for uncleared swaps on 22 October 2015 and 16 December 2015, respectively.

Systemic Harm (2): Misrepresentation #22 also masks the failure of nationally recognized statistical rating organizations (NRSROs) DBRS, Fitch, Moody's and S&P Global to update methodologies for ABS flip clause swaps and adjust ABS ratings soon after 16 December 2015.

The NRSRO actions in respect of one or more legacy SPV swaps were both incomplete and long overdue.

Only Moody's issued a watchlist prior to the compliance date of 1 September 2017. Fitch issued a watchlist belatedly on 29 September 2017. Further, the Fitch and Moody's watchlists contained only tranches of SPVs that are party to ABS flip clause swaps that reference currencies, rather than tranches of all SPVS that are party to any type of ABS flip clause swaps.

Neither DBRS nor S&P Global issued any watch lists.

Corrective to Misrepresentation #19: *For purposes of this letter, 'Legacy SPV Swap' means a swap executed prior to 16 December 2015, the date that the CFTC voted to adopt the margin rules for uncleared swaps (i.e., 22 months before issuing Letter No. 17-52.)*

The margin rules clearly state that: 1) it is the swap dealer that must ensure that a new swap with a financial entity complies with the variation margin requirement; 2) a new swap is one with a financial entity that is entered into or amended in any way from 1 March 2017 onward; and 3) the category of financial entity includes ABS trusts.

Moreover, US bank regulators had signaled the content of the CFTC margin rules in adopting a parallel set of margin rules for uncleared swaps two months earlier in October 2015 (i.e., two years before the CFTC issued Letter No. 17-52.) The CFTC margin rules are "practically identical to the rules of the United States banking regulators," stated then CFTC Commissioner Massad in voting to approve the CFTC rule on 16 December 2015.

On 4 February 2016, the private sector entities Navient, SFIG, JPMorgan Chase, Fitch and Moody's each disregarded the respective variation margin requirements of the CFTC and the US banking regulators. This represents a failure of the private sector.

Specifically, Navient arranged for JPMorgan Chase to provide a balance-guaranteed ABS flip clause swap to Navient Private Education Loan Trust 2016-A, a SLABS deal that closed on 4 February 2016. Navient did not establish a reserve account or provide other resources to enable Navient 2016-A to comply with the parallel variation margin requirements that the US banking regulators and the CFTC had announced three months earlier and six weeks earlier, respectively.

Likewise, JPMorgan Chase did not discharge the explicit responsibility that both sets of margin rules assign to a swap provider prior to entering into any uncleared swap — let alone a balance-guaranteed ABS flip clause swap — with a financial entity such as Navient 2016-A, namely to ensure the swap will comply with the variation margin requirements.

Fitch and Moody's each opted to ignore the variation margin requirements of both the CFTC and US banking regulators in assigning ratings to four classes of notes that Navient 2016-A issued.

Following are the respective announcements from Fitch and Moody's:
"Fitch assigned a AAA rating to the three senior most classes and a AA rating to the fourth, subordinated class;
and
"Moody's assigned a Aaa rating to the three senior most classes and a Aa3 rating to the fourth, subordinated class.

The Moody's announcement described the balance-guaranteed ABS flip clause swap but did not mention the variation margin rules that had been recently adopted.

"Basis Swap Mitigates Prime/LIBOR Basis Risk

"'The trust has entered into a basis swap at closing to mitigate the basis risk that exists because the index for 65.6% of the trust student loans is the Prime rate, while the index for the Class A-1 and A-2B is one-month LIBOR. The trust will pay the Prime rate minus 3% to the swap counterparty in exchange for one-month LIBOR. ***Because the swap terminates 8 to 10 years after closing, and the notional balance of the swap will be reduced by 50% after the swap step-down event, the transaction will be exposed to Prime/LIBOR basis risk in the tail-end of the transaction*** *[bold added to identify the balance-guarantee component of the ABS flip clause swap]. The transaction structure is, in our view, consistent with Aaa ratings because it can withstand Prime equal to one-month LIBOR + 1.50% until the Class A notes are paid in full in our Aaa cash flow analysis."*

Misrepresentation #23 page 6: The variation margin requirements were the first rather than the last nail in the "replacement" coffin.

"Finally, due to the inability of the SPVs to make changes necessary for an SD counterparty to comply with the VM Requirements, it is also unlikely that a new SD counterparty could replace a downgraded SD counterparty, because the new SD counterparty would also be required to comply with the VM Requirements."

Systemic Harm: Misrepresentation #23 indicates that replacement is a valid market mechanic and rating assumption. In fact, all NRSRO rating agencies (including DBRS, Fitch, Moody's, and S&P Global), and all US regulators (including the CFTC), have had firsthand knowledge since 2008 that the replacement mechanic does not work. For more, see Appendix A to this letter.

Corrective to Misrepresentation #23: *Market realities reduced the likelihood that an SPV's SD swap counterparty could be replaced as far back as 2008. Rating agencies should have downgraded all notes where an SPV is party to an ABS flip clause swap in 2008. Since 2008, additional market, regulatory, legal and UK political developments have further reduced the likelihood of timely replacement to almost zero. [Footnote] 3.*

[Footnote] 3. See submission to the CFTC from William J. Harrington regarding "Capital Requirements for Swap Dealers and Major Swap Participants" of 4 May 2017 on cftc.gov.
This submission forms one of two parts of the comment dated 16 May 2017 that Mr. Harrington submitted to Moody's in response to "Moody's Proposes Revisions to Its Approach to Assessing Counterparty Risks in Structured Finance." Moody's reviewed the entirety of Mr. Harrington's comment of 16 May 2017 and posted it under the erroneous name of "Jeremiah Chase." See https://www.moodys.com/RFC/response/ViewComments/UEJTXzEwNzU3OTE=. Moody's also misrepresented the content of Mr. Harrington's comment in summarizing it and the three other comments received regarding the proposal. See https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1075791.

Mr. Harrington's CFTC submission of 4 May 2017 also forms the basis of — "Fitch Ratings Review of Navient Solvency & Swap Losses on USD 5 Billion of SLABS Residuals" — a letter that Mr. Harrington submitted to the Fitch analyst for Navient Ms. Meghan Neenan, 12 of her colleagues, Navient staff, SFIG staff, SEC staff, ESMA staff and CFTC staff on 20 September 2017.

Appendix A of Mr. Harrington's submission to the CFTC of 4 May 2017 contains the correspondence between Mr. Harrington and Fitch Managing Director for Corporate Communications Mr. Daniel Noonan in which Mr. Harrington questions the replacement assumptions that Fitch cited in the announcement "Pending US Swap Rules Could Impact Structured Finance Transactions" of 17 November 2016, available at: https://www.fitchratings.com/site/pr/1014938."

Finally, the CFTC Letter No. 17-52 itself both forges and drives a new nail into the replacement coffin — the difficulty of replacing a defaulting counterparty. Moody's identified this new nail in the rationale for downgrading tranches in nine SLABS deals with ABS flip clause swaps on 11 January 2018.

*"*On 27 October 2017, the US Commodity Futures Trading Commission (CFTC) announced a no-action position with respect to variation margin requirements applicable to legacy swaps with special purpose vehicles (SPVs)….[I]n our view, it does not materially increase the likelihood that, *if a counterparty defaults, the SPV will enter into a new swap with a replacement counterparty [underline added].* Moreover, the relief does not affect initial margin requirements."

Misrepresentation #24 page 6: ABS downgrades are bad. Declining market values of ABS are bad. Propping up ABS ratings and ABS market values to protect current investors at the expense of new investors is good.

"Because of this reduced likelihood of SD counterparty replacement, the SPV's notes face material credit downgrades, which risk posing a serious threat to the price stability of these instruments."

"A downgrade of the obligations of an SPV will, of course, affect their market value, thereby harming current holders of such obligations. If a holder is restricted to only the highest-rated tranches, it may be forced to sell at a time when others are also forced to sell, which could result in additional losses."

Systemic Harm (1): Misrepresentation #24 suggests that the CFTC should work to prevent ABS downgrades and price declines as a matter of policy. Such a policy undermines free market efficiency by favoring current investors who did not perform due diligence over potential investors who did perform due diligence and would buy lower-rated ABS at lower prices. Moreover, such policy harms current investors by depriving them of information that might prompt them to accept moderate losses today to avoid massive losses in the future.

Systemic Harm (2): Misrepresentation #24 suggests that the CFTC should distort free market operations in the EU. Most of the ABS downgrades and watchlists that Sponsors Navient and SFIG cited in lobbying for the no-action position pertained to ABS denominated in Euros or sterling.

Systemic Harm (3): Misrepresentation #24 indicates that the CFTC engages in a fool's errand of predicting rating actions. In fact, Moody's downgraded 26 tranches in nine SLABS deals with ABS flip clause swaps on 11 January 2018. The Moody's announcement cited the CFTC Letter No. 17-52 as one driver of the downgrades.

"On 27 October 2017, the US Commodity Futures Trading Commission (CFTC) announced a no-action position with respect to variation margin requirements applicable to legacy swaps with special purpose vehicles (SPVs)….in our view, it does not materially increase the likelihood that, if a counterparty defaults, the SPV will enter into a new swap with a replacement counterparty [underline added]. Moreover, the relief does not affect initial margin requirements."

Systemic Harm (4): Misrepresentation #24 indicates that the CFTC does not examine market data. The Moody's downgrades on 11 January 2018 did not cause either sharp price changes or forced selling of the downgraded ABS.

Systemic Harm (5): Misrepresentation #24 indicates that the CFTC is a stooge of Navient and SFIG. The no-action position that the CFTC provided in Letter No. 17-52 of 27 October 2017 did not prevent the Moody's downgrades of 11 January, the earlier misrepresentations of Navient and SFIG notwithstanding.

Corrective to Misrepresentation #24: *The longstanding failure of robust replacement mechanisms has indicated that ABS from an SPV that is party to an ABS flip clause swap should have been downgraded during or immediately after the financial crisis. Efficient markets require ABS ratings and ABS prices to reflect all risks posed to investors. ABS from an SPV that is party to an ABS flip clause swap have significantly more risk than ABS that are similar in all respects except that the respective SPV is not party to an ABS flip clause swap. Moreover, ABS from an SPV that is party to a balance-guaranteed, ABS flip clause currency swap with a legal final maturity in 2041 is posed to exponentially more risk than ABS that are similar in all respects except that the respective SPV is not party to an ABS flip clause swap.*

Misrepresentation #25 page 6: The CFTC cannot assess counterparty exposure.

"DSIO notes that these consequences may occur despite the fact that a change in SD counterparty would not entail any change in the material economic terms of the swap, nor would it entail any additional risk to the SPV, the noteholders, or the financial system."

Systemic Harm: Misrepresentation #25 indicates that the CFTC cannot fulfil its mission ("to foster open, transparent, competitive, and financially sound markets") or perform a basic competency — (assess the counterparty exposure for investors in ABS notes where a trust is party to a balance-guaranteed ABS flip clause swap.)

Corrective to Misrepresentation #25: *The CFTC rejects all SFIG or Sponsor Navient representations and withdraws Letter No. 17-52. Some SFIG and Navient representations are patently nonsensical and the remainder intentionally obscure the undercapitalization of both parties — an SPV on one hand and a swap dealer on the other hand — to an ABS flip clause swap.*

The following is an example of a representation by SFIG and Sponsor Navient that is patent nonsense: "[R]eplacing the S[wap] D[ealer] counterparty to an SPV swap will not change the material economic terms of the swap itself and has no effect on risk to the SPV, the noteholders, or the financial system." In fact, rudimentary analysis of counterparty exposure starts with the understanding that replacing one SD counterparty (e.g., GOLDMAN SACHS MITSUI MARINE DERIVATIVE PRODUCTS LP) with a second SD counterparty (e.g., MORGAN STANLEY MUFG SECURITIES CO LTD) changes a fundamental economic term of a swap and thus has pronounced effect on risk to an SPV, noteholders, the Swap Dealer itself (by exposing itself to flip clause losses) and the financial system.

In turn, this nonsense obscures the market reality that in the limited instances where a second swap dealer has replaced an initial swap dealer, the new swap dealer has also excluded or amended economic terms that were present in the initial transaction.

Moreover, the CFTC operates under the maxim of "Fool the CFTC once, shame on SFIG. Fool the CFTC twice, shame on the CFTC." The CFTC cited 14 SFIG misrepresentations regarding ABS flip clause swaps, rating methodologies and ABS operating capabilities in a 2015 no-action letter — the CFTC Letter No. 15-21 of 31 March 2015.

Mr. William J. Harrington and Mr. Rick Michalek discussed the SFIG misrepresentations with the signatories to CFTC Letter No. 15-21, DSIO Acting Director Mr. Tom Smith and DSIO Chief Counsel Mr. Frank Fisanich, in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Mr. Harrington had previously itemized the SFIG misrepresentations in a letter of 15 May 2015 addressed to Mr. Smith, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

Mr. Harrington first informed Mr. Smith and Mr. Fisanich that the Letter No. 15-21 cited many SFIG misrepresentation in an email of 7 April 2015, an excerpt of which follows.

The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.

…

"For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

Misrepresentation #26 page 6: Sponsors Navient and SFIG provide information that is accurate and actionable.

"Based on the foregoing, DSIO believes that a no-action position is warranted."

Systemic Harm: Misrepresentation #26 harms Swap Dealers, current investors, and future investors by endorsing lobbying catchphrases that serve a single company — Navient.

Corrective to Misrepresentation #26: *The DSIO disregards all representations that Sponsors Navient and SFIG have made and concludes that a no-action position is NOT warranted.*

Misrepresentation #27 pages 6-7: The following type of ABS flip clause swap qualifies as a Legacy SPV Swap and is therefore covered by the no-action position: An ABS flip clause swap that an SPV with Moody's-rated debt entered into during the seven-plus year period from 26 May 2006 to 12 November 2013.

"Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the VM Requirements as such regulations may apply to a Legacy SPV Swap, subject to the following conditions:

"(1) The VM Requirements apply to the SD with respect to the Legacy SPV Swap solely as a result of one or more Remedial Actions taken in accordance with the applicable Delinking Criteria of one or more nationally-recognized rating agencies that have rated one or more of the SPV's obligations in response to an actual or reasonably anticipated withdrawal, qualification, and/or downgrade of the credit ratings of the original counterparty to the Legacy SPV Swap."

Systemic Harm: Misrepresentation #27 overstates the ABS flip clause swaps to which the no-action position applies. This masks the risks that are posed to investors in Moody's-rated ABS, and to the respective Swap Dealer, where an SPV is party to an ABS flip clause swap that commenced during the seven-plus year period from 26 May 2006 to 12 November 2013.

Corrective to Misrepresentation #27: *A Swap Dealer must comply with the VM Requirements as such regulations may apply to an ABS flip clause swap that an SPV with Moody's-rated debt entered into during the seven-plus year period from 26 May 2006 to 12 November 2013.*

The Moody's Delinking Criteria that obtained globally from 26 May 2006 to 12 November 2013 ("Framework for De-Linking Counterparty Risks from Global Structured Finance Cashflow Transactions or Moody's Hedge Framework) specified that an ABS SPV complete all swap documentation, including that for a credit support annex, upon entering into an ABS flip clause swap. Moreover, Moody's Hedge Framework assigns many of the housekeeping tasks associated with the Remedial Actions to an SD in recognition of the limited capabilities of an SPV.

Accordingly, a Swap Dealer may not rely on the no-action position contained in CFTC Letter No. 17-52 of 27 October 2017 with respect to an ABS flip clause swap that an SPV with Moody's-rated debt entered between 26 May 2006 and 12 November 2013.

a. *An ABS SPV with Moody's-rated debt that complied with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 will not need to amend the swap. In short, a Swap Dealer will never be required to invoke the no-action position in the first place.*
b. *An ABS SPV that did **not** comply with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 did not use the applicable Moody's "Delinking Criteria." This failure disqualifies a Swap Dealer from treating the ABS flip clause swap as one that is covered by the no-action position.*

The following is a partial list of seventeen ABS deals with Moody's rated debt that entered into an ABS flip clause swap between 26 May 2006 and 12 November 2013.

17 Student Loan Securitizations with ABS Flip Clause Swaps Subject to Moody's Hedge Framework (Shading denotes a Swap Dealer provisionally registered with the CFTC.)
Sources: Navient Website as of 30 January 2018; Rating Agency Announcements and Reports; and CFTC.gov.

1. *Goal Capital Funding Trust 2006-1 – Swap Dealer not identified*
2. *SLM Private Credit Student Loan Trust 2006-B – Deutsche Bank New York*
3. *SLM Private Credit Student Loan Trust 2006-C – Bank of America NA*
4. *SLM Student Loan Trust 2006-10 – Barclays Capital Markets (Euro 208mm / USD 266mm)*
5. *SLM Private Credit Student Loan Trust 2007-A – Credit Suisse First Boston International*
6. *SLM Student Loan Trust 2007-4 – Barclays Capital (Euro 205mm / USD 274mm)*
7. *SLC Student Loan Trust 2008-01 – Credit Suisse First Boston International (euro 115mm / USD 178mm)*
8. *SLM Private Education Student Loan Trust 2010-C – Royal Bank of Scotland*
9. *New Mexico Educational Assistance Foundation - Education Loan Bonds (2010 Indenture) – Swap Dealer not identified*
10. *SLM Private Education Student Loan Trust 2011-C – Royal Bank of Canada, Toronto*
11. *SLM Private Education Student Loan Trust 2012-A – GSMMDP*
12. *SLM Private Education Student Loan Trust 2012-B – Bank of New York*
13. *SLM Private Education Student Loan Trust 2012-C – Bank of New York*
14. *SLM Private Education Student Loan Trust 2012-D – Royal Bank of Canada, Toronto*
15. *SLM Private Education Student Loan Trust 2012-E – Bank of New York*
16. *SLM Private Education Student Loan Trust 2013-A – Bank of New York*
17. *SLM Private Education Student Loan Trust 2013-B – Bank of New York*

These seventeen ABS deals, and possibly others, fall into one of two categories. Both categories obligate a Swap Dealer to comply with the VM Requirements for an ABS flip clause swap.

1. *An ABS SPV with Moody's-rated debt that complied with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 will not need to amend the swap. In short, a Swap Dealer will never be required to invoke the no-action position in the first place.*

   Following are representative excerpts from Moody's Hedge Framework.

   "SPVs do not typically have the resources or capacity to carry out many of their rights and obligations unassisted under these hedge agreements. Further, the agents of these SPVS and their debtholders (such as trustees) may not always have the mandate or resources to fully protect the interests of the cashflow transaction under the hedges. Therefore, 'market standard' contractual terms in hedges involving institutional market parties are not always appropriate for hedges with cashflow transactions. The framework uses market standards wherever possible and

adjusts them where necessary to address the limited capacities of an SPV [underline added]. The principal adjustment occurs with respect to a Counterparty paying for its own replacement; several others follow from the potential time needed for replacement to occur and reliance on the Counterparty to discharge this and certain other tasks."
See page 5, first paragraph.

"An SPV or its arranger should establish a separate collateral account at closing [underline added], secured to its Trustee, for the sole purpose of holding collateral that may be posted at a later date, should the ratings of the Counterparty be downgraded to one of the triggers in this framework."
See page 7, sixth paragraph.

"As the cashflow transaction does not have the capacity to make calculations [underline added] of the hedge mid-market valuation, DV01, etc., the Counterparty should usually be required to calculate collateral requirements. For the same reasons, demand for collateral should be 'deemed' to occur [underline added] either daily or weekly, consistent with the Collateral Amounts and Valuations specified in the CSA."
See page 7, last paragraph.

"The ISDA agreement is designed for hedges between large institutions that are able to look after their own interests. Such institutions have the resources to provide timely notices, monitor Counterparty circumstances and calculations and to terminate the hedge when it is advisable to do so. However, when one of the parties to a hedge is an SPV in a cashflow transaction, the SPV may [underline added] not have adequate capital resources to do these things, but instead rely upon the Counterparty's calculations, notices and goodwill. It is therefore necessary to amend certain of the Events of Default and Termination Events accordingly [i.e., tailor the ISDA standard upfront] to reflect these realities [underline added]."
Page 9, first full paragraph.

2. *An ABS SPV that did **not** comply with Moody's Hedge Framework upon entering an ABS flip clause swap during the seven-plus year period from 26 May 2006 to 12 November 2013 did not use the applicable Moody's "Delinking Criteria." This failure disqualifies a Swap Dealer from treating the ABS flip clause swap as one that is covered by the no-action position.*

   Following is a representative excerpt from Moody's Hedge Framework.

   "Moody's Hedge Framework "specifies Counterparty obligations upfront and does not contemplate their being supplanted in the future by 'other such remedies as may be agreed at a

later date.' Alternatives to this framework will be considered at closing where the relevant provisions are already in place [underline added] rather than being left open-ended for future specification."
See page 4, last paragraph.

Misrepresentation #28 pages 6-7: The CFTC cannot assess counterparty exposure.

"Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the VM Requirements as such regulations may apply to a Legacy SPV Swap, subject to the following conditions:

…

"(2) Any Remedial Action taken in accordance with the applicable Delinking Criteria does not alter the material economic terms of the Legacy SPV Swap."

Systemic Harm: Misrepresentation #28 indicates that the CFTC cannot fulfil its mission ("to foster open, transparent, competitive, and financially sound markets") or perform a basic competency — (assess the counterparty exposure for investors in ABS notes where a trust is party to a balance-guaranteed ABS flip clause swap.)

Corrective to Misrepresentation #28: *The CFTC rejects all SFIG or Sponsor Navient representations and withdraws Letter No. 17-52. Some SFIG and Navient representations are patently nonsensical and the remainder intentionally obscure the undercapitalization of both parties — an SPV on one hand and a swap dealer on the other hand — to an ABS flip clause swap.*

The following is an example of a representation by SFIG and Sponsor Navient that is patent nonsense: "[R]eplacing the S[wap] D[ealer] counterparty to an SPV swap will not change the material economic terms of the swap itself and has no effect on risk to the SPV, the noteholders, or the financial system." In fact, rudimentary analysis of counterparty exposure starts with the understanding that replacing one SD counterparty (e.g., GOLDMAN SACHS MITSUI MARINE DERIVATIVE PRODUCTS LP) with a second SD counterparty (e.g., MORGAN STANLEY MUFG SECURITIES CO LTD) changes a fundamental economic term of a swap and thus has pronounced effect on risk to an SPV, noteholders, the Swap Dealer itself (by exposing itself to flip clause losses) and the financial system.

In turn, this nonsense obscures the market reality that in the limited instances where a second swap dealer has replaced an initial swap dealer, the new swap dealer has also excluded or amended economic terms that were present in the initial transaction.

Moreover, the CFTC operates under the maxim of "Fool the CFTC once, shame on SFIG. Fool the CFTC twice, shame on the CFTC." The CFTC cited 14 SFIG misrepresentations regarding ABS flip clause swaps, rating methodologies and ABS operating capabilities in a 2015 no-action letter — the CFTC Letter No. 15-21 of 31 March 2015.

Mr. William J. Harrington and Mr. Rick Michalek discussed the SFIG misrepresentations with the signatories to CFTC Letter No. 15-21, DSIO Acting Director Mr. Tom Smith and DSIO Chief Counsel Mr. Frank Fisanich, in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

Mr. Harrington had previously itemized the SFIG misrepresentations in a letter of 15 May 2015 addressed to Mr. Smith, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

Mr. Harrington first informed Mr. Smith and Mr. Fisanich that the Letter No. 15-21 cited many SFIG misrepresentation in an email of 7 April 2015, an excerpt of which follows.

The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.
…
"For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

Misrepresentation #29 page 7: The DSIO, including Director DSIO Oversight Mr. Matthew B. Kulkin and Chief Counsel Mr. Frank Fisanich, believes that CFTC Letter No. 17-52 is valid.

"This letter, and the positions taken herein, represent the views of DSIO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission."

Systemic Harm (1): Misrepresentation #29 harms Swap Dealers and ABS investors and undermines free market efficiency.

Systemic Harm (2): Misrepresentation #29 erodes CFTC credibility and demonstrates the extent of regulatory capture by Navient and SFIG. The CFTC will neither publish nor act on the most accurate information available. Instead, the CFTC publishes and acts on lobbying catchphrases that it is spoon fed by Navient and SFIG.

The DSIO, including the author of the CFTC Letter No. 17-52 Mr. Matthew B. Kulkin and a second contact for the letter Mr. Frank Fisanich, knows that the CFTC Letter No. 17-52 and "the positions taken therein" are invalid.

Mr. William J. Harrington apprised Mr. Kulkin of the inaccuracies in CFTC Letter No. 17-52 in two voicemails on 30 October 2017 at 2:18 PM ET and on 29 October 2017 at 10:56 AM ET, respectively.

Mr. Harrington apprised Mr. Fisanich of the inaccuracies in CFTC Letter No. 17-52 in a voicemail on 29 October 2017 at 10:54 AM ET.

On three separate occasions In 2015, Mr. Harrington apprised Mr. Fisanich and his colleague Mr. Tom Davis of 14 similar SFIG misrepresentations regarding ABS flip clause swaps, Delinking Criteria, and ABS operating capabilities in CFTC Letter No. 15-21 of 31 March 2015, a letter that the CFTC groups with CFTC Letter No. 17-52. Mr. Davis is the signatory to CFTC Letter No. 15-21 and Mr. Fisanich is a contact.

1. Mr. Harrington and his former Moody's colleague Mr. Rick Michalek discussed the SFIG misrepresentations with Mr. Fisanich and Mr. Davis in a teleconference from 9:00 AM to 10:00 AM on Tuesday, 28 May 2015. Mr. Smith and Mr. Fisanich acknowledged the SFIG misrepresentations, with Mr. Smith offering: "We aren't stupid, you know."

2. Mr. Harrington itemized the SFIG misrepresentations in a letter of 15 May 2015 addressed to Mr. Smith, to Ms. Harriet Orol of the SEC Office of Credit Ratings and to Head of Unit CRA Supervision at the European Securities and Markets Authority Mr. Felix Flinterman.

3. Mr. Harrington first informed Mr. Smith and Mr. Fisanich that the Letter No. 15-21 cited many SFIG misrepresentation in an email of 7 April 2015, an excerpt of which follows.

   The CFTC Letter No. 15-21 "cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.
   …
   "For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."

For Mr. Harrington's email of 7 April 2015, see Appendix B to this letter. For Mr. Harrington's letter of 15 May 2015, see Appendix C to this letter.

Corrective to Misrepresentation #29: *The CFTC withdraws the CFTC Letter No. 17-52 in response to a determination that the DSIO does not hold the views that Mr. Kulkin expressed therein.*

Misrepresentation #30 page 7: The no-action position was effective on 27 October 2017 and remains effective to the current date.

"Further, this letter, and the positions taken herein, is based upon the representations made to DSIO. Any different, changed, or omitted material facts or circumstances might render this no-action position void."

Systemic Harm: Misrepresentation #30 overstates the ABS flip clause swaps to which the no-action position applies. This masks the risks that are posed to a Swap Dealer and ABS investors where an SPV is party to an ABS flip clause swap.

Corrective to Misrepresentation #30: *This no-action position was void upon issuance of the CFTC Letter No. 17-52 of 27 October 2017. At least 31 "[mis]representations made to DSIO" by two of the Sponsors — Naivent and SFIG — destroyed the basis of CFTC Letter No. 17-52, and thereby nullified the no-action position, from the outset on 27 October 2017.*

Navient, SFIG and a third Sponsor Mizuho Securities may have made additional misrepresentations. To determine if this is the case, the CFTC must post the respective incoming letters from the three Sponsors.

At any rate, the representations by Mizuho Securities — Orient Corporation, Request for No-Action Relief from CFTC Regulations 23.152-161 in Connection with OSCAR US Funding Trust, et al. (July 13, 2017) — were moot as of 30 August 2017, i.e., almost two months prior to 27 October 2017.

On 30 August 2017, Mizuho Securities completed certain remedial actions on behalf of the respective OSCAR deals, according to a Moody's announcement of the same date. The remedial actions prompted Moody's to "confirm the Aaa (sf) ratings on 10 classes of notes from four ABS transactions backed by auto loans issued by OSCAR US Funding Trust, OSCAR US Funding Trust II, OSCAR US Funding Trust IV, and OSCAR US Funding Trust V."

Moody's had placed these 10 classes of notes on watch on 27 July 2017, owing to a reduced "likelihood of swap replacement" that the rating agency attributed to the variation margin requirements. Further, Moody's advised that the scale of downgrades could be two-to-three notches, i.e., downgrades to Aa2 or Aa3 from Aaa. "In the absence of any restructuring of the abovementioned transactions or without any factor that would positively affect the likelihood of swap replacement, the ratings of the notes will likely be downgraded by two to three notches."

Accordingly, the subsequent remedial actions that Mizuho Securities quickly effectuated on behalf of the transactions on negative watch — "the execution of amended documents and the entrustment of additional cash" — constituted AAA mitigation against the low likelihood of swap replacement, according to the Moody's announcement of 30 August 2017.

After this date, Mizuho Securities did not require a no-action position. Nor would Navient have required a no-action position had it taken similar actions.

"The additional cash entrustment serves as credit enhancement to the notes to cover potential losses arising from the transaction becoming unhedged. The amended waterfall also enables any excess spread and principal collections available to the Subordinated Beneficial Interest to cover losses when that scenario arises.

"Moody's believes these additional credit enhancements are sufficient to mitigate the risks -- from the reduced likelihood of entering into a replacement swap -- to a level satisfactory to maintain the Aaa (sf) ratings."

Misrepresentation #31 page 7: The CFTC welcomes and responds to public input.

"Questions concerning this letter may be directed to me at (202) 418-5213; or Frank Fisanich, Chief Counsel, at (202) 418-5949.

"Very truly yours,

"Matthew B. Kulkin Director Division of Swap Dealer and Intermediary Oversight

"cc: Regina Thoele, Compliance National Futures Association, Chicago

" Jamila A. Piracci, OTC Derivatives National Futures Association, New York"

Systemic Harm: Misrepresentation #31 indicates that the CFTC seeks out and welcomes information from all sources. This is not the case. The CFTC, which is subject to regulatory capture by financial lobbyists such as the ABS lobbyist SFIG, disregards and refuses outright to accept information from non-lobbyist sources. As a result, CFTC policy harms the US economy by encouraging suboptimal investment and by increasing bailout risk.

Corrective to Misrepresentation #31: *The CFTC will speak with Mr. William J. Harrington regarding his letter of 2 February 2018 in an open forum. This meeting and the information that Mr. Harrington conveys will:*

4. *help the CFTC adopt policies that ensure the safety and soundness of both Swap Dealers and the financial system;*
5. *help the CFTC adopt policies that help the US economy by encouraging optimal investment and by decreasing bailout risk; and*
6. *redress the failure of the CFTC to speak with Mr. Harrington regarding SFIG misrepresentations of ABS flip clause swaps, despite Mr. Harrington having contacted CFTC staff on at least **ELEVEN** occasions since January 2017.*
   - Mr. Harrington alerted CFTC Secretary Mr. Chris Kirkpatrick to inaccuracies in the CFTC Letter No. 17-52 in an email dated 16 January 2018
   - Mr. Harrington apprised Mr. Kulkin of the inaccuracies in the CFTC Letter No. 17-52 in a voicemail on 30 October 2017 at 2:18 PM ET
   - Mr. Harrington apprised Mr. Kulkin of the inaccuracies in the CFTC Letter No. 17-52 in a voicemail on 29 October 2017 at 10:56 AM ET
   - Mr. Harrington apprised Mr. Fisanich of the inaccuracies in the CFTC Letter No. 17-52 in a voicemail on 29 October 2017 at 10:54 AM ET
   - Mr. Harrington alerted CFTC Secretary Kirkpatrick to SFIG misrepresentations in a series of emails dated 20 September to 3 October 2017
   Mr. Harrington alerted CFTC Secretary Kirkpatrick to SFIG misrepresentations in an email dated 13 September 2017
   - Mr. Harrington alerted CFTC Secretary Kirkpatrick to SFIG misrepresentations in an email dated

8 August 2017
- Mr. Harrington alerted CFTC staff including Secretary Kirkpatrick, Thomas Smith, Mr. Fisanich, Jennifer Bauer, Joshua Beale, Rafael Martinez, Paul Schlichting, Liphong McPhail, Eileen Flaherty, John Lawton, Francis Kuo, Stephen Kane, and the Office of Inspector General to SFIG misrepresentations in an email dated 8 August 2017
- Mr. Harrington asked CFTC Secretary Kirkpatrick to forward materials regarding SFIG misrepresentations to the respective staffs of CFTC Commissioners Quintenz and Behnam on 3 August 2017 (see Appendix D.)
- Mr. Harrington asked CFTC Secretary Kirkpatrick to forward materials regarding SFIG misrepresentations to the respective staffs of CFTC Commissioners Giancarlo and Bowen in an email dated 17 July 2017 (see Appendix D.)
- Mr. Harrington alerted CFTC staff —including Secretary Mr. Chris Kirkpatrick, Thomas Smith, Frank Fisanich, Jennifer Bauer, Joshua Beale, Rafael Martinez, Paul Schlichting, Liphong McPhail and Eileen Flaherty — to SFIG misrepresentations in an email dated 17 July 2017.
- Mr. Harrington asked CFTC Secretary Kirkpatrick to schedule two meetings with DSIO staff in an email of 7 May 2017. One meeting was to discuss margin posting against an uncleared swap with RAC provisions and a flip clause. The second meeting was to discuss CFTC/OMB submission by Mr. Harrington dated 4 May 2017.

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Appendix A* — WJH Correspondence with Staff of Fitch Ratings, the CFTC, the SEC, and the Structured Finance Industry Group (SFIG) from 17 November 2016 to 11 January 2017 Regarding:
1. Empirical and Legal Basis for Fitch "Replacement" Assumptions; and
2. Fitch Public Call for CFTC to Issue a No-Action Letter Regarding Legacy ABS Swaps

------- *Appendix A comprises pp. 81-91 of this rebuttal to CFTC Letter No. 17-52 --------

Fw: Request for Comment on Fitch Lobbying for CFTC No-Action Letter on Swap Margin Rules in Violation of SEC Policy for NRSROs

----- Forwarded Message -----
From: Bill Harrington <wjharrington@yahoo.com>
To: Daniel Noonan <daniel.noonan@fitchratings.com>; Sandro Scenga <sandro.scenga@fitchratings.com>; Andreas Wilgen <andreas.wilgen@fitchratings.com>; "duncan.paxman@fitchratings.com" <duncan.paxman@fitchratings.com>; Kevin Duignan <kevin.duignan@fitchratings.com>
Cc: "orolh@sec.gov" <orolh@sec.gov>; Thomas J. Smith <tsmith@cftc.gov>; Frank Fisanich <ffisanich@cftc.gov>; "richard.johns@sfindustry.org" <richard.johns@sfindustry.org>; Gretchen Morgenson <gretchen@nytimes.com>; "oig@cftc.gov" <oig@cftc.gov>; Bill Harrington <wjharrington@yahoo.com>
Sent: Wednesday, January 11, 2017 9:08 AM
Subject: Request for Comment on Fitch Lobbying for CFTC No-Action Letter on Swap Margin Rules in Violation of SEC Policy for NRSROs

Dear All,

I am writing a blog post on replacement and the Fitch announcement of 17 November. My deadline is today, 11 January at 5:00 EST.

My theme is that timely replacement has occurred in too few instances since 2008 to justify Fitch in assigning a AAA or AA rating to an ABS with an issuer that is party to a swap contract.

The US swap margin rules that are scheduled to take effect on 1 March 2017 are the last rather than the first nail in the replacement coffin.

Fitch should have long ago stricken replacement from the set of "effective counterparty risk mitigants" that justify a high rating for an ABS when an issuer is party to a swap contract.

In short, Fitch is long overdue in not having downgraded ABS where issuers are parties to swap

contracts.

The following statement is one of many inculpatory ones in the Fitch announcement of 17 November.

"Fitch's structured finance ratings rely on effective counterparty risk mitigants, among which the assumption that counterparties will implement remedial actions upon becoming ineligible. If the likelihood of appropriate remedial actions is substantially reduced, potential rating actions could follow.

Here are my questions.

1. The Fitch announcement of 17 November states that "[c]ounter to existing market practice, Fitch expects structured finance issuers will start to face two-way margin requirements on their derivative exposures."

   Has the "existing market practice" that excludes two-way margin posting produced robust ABS?

   Have robust ABS spurred robust economic growth since 2008?

2. The Fitch announcement of 17 November states that "[o]ne concern of this regulatory change is that the two-way collateral posting could make the future use of derivative contracts such as interest rate swaps uneconomical or impossible in Structured Finance."

   Why the concern? The above-mentioned interest rate swaps – uncleared swap contracts with RAC provisions and flip clauses – are intrinsically uneconomical save for the rating arbitrage that Fitch and other rating agencies preserve.

   Does Fitch consider that ABS issuers offset the relative depreciation of a pool of securitized assets viz-a-viz liabilities by entering into an uncleared swap contract with RAC provisions and a flip clause to take advantage of a rating arbitrage?

   Won't the daily exchange of two-way margin instill free-market pricing in the ABS sector?

   Under free-market pricing with no rating arbitrage, an ABS issuer will be indifferent between the following: entering into an "existing market practice" swap contract, buying an option and securitizing additional assets.

   Does Fitch consider that the "existing market practice," – i.e., a Fitch rating arbitrage – makes the latter two options uneconomically expensive relative to the first?

3. How many ABS that are backed by a swap contract does Fitch rate?

4. Other than private student loan ABS that Navient Corp. sponsors and many CLOs with flip clauses, what ABS sectors use swap contracts?

5. How many successful instances of replacement has Fitch observed from 2008 to the present date?

6. In each instance of successful replacement, how much time elapsed between the breaching of a rating trigger and the effecting of replacement?

   If this time was often several months or even years – i.e., much longer than a typical swap contract specifies – did Fitch misinform the marketplace with this statement of 17 November?

   "In the event that an issuer can only replace a counterparty on differing terms it would raise the requirement to seek consent from other parties to the transaction. The requirement to obtain relevant consent would extend the time in which replacement counterparty can be sought exposing the transaction to increased risk in the intervening period."

   In misinforming the marketplace, is Fitch in violation of its or SEC guidelines?

7. How many instances of failed replacement has Fitch observed from 2008 to the present date?

   In other words, what is the baseline "replacement risk" that has been present since the financial crisis and is in no way attributable to "the upcoming regulation" regarding the daily, two-way exchange of variation margin?

8. Please list each factor that has created a "significant barrier to the ability of transaction parties to find suitable replacement entities on equivalent economic terms" from 2008 to the present date. Please do not include "the upcoming regulation" regarding the daily, two-way exchange of variation margin.

9. Is the 2016 ruling in Lehman Brothers Special Financing Inc. v. Bank of America National Association (Case No. 10-3547) one such "significant barrier?"

   This ruling largely upheld the validity of a flip clause and could dissuade stronger counterparties from bidding to replace. In recognition, why didn't Fitch update methodologies and downgrade ratings of ABS where issuers were parties to swap contracts? https://www.claytonutz.com/knowledge/2016/september/the-courts-flip-flopping-again-on-

the-validity-of-flip-clauses

10. The Fitch announcement of 17 November states that "[i]n structured finance transactions rated by Fitch to date, collateral is typically posted under a one-way agreement in favor of the issuer."

    In how many instances since 2008 did a swap counterparty that was obligated to post collateral under the original terms of a swap contract not do so?

11. When a swap provider unilaterally amended a derivative contract with an ABS issuer or obtained RAC to duck contractual obligations such as posting collateral or effecting replacement, what compensation or other form of consideration did the ABS issuer receive?

    If none, are the amendments to the uncleared swap contracts with RAC provisions and flip clauses enforceable?

12. The Fitch announcement of 17 November states that "the swap counterparty is required to take credit risk to the issuer, usually in exchange for seniority in the ranking of payments due it, as stipulated in the transaction's priority of payments."

    This statement omits the subordination from a flip clause and thus misinforms the marketplace. My research shows that most private student loan ABS that Navient sponsors and approximately half of new US CLOs contain a flip clause in the priority of payments.

    In publishing this misinformation, is Fitch in violation of its or SEC guidelines?

    Does Fitch reflect the all-or-nothing risk of a flip clause in the rating of a swap provider?

    Has Fitch properly apprised or alternatively misinformed the CFTC of the self-referencing, all-or-nothing credit risk that a flip clause poses to a swap provider?

13. Is Fitch assigning derivative counterparty ratings to mask the baseline "replacement risk" and failure to collateralize?

Best regards,

Bill Harrington
Wikirating Experts Board -- Key Expert on Structured Finance Topics
wjharrington@yahoo.com
917-680-1460

From: Bill Harrington <wjharrington@yahoo.com>
To: Daniel Noonan <daniel.noonan@fitchratings.com>
Cc: "orolh@sec.gov" <orolh@sec.gov>; Thomas J. Smith <tsmith@cftc.gov>; Frank Fisanich <ffisanich@cftc.gov>; "richard.johns@sfindustry.org" <richard.johns@sfindustry.org>; Gretchen Morgenson <gretchen@nytimes.com>; "oig@cftc.gov" <oig@cftc.gov>
Sent: Thursday, December 22, 2016 4:43 PM
Subject: Re: Fitch Request for CFTC No-Action Letter on Swap Margin Rules in Violation of SEC Policy for NRSROs

Dear Mr. Noonan,

Thank you for your prompt reply. This email exchange will form an appendix to my upcoming comment letter to the CFTC regarding the capital treatment of the non-cleared swap contracts with RAC provisions and flip clauses that are the subject of the Fitch announcement of 17 November.

The moribund ABS sector in the EU provides a bad example that the US should not follow. Lax margin rules for the EU sector have done nothing to revive it. Moreover, not requiring swap dealers to fully capitalize their self-referencing risk under flip clauses is a gimmick that rests on rating arbitrage and undermines systemic stability. Fortunately, the daily, two-way exchange of variation margin makes flip clauses irrelevant.

SFIG had a meeting of its Derivatives in Securitization Task Force on 5 December that followed up on the Fitch announcement.

I should note that I was a member of this task force in 2013 and would have continued as one had SFIG not declined to renew my membership for 2014. Even so, members of this task force have periodically contacted me regarding margin posting and non-cleared swap contracts with RAC provisions and flip clauses.

I should also note that in the teleconference that a colleague and I had with Mr. Smith and Mr. Fisanich of the CFTC, we were clear that SFIG had lied to the CFTC about non-cleared swap contracts with RAC provisions and flip clauses. My colleague and I also expressed concern and bafflement that the CFTC Letter No. 15-21 of 31 March 2015 simply recited those lies.

Why has Fitch not downgraded affected ABS to reflect the lifetime linkage to existing counterparties that will commence on 1 March 2017? Taking timely, forward-looking rating actions are one of the few responsibilities that NRSROs acknowledge. Why is Fitch failing to perform even this simple task?

Further, why has Fitch not addressed the swap margin rules in any of its ABS or derivative methodologies or proposed updates? I have read all these documents and stand by my assertion that Fitch is derelict in its responsibilities as an NRSRO.

Does Fitch have a hotline where I can report these violations in detail, deal-by-deal and with respect to the methodologies, page-by-page?

Unfortunately, the same is true of the other NRSROs, based on my close review of their respective ABS ratings, methodologies and update proposals. Once again, the SEC is negligent in its oversight of NRSROs.

I asked SEC Commissioner Piwowar about margin posting and non-cleared swap contracts with RAC provisions and flip clauses during the open question session at the Cato Institute Summit on Financial Regulation in New York City on 2 June 2015. He replied that that was a good question and offered no analysis.

CFTC Commissioner Giancarlo spoke at the Cato summit and was in attendance when I posed my question to Commissioner Piwowar. I followed up repeatedly with staff of each commissioner.

Commissioner Piowar and other SEC officials attended the lunch provided by the Tepper School at its Economics of Credit Ratings Conference from 4-6 December 2015. At the open question session, I asked about margin posting and non-cleared swap contracts with flip clauses and RAC provisions.

Best regards,

Bill Harrington

From: Daniel Noonan <daniel.noonan@fitchratings.com>
To: Bill Harrington <wjharrington@yahoo.com>
Cc: "orolh@sec.gov" <orolh@sec.gov>; Thomas J. Smith <tsmith@cftc.gov>; Frank Fisanich <ffisanich@cftc.gov>; "richard.johns@sfindustry.org" <richard.johns@sfindustry.org>; Gretchen Morgenson <gretchen@nytimes.com>; "oig@cftc.gov" <oig@cftc.gov>
Sent: Thursday, December 22, 2016 3:17 PM
Subject: FW: Fitch Request for CFTC No-Action Letter on Swap Margin Rules in Violation of SEC Policy for NRSROs

Bill,

Thank you for your note. While you are certainly welcome to your own opinions, please do not distort Fitch's position in the process. Fitch has not, and has no intention of requesting anything from the CFTC or any other regulator on this subject. We stand by our published commentary, which others may wish to read for themselves. Thank you.

Dan Noonan
Managing Director, Corporate Communications
Fitch Ratings

----- Forwarded Message -----
From: Bill Harrington <wjharrington@yahoo.com>
To: "orolh@sec.gov" <orolh@sec.gov>; Thomas J. Smith <tsmith@cftc.gov>; Frank Fisanich <ffisanich@cftc.gov>; "sandro.scenga@fitchratings.com" <sandro.scenga@fitchratings.com>
Cc: "richard.johns@sfindustry.org" <richard.johns@sfindustry.org>; Gretchen Morgenson <gretchen@nytimes.com>; "oig@cftc.gov" <oig@cftc.gov>
Sent: Wednesday, December 21, 2016 5:32 PM
Subject: Fitch Request for CFTC No-Action Letter on Swap Margin Rules in Violation of SEC Policy for NRSROs

Dear All,

Further below in this email, please find the Fitch announcement entitled "Fitch: Pending US Swap Rules Could Impact Structured Finance Transactions" of 17 November.

The Fitch announcement posits that a CFTC no-action letter -- the CFTC Letter No. 15-21 of 31 March 2015 -- could conceivably "be extended to the two-way margin posting requirements" that take effect on 1 March 2017.

Why? A "possible 'no-action position' from the CFTC could, in Fitch's view, make the replacement of legacy swaps more likely and therefore reduce replacement risk arising from the upcoming regulation."

As the Fitch announcement notes, the margin posting requirements, which apply to new swaps entered into from 1 March 2017 onward, may also apply to legacy swaps that are amended.

I made the same point in my Debtwire article "Existing ABS also caught in swap margin net," which was published on 12 August and subsequently released on the public Debtwire Exclusives site. I have distributed this article to the SEC Office of Credit Ratings and recognized credit rating agencies (NRSROs), including Fitch.

Unlike Fitch's view, my evaluation showed that the swap margin requirements will improve protections for ABS investors and the financial system as a whole. The article enumerates why in

the last section under the sub-heading "**Rorschach test — maybe the margin rules are a great solution?**"

Existing ABS swaps also caught in swap margin net — ANALYSIS - Debtwire

The Fitch announcement of 17 November also states that the Structured Finance Industry Group (SFIG) "requested and received" the CFTC Letter No. 15-21 of 31 March 2015.

I enumerated 14 misrepresentations that the SFIG made in its successful request for the no-action letter in an email to Mr. Smith of the CFTC, Ms. Orol of the SEC and Mr. Flintermann of the ESMA dated 15 May 2015. A colleague and I discussed this letter with Mr. Smith and Mr. Frank Fisanich of the CFTC in a teleconference on 28 May 2015.

I also sent an email that articulated enforcement implications for NRSROs that flow from the CFTC Letter No. 15-21 to Mr. Smith, other CFTC staff and Mr. Richard Johns of SFIG on 7 April 2015.

My comment letter to the prudential regulators of 31 January 2016 contains both my letter of 15 May 2015 and email of 7 April 2015. Please see Appendix A (pp. 6-22) and Appendix B (pp. 23-24), respectively.

https://www.fdic.gov/regulations/laws/federal/2015/2015-covered_swap_entities_3064-ae21-c02.pdf

The linkage of the swap margin requirements and the CFTC Letter No. 15-21 in the Fitch announcement of 17 November begs many questions.

1. Why is Fitch lobbying the CFTC for a no-action letter with respect to swap margin requirements rather than downgrading ABS with swap exposures?
2. In lobbying for a no-action letter, has Fitch undermined its First Amendment protections as a mere publisher of information?
3. Why have other NRSROs *not* downgraded ABS with swap exposures?
4. Why has Fitch not proposed a methodology update to reflect the swap margin requirements?
5. Why have other NRSROs *not* proposed methodology updates to reflect the swap margin requirements?
6. Has the SEC Office of Credit Ratings asked NRSROs about the impact of the swap margin requirements on ABS ratings and methodologies?

NRSROs had have 14 months to reflect the swap margin requirements in ABS ratings and methodologies. The prudential regulators adopted the relevant rule on 22 October 2015 and the CFTC adopted a parallel rule on 16 Dec 2015. Moreover, I contacted each NRSRO with detailed questions regarding its respective ABS and swap methodology in light of the swap margin requirements in April 2016.

In submitting questions to each NRSRO, I included my Debtwire article "US margin rules for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures" of 4 November 2015. I did the same in asking questions of the SEC Office of Credit Ratings.

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

I will also send this email to each of you individually to minimize the chance that spam filters block it.

Best regards,
Bill Harrington

From: Sandro Scenga [mailto:sandro.scenga@fitchratings.com]
Sent: Thursday, November 17, 2016 9:10 AM
To: Bill Harrington <Bill.Harrington@debtwire.com>
Subject: Fitch: Pending U.S. swap rules could impact structured finance transactions

Fitch: Pending US Swap Rules Could Impact Structured Finance Transactions

Pending derivative regulations including swap margin posting requirements are creating uncertainties for both new and existing structured finance transactions, according to Fitch Ratings. Scheduled to go into effect in March 2017, the new rules require daily posting of two-way variation margin on affected derivatives.

While new swaps executed after March 1, 2017 would clearly be affected, Fitch's interpretation of the current proposals is that in the event of a replacement of a derivative counterparty in an existing transaction, the consequent contractual agreement between issuer and replacing derivative counterparty would have to obey two-way daily variation margining. In Fitch's view, this aspect has the potential to create a significant barrier to the ability of transaction parties to find suitable replacement entities on equivalent economic terms.

The Structured Finance Industry Group (SFIG) has previously requested and received a 'no action position' from the U.S. Commodity Futures Trading Commission (CFTC) for certain commission regulations applicable to swaps with legacy special purpose vehicles (see CFTC Letter No. 15-21). Given the nature of this no-action position it is conceivable that it will be extended to the two-way margin posting requirements.

Background:

Fitch's structured finance ratings rely on effective counterparty risk mitigants, among which the assumption that counterparties will implement remedial actions upon becoming ineligible. If the likelihood of appropriate remedial actions is substantially reduced, potential rating actions could

follow. The U.S. Prudential Regulators' non-cleared margin requirements for covered swap entities are scheduled to be effective for all financial end users of derivative contracts by March 1, 2017. The impact of these rules on structured finance will be substantial with all in-scope derivatives requiring daily posting of two-way variation margin; this is in contrast to European regulations, which to date have sought to exempt structured finance issuers from similar margin posting requirements. Counter to existing market practice, Fitch expects structured finance issuers will start to face two-way margin requirements on their derivative exposures.

Fitch understands that the scope of the requirements extend to all U.S. issuers as well as a U.S. financial institution facing non-U.S. issuers. The extent to which a non-U.S. bank with significant U.S. operations facing a non-U.S. issuer would be impacted remains unclear. In addition Fitch understands that existing derivatives, to the extent that no changes are made to the contractual agreements in place, will remain outside of the margin requirements. In contrast, modifications to existing transaction terms or novation to a replacement counterparty would bring that transaction into scope and therefore, subject to the two-way margin posting requirement.

In structured finance transactions rated by Fitch to date, collateral is typically posted under a one way agreement in favour of the issuer. This allows for the issuer to mitigate its credit risk whilst avoiding the introduction of a volatile, and potentially large, obligation to the transaction. By contrast, the swap counterparty is required to take credit risk to the issuer, usually in exchange for seniority in the ranking of payments due to it, as stipulated in most transaction's priority of payments.

Fitch considers that, in the absence of specific mechanisms dealing with the margin posting requirement, the introduction of a daily variation margin obligation on the issuer could be incompatible with the relatively predictable cashflows received by an issuer and owed under its debt securities. One concern of this regulatory change is that two-way collateral posting could make the future use of derivative contracts such as interest rate swaps uneconomical or impossible in Structured Finance. Some transactions rated by Fitch use instruments, such as interest rate caps, which do not have as volatile a mark to market. By definition a purchased option will never have a liability to the buyer once any associated premium has been settled. The requirement for variation margin to be paid by an issuer would arise only if the mark to market of its derivative position becomes, from its own perspective, a value less than zero. As a purchased option has a floor in its value to the buyer of zero, these instruments do not present a potential margin outflow for issuers and are consequently not a concern for collateral implications.

In its 'Counterparty Criteria for Structured Finance and Covered Bonds' Fitch considers a commitment to remedial action as a key mitigant against counterparty risk. Many securitisation derivatives contain obligations to replace a counterparty upon downgrade below a defined minimum level. Fitch's interpretation of the current proposals is that in the event of a replacement of a derivative counterparty, the consequent contractual agreement between issuer and replacing derivative counterparty would have to obey two-way daily variation margining. In Fitch's view, this aspect has the potential to create a significant barrier to the ability of transaction parties to find suitable replacement entities on equivalent economic terms. In the event that an issuer can only replace a counterparty on differing terms it would raise the requirement to seek consent from other parties to the transaction. The requirement to obtain

relevant consent would extend the time in which replacement counterparty can be sought exposing the transaction to increased risk in the intervening period.

Fitch considers the extent to which the requirements may impact the potential for an issuer to source a replacement counterparty to be dependent on the jurisdiction of the issuer. While the full extent of any impact remains unclear, Fitch considers the greatest impact is likely to be felt in the U.S. where it may become more difficult to transfer some existing arrangements to a new counterparty. In Europe Fitch considers that the implications are likely to be felt through a reduction in the number of available market participants, the scope of which will be dependent on the breadth of the definition of a U.S. entity imposed.

Fitch will continue to monitor developments as these regulatory changes are brought into effect. In particular Fitch will continue to review challenges to its assumptions with regards to the replacement of counterparties and will comment further as appropriate. In the U.S., a possible 'no action position' from the CFTC could, in Fitch's view, make the replacement of legacy swaps more likely and therefore reduce replacement risk arising from the upcoming regulation.

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Appendix B* — WJH email of 7 April 2015 to Mr. Thomas Smith, Acting Director, Division of Swap Dealer and Intermediary Oversight (DSIO), and to Mr. Frank Fisanich, DSIO Chief Counsel: "CFTC Letter No. 15-21 & Inaccurate Representations of Delinking Criteria"

------- *Appendix B comprises pp. 92-93 of this rebuttal to CFTC Letter No. 17-52 --------

From: Bill Harrington <wjharrington@yahoo.com>

To: "tsmith@cftc.gov" <tsmith@cftc.gov>; "ffisanich@cftc.gov" <ffisanich@cftc.gov>

Cc: Brian EO'Keefe <bokeefe@cftc.gov>; "ckirkpatrick@cftc.gov" <ckirkpatrick@cftc.gov>; "michel.madelain@moodys.com" <michel.madelain@moodys.com>; "richard.johns@sfig.org" <richard.johns@sfindustry.org>; "orolh@sec.gov" <orolh@sec.gov>; "rthoele@nfa.futures.org" <rthoele@nfa.futures.org>; "jpiracci@nfa.futures.org" <jpiracci@nfa.futures.org>; "nicolas.weill@moodys.com" <nicolas.weill@moodys.com>

Sent: *Tuesday, April 7, 2015 12:58 PM*

Subject: *CFTC Letter No. 15-21 & Inaccurate Representations of Delinking Criteria*

Dear Mr. Smith:

I am writing in regard to CFTC Letter No. 15-21 dated March 31, 2015. This no-action letter cites several representations by the Structured Finance Industry Group (SFIG) which, if correct, provide the US Securities and Exchange Commission (SEC) with grounds to bring an action against at least one of the credit rating agencies. As a result, amendments to existing swap contracts that rely on CFTC Letter No. 15-21 may become evidence in an SEC enforcement against one or more credit rating agencies.

In preparing CFTC Letter No. 15-21, did the CFTC consult with the credit rating agencies or simply rely upon representations by SFIG?

For the entirety of the period covered by CFTC Letter No. 15-21, the delinking criteria of Moody's Investors Service ("Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions") contained an explicit provision that ruled out Remedial Action #4 (CFTC Letter No. 15-21, p.5). I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread, and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill.

Next week, I will submit a letter that lays out my points more fully. In the interim, attached please find "Efficient, commonsense steps to foster rating accuracy" by my Wikirating colleague Norbert Gaillard and me. This paper, which has been accepted for publication by the Capital Markets Law Journal, details the rating agency processes that are cited in CFTC Letter No. 15-21 -- most notably, the issuance of rating agency condition or confirmation (RAC) to dealer proposals to strip investor protections from existing swap contracts. Moody's RACs have often cited Remedial Action #4 as rationale in direct violation of the Moody's delinking criteria. Under these RACs, swap dealers avoided posting collateral, avoided replacing themselves, avoided obtaining guarantees, and ratcheted up investor exposure to unenforceable flip clauses.

Simply put, swap dealers have obtained the blessing of Moody's and all credit rating agencies to define Remedial Action #4 as taking no action at all (i.e., to renege on existing contractual responsibilities that, if honored, would have protected investors). Contrary to the SFIG representation, the delinking criteria have NOT "proven to be prescriptive rules that aim to ensure performance by the swap dealer" (CFTC Letter No. 15-21, p. 4), but rather a very, very fluid set of protocols that swap dealers can unilaterally change simply by paying credit rating agencies to issue RAC.

Best regards,

William J. Harrington
917-680-1465

Appendix C* — WJH Letter of 15 May 2015 Letter to Mr. Thomas Smith of the CFTC, Ms. Harriet Orol of the U.S. Securities and Exchange Commission, and Mr. Felix Flinterman of the European Securities and Market Authority: "Letter No. 15-21 & Rating Agency Overrides of Published Methodologies for Swap Contracts"

------- *Appendix C comprises pp. 94-110 of this rebuttal to CFTC Letter No. 17-52 --------

William J. Harrington
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May 15, 2015

VIA ELECTRONIC MAIL

Mr. Thomas Smith
Acting Director
Division of Swap Dealer and Intermediary Oversight
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, D.C. 20581

Ms. Harriet Orol
Office of Credit Ratings
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20002-4224

Mr. Felix Flinterman
Head of Unit CRA Supervision
European Securities and Markets Authority
103 Rue de Grenelle CS 60747 Paris
75345 CEDEX 07 France

Re: CFTC Letter No. 15-21 of March 31, 2015

Division of Swap Dealer and Intermediary Oversight
"No-Action Position: Certain Commission Regulations Applicable to Swaps with Legacy Special Purpose Vehicles"

Dear Mr. Smith, Ms. Orol, and Mr. Flinterman:

I am writing with respect to the CFTC Letter No. 15-21 that was issued on March 31, 2015.

For several days in May 2015, the CFTC Letter No. 15-21 could not be accessed on the CFTC website. Accordingly, my letter today quotes the entirety of key passages from the CFTC Letter No. 15-21 in the event that it again becomes inaccessible or is withdrawn. My letter also uses several terms that were defined in the CFTC Letter No. 15-21, such as Legacy SPV Swap, Remedial Action, and Delinking Criteria.

Today's letter follows up on my April 7, 2015 e-mail "CFTC Letter No. 15-21 & Inaccurate Representations of De-Linking Criteria," which is contained herein as an Appendix.

As my April 7 e-mail stated, the CFTC Letter No. 15-21 provides the SEC and the U.S. Department of Justice with grounds to bring enforcement actions against Fitch, Moody's, and S&P. From 2006 onward, each of these credit rating agencies ignored its respective Delinking Criteria in assigning ratings to debt issued by SPVs that were party to swap contracts. These swap contracts are the same Legacy SPV Swap contracts that are the subject of the CFTC Letter No. 15-21.

The CFTC Letter No. 15-21 also provides ESMA with grounds to bring enforcement actions against Fitch, Moody's, and S&P. From 2006 onward, each of these credit rating agencies ignored its respective Delinking Criteria in assigning and subsequently monitoring ratings to debt issued by SPVs in the EU that were party to swap contracts.[9]

Ignoring published criteria to assign and monitor the ratings of SPV debt is a violation of the respective procedures of each credit rating agency and the regulatory rules of both the SEC and ESMA. Investors in SPV debt (e.g., residential mortgage-backed securitizations, collateralized debt obligation transactions, credit-linked note transactions, and other financial asset repackage transactions) that were originated or restructured in as late as 2009 suffered losses, as did U.S.

[9] See Norbert J. Gaillard and William J. Harrington, "Efficient, Commonsense Steps to Foster Rating Accuracy," *Capital Markets Law Journal* (in press 2015), footnote 109. Moody's applied its Delinking Criteria to assign ratings to debt issued by an SPV established by Greece so that it could mask borrowings of Euro 5 billion under swap contracts with Goldman Sachs.

and EU taxpayers. Accordingly, a U.S. action under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 may be commenced as late as 2019.

Furthermore, each credit rating agency compounded its violations of internal policies and external rules by greenlighting amendments to the Legacy SPV Swap contracts and similar SPV swap contracts in the EU that stripped them of existing protections for investors in SPV debt. As of this writing, the credit rating agencies were continuing to greenlight these amendments. As a result, a U.S. action under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 may be commenced on any date up to and including the earlier of either May 15, 2025 or 10 years after the last date on which a credit rating agency greenlighted an amendment to a Legacy SPV Swap contract. In the EU, both ESMA and investors have multiple grounds for bringing actions.[10]

The CFTC Letter No. 15-21 cites as rationales a series of representations that were made by the SFIG with respect to the operations of SPVs and the content of Delinking Criteria. Many of these representations are inaccurate and, as a consequence, the CFTC Letter No. 15-21 provides a safe harbor for the Legacy SPV Swap contracts to be amended in ways that will strip them of still more investor protections.

To preserve what investor protections still remain in the Legacy SPV Swap contracts, the CFTC should revise the definition of a Remedial Action[11] as follows:

"The taking of any Remedial Action will not affect the material economic terms of the Legacy SPV Swap, ***nor increase the exposures of investors in SPV debt to the credit quality of SDs that may be attributable to the non-enforcement, nullification, or vitiation of a flip clause.***

"*A 'Remedial Action' means* ***either*** *of the following:*

1. *Posting of collateral; or*
2. *Replacing the downgraded SD with an entity who satisfies the* ***currently*** *applicable credit rating requirements of the Legacy SPV Swap,* ***with the rating or ratings of such entity classified by the respective credit rating agencies as "fundamental" and provided that such entity is not an SPV, a structured finance operating company, or an entity with a structured finance rating.***

"For the avoidance of doubt, no other actions are Remedial Actions."

[10] Ibid., pp. 8-10.
[11] Remedial Actions are defined on p. 5 of the CFTC Letter No. 15-21.

Attached to the e-mail delivering today's letter is "Efficient, Commonsense Steps to Foster Rating Accuracy," written by my Wikirating colleague Norbert J. Gaillard and me (GH2015). This paper has been accepted for publication by the *Capital Markets Law Journal* and is being presented at several conferences this year.

Today's letter cites passages, footnotes, and sources from GH2015. Sources are identified using the abbreviations established in GH2015 (e.g., Harrington (2014), p. #.) Collectively, these passages, footnotes, and sources (most of which have been posted on sec.gov for at least two years) memorialize the development and content of the two Moody's Delinking Criteria that are, whether in whole, in part, or in tandem, present in most Legacy SPV Swap contracts and similar SPV swap contracts in the EU.

I was a co-author of both of Moody's Delinking Criteria (as well as a third, analogous criteria for application in assigning and monitoring ratings of credit-linked note transactions and other financial asset repackage transactions and a fourth, separate methodology for application in assigning and monitoring the ratings of counterparties to SPVs under swap contracts).[12]

In developing the second of the two Delinking Criteria for Moody's, my U.S. and EU colleagues and I actively solicited the input of SDs by meeting with individual SDs[13] and their regulators[14] and by issuing several comment requests.[15] We also announced the key provisions of the Delinking Criteria in succinct press releases[16] and worked closely with SDs, SPVs, and their respective counsels in incorporating the Delinking Criteria into what have become the Legacy SPV Swap contracts.[17]

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[12] See Harrington (2014), pp. 1-2 and footnote 9.

[13] Moody's U.S. and EU teams met with the following SDs: Bank of America, Bank of New York, Barclays Bank, Bear Stearns and Bear Stearns Financial Products, CSFB, Deutsche Bank, Lehman Brothers and the two Lehman Brothers Derivative Product Companies, Merrill Lynch Derivative Products, Nomura Derivative Products Inc., Royal Bank of Scotland, SwissRe, Wachovia, and UBS. From 2004 to 2006, Moody's teams were rebuffed in their repeated offers to meet with Goldman Sachs. Three years later, in 2009, as SD downgrades loomed and Remedial Actions were being activated, Goldman Sachs offered to discuss the Delinking Criteria.

[14] In 2006, I discussed Moody's new Delinking Criteria with Paul Tucker of the Bank of England during his visit to Moody's offices in New York. Afterwards, I forwarded a copy of the framework to Mr. Tucker with a cc: to my London colleagues, as they were best suited to provide further updates.

[15] See PDF-numbered pages 35-36 of the document cited in footnote 9 of Harrington (2014). See also "Moody's Requests Comments on Proposals for Swaps in Highly-Rated Structured Finance Cash-flow Transactions" (December 7, 2005).

[16] Ibid., PDF-numbered pages 34 and 37.

[17] Ibid., PDF-numbered pages 25-29.

Our team had a big-picture goal of approving a standard swap contract with each SD[18] as an efficient means to codifying several best practices for the benefit of investors, SDs, and Moody's. Investors in all types of SPV debt would benefit from the same protections. Rating teams could focus most of their analysis on the assets being securitized. SDs could accurately price the costs of Remedial Actions. And all SDs would face a level playing field.[19]

The second of the two Moody's Delinking Criteria, "Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions" (Moody's Hedge Framework), was in worldwide effect from December 15, 2006 until November 12, 2013. Moody's Hedge Framework was in development from 2003 until its publication on May 25, 2006.

The forerunner to Moody's Hedge Framework, "Guidelines for CDO Hedge Counterparties," was in effect in North America from November 2, 2002 until its ostensible withdrawal on December 15, 2006.[20] However, in violation of both its published guidelines and SEC regulations, Moody's accommodated requests by SDs to apply this Delinking Criteria on a piecemeal basis in assigning ratings to new collateralized debt obligations,[21] credit-linked note transactions,[22] and residential mortgage-backed securities.[23] Moreover, Moody's continued its practice of applying the criteria on a piecemeal basis for at least three years after December 15, 2006.[24]

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[18] Ibid. See PDF-numbered pages 24-29 with respect to the standard swap contract approved for Bear Stearns Financial Products and SPVs that issued debt backed by residential mortgage-backed securities. Similarly, my Moody's colleagues Nicolas Weill (Chief Credit Officer, Global Structured Finance) and Michael Kanef (Chief Regulatory Affairs and Compliance Officer) and I approved a standard form for UBS to use when entering into swap contracts with SPVs that issued debt backed by student loans.

[19] Ibid., PDF-numbered pages 35-37.

[20] See Moody's Hedge Framework, p. 1.

[21] See "Guidelines for CDO Hedge Counterparties," pp. 1 and 3, and Harrington (2011), pp. 25-29 and 63-64. Moody's Delinking Criteria for CDOs stipulated higher rating triggers for an SD that provided a hedge "*whose market risk is potentially greater than that of a single-currency, interest rate swap that is on market at initiation*." In direct violation of this criteria, Moody's assigned ratings to more than 50 CDOs issued by SPVs that had entered into swap contracts that were off-market at initiation but that did not contain the higher ratings triggers. AIG was, and remains, the SD for most of these off-market swap contracts. See also PDF-numbered pages 27 and 57-59 of the document cited in footnote 9 of Harrington (2014).

[22] See Harrington (2011), pp. 21-24.

[23] See PDF-numbered pages 25-29 of the document cited in footnote 9 of Harrington (2014). I led a series of Moody's committees that exempted Bear Stearns Financial Products Inc. from complying with a key provision of Moody's Hedge Framework. These exemptions violated both Moody's internal guidelines and SEC regulations.

[24] Ibid. See also Harrington (2011), Item 4a on p.62 and PDF-numbered page 27 of the document cited in footnote 9 of Harrington (2014).

Based on my 15-year experience in developing and evaluating Moody's Delinking Criteria, as well as on the analogous criteria of Fitch and S&P with respect to both SPV investors and SDs,[25] I offer the following observations regarding the SFIG representations cited in the CFTC Letter No. 15-21.

SFIG Representation #1. *"SFIG states that an SD would not be able to comply with the Specified Regulations because restrictions in SPVs' governing documentation may prevent an SPV from taking certain actions required by the SD to comply with the Specified Regulations."* (CFTC Letter No. 15-21, pp. 1-2.)

The *"restrictions in SPVs' governing documentation"* do not *"prevent an SPV from taking certain actions required by the SD to comply with the Specified Regulations."* The trustee of an SPV can amend governing documentation either by obtaining the consents of SPV noteholders or by paying a modest fee to a credit rating agency to induce it to issue a RAC.[26] However, the trustees of an SPV should not need to obtain a RAC in order for an SD to perform a Remedial Action; these contractual obligations should have been undertaken by SDs when they began being downgraded in 2009.[27]

To find examples of trustees having amended SPVs' governing documentation by obtaining RACs that relate directly to the CFTC Letter No. 15-21, one needs only to examine the amendments to the governing documentation of 100 SPVs that unilaterally stripped investor protections from Legacy SPV Swap contracts and similar SPV swap contracts in the EU for the benefit of SDs.[28] The RACS issued by Moody's increased the expected losses of SPV debt and thus violated a key provision in Moody's Hedge Framework.[29]

In contrast, amending governing documentation to allow SPVs to take "*certain actions required by the SD to comply with the Specified Regulations"* that would not reduce protections for investors in SPV debt would be noncontroversial. Trustees could effectuate these amendments either by obtaining the consents of SPV noteholders or by obtaining RACs from credit rating agencies.

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[25] See also PDF-numbered pages 1-6 and 89-152 of the document cited in footnote 9 of Harrington (2014).
[26] See GH2015, p. 7.
[27] See Moody's Hedge Framework, p. 6: *"None of these obligations may be contingent upon issuance of Rating Agency Confirmation by Moody's prior to being activated."*
[28] See GH2015, footnote 38.
[29] See Moody's Hedge Framework, footnote 5: *"Governing documents of most cashflow transactions enable an existing hedge to be adjusted, or a new one entered into, if modeling shows the expected losses of rated liabilities to be unimpaired by the proposed hedge."*

SFIG Representation #2. *"Of note in relation to this letter, a number of the Commission's rules under the External BCS require SDs and MSPs to provide or obtain specific information from their counterparties and to perform certain due diligence inquiries with respect to their counterparties prior to entering into (or in some cases, offering to enter into) a swap with such counterparties."* (CFTC Letter No. 15-21, p. 2.)

In relation to the CFTC Letter No. 15-21, the Commission's rules do not, but should, *"require SDs and MSPs to provide or obtain specific information from their counterparties"* that are SPVs in regard to investor protections and the enforceability of flip clauses in their swap contracts and priorities of payments. Similarly, the Commission's rules do not, but should, require SDs and MSPs *"to perform certain due diligence inquiries with respect to their counterparties prior to entering into (or in some cases, offering to enter into) a swap with such counterparties"* that are SPVs in regard to investor protections and the enforceability of flip clauses in their swap contracts and priorities of payments.

The flip clause, which subordinates swap payments owed by an SPV to an SD or MSP that has defaulted or is bankrupt, was an integral part of Moody's Hedge Framework.[30] However, the well-publicized nullification of a flip clause in 2010[31] has left SPVs that are parties to out-of-the-money swap contracts fully exposed to the credit quality of SDs.[32] Owing to very low interest rates, the vast majority of Legacy SPV Swap contracts are in fact out-of-the-money and expose investors in SPV debt to the credit quality of SDs and MSPs.

The Delinking Criteria of Moody's, S&P, and Fitch either glossed over or entirely ignored the loss of investor protections and the increase in exposures of SPV debt to the credit quality of SDs and MSPs that occurred with nullification of a flip clause in 2010.[33] As a result, most SPVs continue to insert flip clauses into both their priorities of payments and their swap contracts more than five years after a flip clause was nullified in 2010.

SFIG Representation #3. *"Regarding the content of swap trading relationship documentation, each SD must establish policies and procedures reasonably designed to ensure that the parties have agreed in writing to all terms governing their trading relationship, including, among other things, terms related to credit support arrangements, such as initial and variation margin*

[30] Ibid., p. 16, *"Priority of Termination Payments to Counterparty."*
[31] See GH2015, footnote 40.
[32] See Harrington (2011), pp.24-34 and PDF-numbered pages 57-59 of the document cited in footnote 9 of Harrington (2014).
[33] See Harrington (2011), pp. 30-34, S&P's "Counterparty and Supporting Obligations Methodology and Assumptions" (December 6, 2010), and Fitch's "Lehman Court Settlement Leaves Legal Conflict for Structured Finance Derivatives: Criteria Amended (March 14, 2011). Additionally, see PDF-numbered pages 25-29 and 89-152 of the document cited in footnote 9 of Harrington (2014).

requirements and custodial arrangements, and terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution. With respect to valuation of swaps, SDs must include agreement on the process for determining the value of each swap at any time from execution to the termination, maturity, or expiration of the swap, for the purposes of complying with: (1) the margin requirements under section 4s(e) of the CEA and Commission regulations; and (2) the risk management requirements under section 4s(j) of the CEA and Commission regulations. The documentation also must include either: (1) alternative methods for determining the value of the swap, in the event of the unavailability or other failure of any input required to value the swap; or (2) a valuation dispute resolution process." (CFTC Letter No. 15-21, pp. 3-4.)

The attributes of a Legacy SPV Swap contract that are laid out in SFIG Representation #3 were all present in Moody's Hedge Framework in 2006. Each of the following three paragraphs contains a portion of SFIG Representation #3 and ends with a footnote that identifies the analogous provisions in Moody's Hedge Framework.

An SPV and an SD or MSP were to agree at the outset *"in writing to all terms governing their trading relationship, including, among other things, terms related to credit support arrangements, such as initial and variation margin requirements and custodial arrangements, and terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution."*[34]

When entering into a swap contract, SPVs and *"SDs must include agreement on the process for determining the value of each swap at any time from execution to the termination, maturity, or expiration of the swap…."*[35]

For a swap contract between an SPV and an SD, initial *"documentation also must include either: (1) alternative methods for determining the value of the swap, in the event of the unavailability or other failure of any input required to value the swap; or (2) a valuation dispute resolution process."*[36]

In sum, with respect to *"the content of swap trading relationship documentation"* and the "*valuation of"* any Legacy SPV Swap contract associated with debt that was rated by Moody's, an SD should already be in compliance and thus not require the relief of the CFTC Letter No. 15-21.

[34] For analogous provisions in Moody's Hedge Framework, see pp. 4-6 and 15-16.
[35] Ibid., pp. 7-13 and 31-45.
[36] Ibid., pp. 40-41.

With respect to an SD that is not in compliance and thus requires the relief of CFTC Letter No. 15-21, the credit quality of the SD is linked to the SPV debt rated by Moody's and moreover has been linked from the time of initial rating. In other words, Moody's violated—and continues to violate—its published methodology and assigned an inaccurate rating to the SPV debt by modeling it as being delinked from the credit risk of an SD.[37]

SFIG Representation #4. *"SPVs commonly enter into swaps with SDs to:…(ii) transfer the credit and/or market risk on certain underlying obligations to or from the SPV."* (CFTC Letter No. 15-21, p. 4.)

Moody's Hedge Framework was applicable to interest rate swap contracts, basis rate swap contracts, and currency swap contracts only. The framework explicitly excluded credit default swap contracts.[38]

"Moody's Approach for Rating Thresholds of Hedge Counterparties in CDO Transactions" stipulated that a credit default swap contract would contain higher rating triggers than those for an "on-market, interest rate swap."[39] To the extent that Moody's assigned ratings to debt issued by an SPV that entered into a credit default swap contract that did not incorporate the higher rating triggers, Moody's violated its own internal guidelines as well as SEC regulations.

SFIG Representation #5. *"SFIG represents that, in order to minimize the impact of SD credit risk on the risk profile of the obligations issued by the SPV, the rating agencies have developed criteria designed to isolate the credit risk of the SD (the "Delinking Criteria") so that the rating agencies may assign a credit rating to the obligations issued by the SPV based solely on the quality of the underlying assets of the SPV and the structural features of the SPV, without taking into account the credit quality of the SD."* (CFTC Letter No. 15-21, p. 4.)

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[37] See Moody's "Approach to Assessing Linkage to Swap Counterparties in Structured Finance Cash Flow Transactions" (November, 12, 2013). See also PDF-numbered page 16 of the document cited in footnote 9 of Harrington (2014). "Moody's warns that even full 'compliance with the de-linkage framework at closing does not ensure that de-linkage will persist throughout the life of a transaction,' although Moody's will assume persistent de-linkage in assigning new ratings of Aaa(sf)." Using different assumptions to assign new ratings and monitor existing ones (e.g., the delinkage assumption for new ratings and the linkage assumption for existing ratings) is a violation of the regulatory rules of both the SEC and ESMA.

[38] See Moody's Hedge Framework, footnote 2.

[39] See "Moody's Approach for Rating Thresholds of Hedge Counterparties in CDO Transactions" (October 23, 2002), p. 1.

The flip clause, which remains a structural feature in the priorities of payments of most SPVs, was an integral part of Moody's Hedge Framework.[40] However, the nullification of a flip clause in 2010[41] has fully exposed SPVs with out-of-the-money swap contracts to the credit risk of SDs.[42] The vast majority of Legacy SPV Swap contracts are out-of-the-money and thus expose investors in SPV debt to *"the credit quality of the SDs."*

The updated Delinking Criteria do not state that the respective credit rating agencies can "*assign a credit rating to the obligations issued by the SPV based solely on the quality of the underlying assets of the SPV and the structural features of the SPV, without taking into account the credit quality of the SD."* Nor do the credit rating agencies represent that they, in assigning *"credit ratings to the obligations issued by the SPV,"* establish whether an SPV and SD have incorporated the provisions of Delinking Criteria into a swap contract.[43]

SFIG Representation #6. *"The Delinking Criteria are prescriptive rules that aim to ensure performance by the SD."* (CFTC Letter No. 15-21, p. 4.)

Delinking Criteria are no longer "*prescriptive rules that aim to ensure performance by the SD."*[44]

With respect to the Delinking Criteria that are applicable to the Legacy SPV Swap contracts, Moody's Hedge Framework contained pro-forma language that was to be included in the formation of what are now Legacy SPV Swap contracts.[45] This pro-forma language articulated all aspects of the framework and was intended to be incorporated into a swap contract at the outset and to be binding. Otherwise, if the provisions were not present in the swap contract at the outset or were not binding, the SPV debt was not delinked from the credit profile of an SD.[46]

Rather than abide by the binding provisions of the Legacy SPV Swap contracts, SDs directed trustees to have the provisions nullified by obtaining RACs from credit rating agencies that

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[40] See Moody's Hedge Framework, p. 16, *"Priority of Termination Payments to Counterparties."*
[41] See GH2015, footnote 40.
[42] See Harrington (2011), pp. 24-34, and Harrington (2014), pp. 2-8.
[43] See Fitch's "Counterparty Criteria for Structured Finance and Covered Bonds" (May 13, 2013), Moody's "Approach to Assessing Linkage to Swap Counterparties in Structured Finance Cash Flow Transactions" (November, 12, 2013), and S&P's *"Counterparty Risk Framework Methodology and Assumptions"* (May 31, 2012).
[44] Ibid. The current Delinking Criteria of Fitch, Moody's, and S&P explicitly acknowledge that key provisions are absent from new swap contracts between ABS issuers and SDs. See PDF-numbered pages 110-115 of the document cited in footnote 9 of Harrington (2014) for Moody's comments on the partial incorporation of its criteria into swap contracts between ABS issuers and SDs.
[45] See Moody's Hedge Framework, pp. 6 and 14-45.
[46] Ibid., pp. 1 and 4.

amended the provisions without offering compensation, consideration, or other forms of protection to SPV noteholders.[47] With respect to the RACs that were issued by Moody's, the agency violated an explicit tenet of Moody's Hedge Framework and, in so doing, violated both its internal guidelines and U.S. and EU regulations.[48]

In other words, credit rating agencies proactively undermined their Delinking Criteria by assisting SDs in not performing their obligations under Legacy SPV Swap contracts.

SFIG Representation #7. *"SFIG explains that under the Delinking Criteria, certain provisions of the documents governing the Legacy SPV Swap (the "Legacy SPV Swap Documentation") require the SD to take one or more Remedial Actions (as defined below) within designated time periods (in many cases, 30 days or less) following the withdrawal, qualification, and/or downgrade of the SD's credit ratings below certain specified thresholds."* (CFTC Letter No. 15-21, pp. 4-5.)

Moody's Hedge Framework was developed in close consultation with the SDs.[49]

In part based on these consultations, Moody's Hedge Framework explicitly stated that, alone of the Remedial Actions to be undertaken by an SD, only the posting of collateral was to occur within 30 days or less.[50] Posting of collateral is a key protection for holders of SPV debt when a Legacy SPV Swap contract is in-the-money to an issuer. The collateral amounts and valuation percentages set out in Moody's Hedge Framework were calibrated to offset the maximum number of days of market risk that could elapse before initial margin was posted and between the subsequent postings of variation margin.[51]

Moody's Hedge Framework also contained several provisions to facilitate timely posting of collateral by an SD, which, when present in a swap contract from the outset as stipulated by the

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[47] See GH2015, footnote 38.

[48] See Moody's Hedge Framework, footnote 5: *"Governing documents of most cashflow transactions enable an existing hedge to be adjusted, or a new one entered into, if modeling shows the expected losses of rated liabilities to be unimpaired by the proposed hedge."* See also p. 6: *"None of these obligations may be contingent upon issuance of Rating Agency Confirmation by Moody's prior to being activated."*

[49] See PDF-numbered page 36 of the document cited in footnote 9 of Harrington (2014): *"These obligations and sanctions incorporate the practical concerns aired by swap counterparties and participants in structured finance transactions, including the length of time typically required to post collateral under automatic notification, the time needed to effect replacement, and the potentially limited universe of replacement counterparties."* See also footnotes 5 and 10 in today's letter.

[50] See Moody's Hedge Framework, pp. 15-16.

[51] Ibid., pp. 11-13 and 19-28.

framework,[52] would enable an SD to easily post collateral under a Legacy SPV Swap contract within 30 days.[53] Moreover, other than in a single circumstance, failure of an SD to post collateral gave rise only to a termination event rather than an SD event of default.[54]

With respect to the other Remedial Actions—effecting replacement or obtaining a guaranty—Moody's Hedge Framework explicitly acknowledged that market realities might prevent an SD from ever complying let alone doing so within 30 days.[55] Accordingly, the framework introduced measures to maximize the likelihood of replacement occurring,[56] but provided no sanctions or penalties for an SPV to apply against an SD that had failed to either replace itself or obtain a guaranty.[57]

SFIG Representation #8. *"The purpose of any Remedial Action is to insulate the investors in obligations issued by the SPV from the credit risk of the SD. The taking of any Remedial Action will not affect the material economic terms (as represented by SFIG, for the purposes hereof, "material economic terms" means the pricing and other economic terms typically documented in a transaction confirmation that establish the amount and timing of the SPV's obligations) of the Legacy SPV Swap.*

SFIG represents that "Remedial Action" means any of the following:

1. Posting of collateral by the SD, which may require the SD and the SPV to enter into a collateral agreement and amend the Legacy SPV Swap Documentation in order to give effect thereto;" (CFTC Letter No. 15-21, p. 5.)

Moody's Hedge Framework explicitly and intentionally stipulated that an SD and an SPV were to enter into a collateral agreement at closing.[58] In other words, *"posting of collateral by the SD"* should not *"require the SD and the SPV to enter into a collateral agreement and amend the Legacy SPV Swap Documentation in order to give effect thereto"* at this late date.

To the extent that Moody's assigned ratings to debt issued by SPVs that had not entered into collateral agreements under the assumption that the debt was delinked from the credit risk of an

[52] Ibid., p. 4 and also p. 6: *"None of these obligations may be contingent upon issuance of Rating Agency Confirmation by Moody's prior to being activated."*
[53] Ibid., pp. 6-8 and 15-16.
[54] Ibid., pp. 17-18.
[55] Ibid., pp. 5-6.
[56] Ibid., pp. 9-10.
[57] Ibid., pp. 16-18.
[58] See Moody's Hedge Framework, pp. 4, 6-8, and 15-16. Also note on p. 6: *"None of these obligations may be contingent upon issuance of Rating Agency Confirmation by Moody's prior to being activated."*

SD, the debt ratings were both inaccurate and inconsistent with Moody's published methodology.

SFIG Representation #9. (Remedial Actions, continued)

"2. Replacing the downgraded SD with an entity who satisfies (or whose guarantor satisfies) the applicable credit rating requirements of the Legacy SPV Swap;

3. Obtaining a guaranty of the SD's obligations under the Legacy SPV Swap from a guarantor that satisfies the requisite credit ratings;" (CFTC Letter No. 15-21, p. 5.)

Moody's Hedge Framework included the flip clause as an investor protection of last resort for instances when an SD defaulted or entered bankruptcy[59] without having effected either Remedial Action #2 or #3 with respect to a swap contact that was out-of-the-money to an SPV.[60] Without a flip clause, an SPV with a swap contract that was out-of-the-money would be obligated to divert funds earmarked solely to pay SPV debt and use them to pay an accelerated termination amount to a SD counterparty that had defaulted or was in bankruptcy.

However, the nullification of a flip clause in 2010 also nullified Remedial Action #3, "*Obtaining a guaranty of the SD's obligations under the Legacy SPV Swap from a guarantor that satisfies the requisite credit ratings"* as a means of delinking SPV debt from the credit quality of an SD.

Simply put, a guaranty leaves the contractual relationship between an original SD and an SPV intact and does not relieve the SPV of its obligation to divert funds earmarked solely to pay SPV debt and use them to pay an accelerated termination amount to the SD in the event it defaults or enters bankruptcy.

A large-scale instance of ongoing linkage to the credit quality of an SD exists with respect to the 50+ guarantees that were provided by Merrill Lynch Derivative Products AG in respect of AIG obligations under Legacy SPV Swap contracts that were and remain deeply out-of-the-money to the respective CDO issuers.[61] These issuers remain fully exposed to the credit quality of AIG and will be obligated to divert funds earmarked solely to pay SPV debt and use them to pay accelerated termination amounts to AIG in the event of its default or bankruptcy.

To protect investors in SPV debt from its own credit quality, an SD must replace itself "*with an entity who satisfies the applicable credit rating requirements of the Legacy SPV Swap."*

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[59] Ibid., p. 16, "*Priority of Termination Payments to Counterparty."*

[60] Ibid., pp. 5-6, "*Replacement Drives the Framework, but Cannot be Guaranteed."*

[61] See Harrington (2011), pp. 25-29 and 63-64. See also PDF-numbered pages 57-59 of the document cited in footnote 9 of Harrington (2014).

However, the new Delinking Criteria of Moody's, S&P, and Fitch continue to include *obtaining a guaranty* as a Remedial Action that is equivalent to replacement in fully protecting investors in SPV debt.[62]

SFIG Representation #10. (Remedial Actions, continued)
"*4. Taking any other action as agreed with each relevant rating agency through procedures that are specified in the Legacy SPV Swap Documentation."* (CFTC Letter No. 15-21, p. 5.)

Moody's Hedge Framework intentionally and explicitly ruled out Remedial Actions such as "*(T)aking any other action as agreed with each relevant rating agency through procedures that are specified in the Legacy SPV Swap Documentation."*[63]

As I stated in my e-mail of April 7, 2015: "*I wrote this provision to mitigate the gaming of structured finance methodologies and criteria which was widespread and which has since been identified as a major source of investor losses and a key catalyst of the financial crisis. With respect to this provision, you may verify my account with Moody's Chief Credit Officer for Structured Finance Nicolas Weill."* You may also verify my account with Moody's Chief Regulatory Affairs and Compliance Officer Michael Kanef.

All Moody's RACs that enabled an SD to forgo either posting collateral under a Legacy SPV Swap contract and similar SPV swap contracts in the EU or installing a replacement counterparty for a Legacy SPV Swap contract and similar SPV swap contracts in the EU have violated Moody's Delinking Criteria and either SEC or ESMA regulations. These Moody's RACs affected "*the material economic terms"* of the Legacy SPV Swap contracts in a way that diminished previously existing protections for SPV debt and increased the extent of their linkage to the credit quality of SDs.[64]

As I wrote in my e-mail of April 7, 2015: "*Moody's RACs have often cited Remedial Action #4 as rationale in direct violation of the Moody's delinking criteria. Under these RACs, swap dealers avoided posting collateral, avoided replacing themselves, avoided obtaining guarantees, and ratcheted up investor exposure to unenforceable flip clauses.*

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[62] See Fitch's "Counterparty Criteria for Structured Finance and Covered Bonds" (May 13, 2013), Moody's "Approach to Assessing Linkage to Swap Counterparties in Structured Finance Cash Flow Transactions" (November, 12, 2013), and S&P's *"Counterparty Risk Framework Methodology and Assumptions"* (May 31, 2012).

[63] See Moody's Hedge Framework, p.4: *"To eliminate these distortions, the framework specifies Counterparty obligations upfront and does not contemplate their being supplanted in the future by 'other such remedies as may be agreed at a later date.' Alternatives to this framework will be considered at closing where the relevant provisions are already in place, rather than being left open-ended for future specification."*

[64] See GH2015, footnote 38.

"Simply put, swap dealers have obtained the blessing of Moody's and all credit rating agencies to define Remedial Action #4 as taking no action at all (i.e., to renege on existing contractual responsibilities that, if honored, would have protected investors). Contrary to the SFIG representation, the delinking criteria have NOT "proven to be prescriptive rules that aim to ensure performance by the swap dealer" (CFTC Letter No. 15-21, p. 4), but rather a very, very fluid set of protocols that swap dealers can unilaterally change simply by paying credit rating agencies to issue RAC."

Similarly, all S&P RACs with respect to Legacy SPV Swap contracts and similar SPV swap contracts in the EU issued after December 6, 2011 violated S&P's Delinking Criteria.[65] As with the Moody's RACs, the S&P RACs affected "*the material economic terms"* of the Legacy SPV Swap contracts and similar SPV swap contracts in the EU in a way that diminished previously existing protections for SPV debt and increased the extent of their linkage to the credit quality of SDs.

Additionally, RACs issued by S&P in 2015 may also violate the terms of various settlements between S&P and the SEC and the U.S. Department of Justice.[66]

SFIG Representation #11. *"The Remedial Actions required to be taken by SDs and SPVs may include amending a Legacy SPV Swap or amending and transferring the obligations of the SD under a Legacy SPV Swap to a third party or an affiliate of the SD. Although any such action will not change the material economic terms of a Legacy SPV Swap, it may cause a Legacy SPV Swap to be considered a 'new swap' or a 'swap transaction' for the purposes of the Specified Regulation."* (CFTC Letter No. 15-21, p. 5.)

SDs have created this problem for themselves by not having undertaken their contractual obligations to post collateral or to transfer "*the obligations of the SD under a Legacy SPV Swap to a third party or an affiliate of the SD"* as soon as these obligations were activated by the first of a series of downgrades of the credit ratings of SDs, beginning in 2009. The credit rating agencies signaled each series of SD downgrades well in advance. In response, SDs could have easily started posting collateral or transferring obligations under a Legacy SPV Swap contract to *"an affiliate."*

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[65] See S&P's "Counterparty and Supporting Obligations Methodology and Assumptions" (December 6, 2011), "*Evidence of binding obligation," p. 8.*
[66] See GH2015, footnotes 82, 83, 84, and 96.

Prior to the enactment of the Specified Regulations, neither the posting of collateral nor *"transferring the obligations of the SD under a Legacy SPV Swap to a third party or an affiliate of the SD"* would have been contingent upon *"amending a Legacy SPV Swap."*[67]

Instead, the SDs have responded to their downgrades from 2009 onward by inducing SPV trustees to obtain RACs to dilute the Legacy SPV Swap contracts and similar SPV swap contracts in the EU of the obligations pertaining to the posting of collateral or "*transferring the obligations of the SD under a Legacy SPV Swap to a third party or an affiliate of the SD*." These RACs did change "*the material economic terms of a Legacy SPV Swap"* contract and similar SPV swap contracts in the EU in ways that impaired investor protections. With respect to the RACs it issued, Moody's issued them even though the associated amendments increased the expected losses to investors,[68] which violated an explicit provision of Moody's Hedge Framework.[69]

Similarly, staff at Fitch, Moody's, S&P, several of the prudential regulators, and the SEC were alerted as early as 2011 to the deficiencies in the Delinking Criteria that were eroding protections for investors in SPV debt and increasing the extent of linkage to the credit quality of SDs.[70] In 2012, these credit rating agencies and the SEC were also alerted to the likelihood that the Legacy SPV Swap contracts would run afoul of clearing requirements.[71]

SFIG Representation #12. *"This is significant because, as discussed above, the Legacy SPV Swap may not previously have been subject to or affected by some or all of the Specified Regulations because it was entered into prior to the compliance date of such regulations. Thus, a Legacy SPV Swap may be subject to one or more Specified Regulations solely as a result of Remedial Actions taken by the SD and the SPV to remediate a credit ratings downgrade."* (CFTC Letter No. 15-21, p. 5.)

As with the SFIG Representation #11, the SDs have brought this problem on themselves by not posting collateral or obtaining replacement counterparties as the contractual obligations began being activated in 2009.[72] Moody's Hedge Framework specified provisions that, when implemented in a swap contract, would have prevented surprises such as a Legacy SPV Swap

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[67] See Moody's Hedge Framework, p. 6: *"None of the obligations may be contingent upon issuance of a Rating Agency Confirmation by Moody's prior to being activated."*

[68] See GH2015, footnote 38.

[69] See Moody's Hedge Framework, footnote 5: *"Governing documents of most cashflow transactions enable an existing hedge to be adjusted, or a new one entered into, if modeling shows the expected losses of rated liabilities to be unimpaired by the proposed hedge."*

[70] See Harrington (2011), pp. 24-25. See also PDF-numbered pages 1-6 of the document cited in footnote 9 of Harrington (2014).

[71] See PDF-numbered page 103 of the document cited in footnote 9 of Harrington (2014).

[72] Ibid.

contract being *"subject to one or more Specified Regulations solely as a result of Remedial Actions taken by the SD and the SPV to remediate a credit ratings downgrade."*[73]

SFIG Representation #13. *"Consequently, SFIG represents that it is highly likely that service providers will take the position that it is, at best, unclear whether they have the authority or discretion to take the steps on behalf of SPVs that may be necessary to enable the SD to comply with its regulatory obligations under the Specified Regulations."* (CFTC Letter No. 15-21, p. 6.)

Service providers such as trustees and rating agencies have already demonstrated with more than 100 RACs that they don't lack *"the authority or discretion to take the steps on SPVs that may be necessary to enable the SD to comply with its regulatory obligations under the Specified Regulations."*[74]

In particular, credit rating agencies, by having issued the RACs and weakened the investor protections in their updated Delinking Criteria,[75] have demonstrated that they have both the authority and discretion to take all steps requested by SDs even when these steps harm the interests of investors in SPV debt.

SFIG Representation # 14. *"Due to the legal and practical impediments described above, SFIG represents that SDs have a reasonable basis to believe that SPVs will not be able to agree to: (i) provide information necessary to satisfy an SD's onboarding procedures required to comply with the Specified Regulations; (ii) further amend their Legacy SPV Swaps, either via an industry-wide protocol or on a bilateral basis, to incorporate contractual provisions; or (iii) enter into new agreements (e.g., agreements related to portfolio reconciliation) that may be required to enable the SD to comply with its regulatory obligations under the Specified Regulations*. (CFTC Letter No. 15-21, p. 6.)

For the reasons already stated in today's letter, there is no *"reasonable basis"* for the SD's beliefs.

By obtaining noteholder consents or RACs,[76] the trustees of SPVs can easily and costlessly "*agree to: (i) provide information necessary to satisfy an SD's onboarding procedures required to comply with the Specified Regulations; (ii) further amend their Legacy SPV Swaps, either via*

[73] See Moody's Hedge Framework, p. 4.
[74] See GH2015, footnote 38.
[75] See Harrington (2014), pp. 4-5.
[76] See GH2015, p. 7.

an industry-wide protocol or on a bilateral basis, to incorporate contractual provisions; or (iii) enter into new agreements (e.g., agreements related to portfolio reconciliation) that may be required to enable the SD to comply with its regulatory obligations under the Specified Regulations."

Sincerely yours,

William J. Harrington
Experts Board, Wikirating.org – Key Expert, Structured Finance Topics

cc: Ms. Regina Thoele, Compliance, National Futures Association, Chicago
Ms. Jamila A. Piracci, OTC Derivatives, National Futures Association, New York
Mr. Frank Fisanich, Division of Swap Dealer and Intermediary Oversight, CFTC, Washington, D.C.
Mr. Christopher Kirkpatrick, Secretary, CFTC, Washington, D.C.
Mr. Brian O'Keefe, Division of Clearing and Risk, CFTC, Washington, D.C.
Ms. Verena Ross, Executive Director, European Securities and Markets Authority, Paris, France
Mr. Adam Ashcraft, Credit Risk Management, Federal Reserve Bank of New York, New York
Mr. Andy Haldane, Bank of England, London, UK
Ms. Allison Parent, Bank of England, London, UK
Mr. Michael Hume, Bank of England, London, UK
Mr. Richard Johns, Executive Director, Structured Finance Industry Group, Washington, D.C.
Mr. Michel Madelain, President, Moody's Investors Services, New York
Mr. Michael Kanef, Chief Regulatory Affairs and Compliance Officer, Moody's Investors Services, New York
Mr. Nicolas Weill, Chief Credit Officer – Global Structured Finance, Moody's Investors Services, New York

Appendix D* — WJH Correspondence with Staff of the CFTC (Including the CFTC Secretary, Office of Inspector General, and Division of Swap Intermediary Oversight (DSIO)) from 17 July 2017 to 3 August 2017 Regarding:
1. Five Meeting Requests for WJH to Discuss the Benefits of Margin Posting Under an ABS Flip Clause Swap with Staff of the Respective CFTC Commissioners and the DSIO; and
2. Seven Meetings in Which Structured Finance Industry Group (SFIG) Staff and Members Lobbied CFTC Staff to Exempt ABS Flip Clause Swaps from Margin Posting

------- *Appendix D comprises pp. 111-116 of this rebuttal to CFTC Letter No. 17-52 ---------

---- Forwarded Message -----
From: Bill Harrington <wjharrington@yahoo.com>
To: "Kirkpatrick, Chris" <CKirkpatrick@CFTC.gov>
Cc: "Smith, Thomas J." <tsmith@CFTC.gov>; "Fisanich, Frank" <FFisanich@CFTC.gov>; "Bauer, Jennifer" <JBauer@CFTC.gov>; "Beale, Joshua" <JBeale@CFTC.gov>; "Martinez, Rafael" <RMartinez@CFTC.gov>; "Schlichting, Paul" <PSchlichting@CFTC.gov>; "McPhail, Lihong" <LMcPhail@CFTC.gov>; "Flaherty, Eileen" <EFlaherty@CFTC.gov>; Gretchen Morgenson <gretchen@nytimes.com>; "sairah.burki@sfindustry.org" <sairah.burki@sfindustry.org>; "oig@cftc.gov" <oig@cftc.gov>; "richard.johns@sfig.org" <richard.johns@sfindustry.org>; "orolh@sec.gov" <orolh@sec.gov>
Sent: Thursday, August 3, 2017 7:49 PM
Subject: Re: NO! to SFIG Request for No-Action Relief for Securitization Vehicles from Variation Margin Compliance

Dear Secretary Kirkpatrick,

Please forward my request to the offices of Commissioners Quintenz and Benham. Please also respond by email letting me know that you have done so.

I note that staff of the CFTC and the prudential regulators discussed the SFIG request for a no-action letter with SFIG staff and members yesterday.

Best regards,

Bill Harrington

From: "Kirkpatrick, Chris" <CKirkpatrick@CFTC.gov>
To: Bill Harrington <wjharrington@yahoo.com>
Cc: "Smith, Thomas J." <tsmith@CFTC.gov>; "Fisanich, Frank" <FFisanich@CFTC.gov>; "Bauer, Jennifer" <JBauer@CFTC.gov>; "Beale, Joshua" <JBeale@CFTC.gov>; "Martinez, Rafael" <RMartinez@CFTC.gov>; "Schlichting, Paul" <PSchlichting@CFTC.gov>; "McPhail, Lihong" <LMcPhail@CFTC.gov>; "Flaherty, Eileen" <EFlaherty@CFTC.gov>
Sent: Monday, July 17, 2017 12:41 PM
Subject: RE: NO! to SFIG Request for No-Action Relief for Securitization Vehicles from Variation Margin Compliance

Dear Mr. Harrington,

This confirms receipt by the CFTC of your email submission, below. Your submission has been forwarded to the Offices of Acting Chairman Giancarlo and Commissioner Bowen, respectively. I see that your email was also sent to the Director and several staff members of the Division of Swap Dealer and Intermediary Oversight (DSIO). As they are now also in receipt of your correspondence, I must defer to them regarding your request for a meeting.

Sincerely,

Christopher Kirkpatrick

From: Bill Harrington [mailto:wjharrington@yahoo.com]
Sent: Monday, July 17, 2017 12:13 AM
To: Kirkpatrick, Chris; Smith, Thomas J.; Fisanich, Frank; Bauer, Jennifer; Beale, Joshua; Martinez, Rafael; Schlichting, Paul; McPhail, Lihong; Flaherty, Eileen
Cc: Gretchen Morgenson; richard.johns@sfig.org; sairah.burki@sfindustry.org; orolh@sec.gov
Subject: NO! to SFIG Request for No-Action Relief for Securitization Vehicles from Variation Margin Compliance

Dear Mr. Kirkpatrick:

My name is Bill Harrington. I am a private US citizen and am writing to ask that you schedule a meeting with CFTC staff and me.

I will discuss the *benefits* of margin posting against an uncleared swap with RAC provisions and a flip clause. These benefits accrue to the US financial system and economy as a whole and to each provider of an uncleared swap with RAC provisions and a flip clause.

The *benefits* of margin posting against an uncleared swap with RAC provisions and a flip clause also accrue to the entire securitization sector—the only sector to use this type of swap.

Without margin posting, the securitization sector cannot come clean and mature into a sector that helps grow the US economy rather than harms the country by causing financial crises and bailouts.

Remember! An unmargined, uncleared swap with RAC provisions and a flip clause was the gateway component of the gateway securitizations (CDOs, CDS and RMBS) that caused the financial crisis.

Margin posting will shut down the gateway swap component for good.

This is long overdue! Without the gateway swap component, the gateway securitizations could not have been issued in the first place and the financial crisis might never have occurred.

Simply put, margin posting against an uncleared swap with RAC provisions and a flip clause is a win-win-win-win-win best practice and simple common sense.

Only industry lobbyists such as SFIG Finance—an algae bloom that flourishes in the fetid DC swamp—and rating agencies lost when the CFTC and the prudential regulators adopted the parallel sets of swap margin rules in late 2015.

Accordingly, the CFTC must keep 1 September 2017 as the compliance deadline for the daily exchange of variation margin against an uncleared swap with RAC provisions and a flip clause.

2017 At Bats at CFTC Field: SFIG = 6/Bill Harrington = 0

I would like to meet with all CFTC staff who have had discussions with SFIG staff and members regarding an unmargined, uncleared swap with RAC provisions and a flip clause.

You may identify many of these CFTC staff using the SFIG request for no-action relief from variation margin compliance of 11 July 2017. See 'Recent History' of the SFIG request, page 2. For instance, SFIG staff and members met with CFTC Division of Swap Intermediary Oversight (DSIO) staffers Tom Smith, Frank Fisanich and Rafael Martinez on 31 January 2017.

Most recently, SFIG staff and members lobbied DSIO staff regarding the request for no-action relief of 11 July 2017 two days later on 13 July 2017, according to the SFIG News of the same date.

I *did* meet with DSIO staff to describe the systemic, sector and entity-level benefits of margin posting against an uncleared swap with RAC provisions and a flip clause—in 2015! These DSIO staff included Messrs. Smith, Fisanich and Martinez.

Mr. Martinez posted a summary of one such meeting, a joint intake call on 12 May 2015 that I led with the six respective teams of the CFTC and the five prudential regulators that drafted the two parallel sets of swap margin rules.

The CFTC takeaway? Mr. Harrington and his colleague "believe ABS issuers' current practice for dealing with counterparty credit risk [an unmargined, uncleared swap with RAC provisions and a flip clause] is inadequate by construction and presents a systemic risk."

Mr. Martinez denied my repeated requests to meet again with him, Mr. Smith, Mr. Fisanich and other DSIO staff in 2016.

My email correspondence with Mr. Martinez and the CFTC Office of Inspector General on this matter is included in my submission to the CFTC and OMB 'Capital Requirements for Swap Dealers and Major Swap Participants' of 4 May 2017. See Appendix C (pages 137-143) and also pages 16-20, which detail aspects of Appendix C.

Other of my communications with CFTC staff, including yourself, may also be found in my CFTC/OMB submission. As examples, see: footnote 5 (page 5); the description of Appendix D (pages 20-21); and Appendix D (pages 144-167).

SFIG Will Offer the CFTC Any Line in Pushing Gateway Swaps!

My submission to the CFTC/OMB also lists and rebuts the very many serious misrepresentations that SFIG staff and members have made to DSIO staff regarding the characteristics of an uncleared swap with RAC provisions and flip clauses. See pages 40-53 of my CFTC/OMB submission.

SFIG staff and members continue to make serious misrepresentations regarding the characteristics of an unmargined, uncleared swap with RAC provisions and a flip clause not only to DSIO staff but also to Acting Chair Giancarlo and to Commissioner Bowen.

Three SFIG lines fall outside the overly generous characterization of misrepresentation.(A parenthetical correction follows each italicized line.)

1. *Both the CFTC and the prudential regulators excluded legacy swaps in the respective swap margin rules.*(In fact, CFTC and prudential regulators each defined a legacy swap that was amended in any manner at all as a new swap subject to the respective swap margin rules. No exceptions.)
2. *A replacement market of highly-rated swap providers for legacy unmargined, uncleared swaps with RAC provisions and flip clauses exists.* (Rating agency data and RAC letters demonstrate that the pre-crisis rating and risk management assumption of replacement has been a mirage since 2008. The enforceability of a flip clause, if upheld, is the last and not the first nail in the replacement coffin.)
3. *A swap provider of an unmargined, uncleared swap with RAC provisions and a flip clause that is a swap asset enjoys security in securitization collateral 100% of the time.* (The flip clause, when upheld, instantaneously transforms an uncleared swap asset with RAC provisions and a flip clause into a fixed claim of USD 0.00. The security is, like the replacement assumption, a mirage.)

Below is the pertinent language on pages 2-3 of the SFIG request for no-action relief of 11 July 2017. Each whopper appears in the order above and is italicized.

"While *legacy transactions were intended to be excluded from the new margin requirements* [italics added], life cycle events unrelated to the performance of the securitization transaction may require *that a legacy transaction may have to replace the swap and/or the swap*

provider (i.e., a novation may be required due to the downgrade of the swap provider) [italics added]."

"We further continue to request that the CFTC, in tandem with the prudential regulators, reconsider the regulations that have resulted in some securitization SPVs being characterized as "financial end users" and therefore being subject to daily two-way margin requirements, *despite the fact that swap providers in securitization transactions are fully secured in the collateral owned by the SPV* [italics added]. We would be pleased to speak with you regarding this point at your convenience."

SFIG Talks Both Sides of the USD 0.00 Flip Clause Coin

A month earlier, SFIG acted to debase one of its lines—namely, that a swap provider is "fully secured in the collateral owned by the SPV"—by filing an amicus brief with respect to *Lehman Bros. Special Financing, Inc. v. Bank of America, et al., Case No. 17-cv-01224 (LGS)*.

The SFIG brief urges the court to uphold the enforcement of flip clauses against the Lehman Brothers estate, even though the flip clauses in question instantaneously transformed each respective unmargined, uncleared swap asset of Lehman Brothers, regardless of how deeply-in-the-money, into a fixed claim of USD 0.00.

SFIG is technically correct that each claim of the Lehman Brothers estate to a fixed amount of USD 0.00 is "*fully secured in the collateral owned by the SPV."* Securing a fixed amount of USD 0.00 ain't tough.

SFIG is also technically correct that Lehman Brothers staff agreed to the flip clauses in question when entering into hundreds of pre-crisis swaps with the defendants—44 CDO issuers.

However, SFIG ignores the counterfactual that few if any of these 44 CDOs obtained an opinion on waterfall enforceability that did not carve-out the flip clause.

These carve-outs demonstrated over and over again that a flip clause had dubious standing under US law. The CDO issuers and their counsel knew this from the outset but this knowledge never stopped them from adding a flip clause to an unmargined, uncleared swap with RAC provisions day in and year out.

In other words, there was always bad faith on the part of both securitization issuers and swap providers of an unmargined, uncleared swap with RAC provisions and a flip clause. Each group—and by extension 100% of players in 100% of the securitization sector—has long known that a flip clause exposes one of the two parties to losses equal to the 100% of the swap asset. Even so, neither party holds meaningful reserves against this exposure.

In short: A pox on both parties to an unmargined, uncleared swap with RAC provisions and a flip clause. This gateway swap, which does not work in practice and cannot work even in theory, can be pushed only for so long as *all* interested parties—including the CFTC—ignore their respective responsibilities.

This may be a key reason that SFIG would be "pleased to speak" with Acting Chair Giancarlo and Commissioner Bowen "regarding this point [the flip clause] at your convenience," i.e. in a private, off-the-record setting. Neither SFIG, nor rating agencies, nor counsel, nor any other entity can or will defend the flip clause for attribution.

Expanding on an earlier analogy, the flip clause was the gateway provision in the type of swap that was the gateway swap component of the gateway securitizations—CDOs, CDS and RMBS—that caused the financial crisis.

My CFTC/OMB submission makes this point clear. An unmargined, uncleared swap with RAC provisions and a flip clause should be consigned to the dustbin of history along with the other failed crisis-era structures.

Margin posting alone will do the trick perfectly.

Hey CFTC: Cut Off SFIG Pushers and Cut In Bill Harrington!

I cited similar SFIG misrepresentations in an email to you of 7 May 2017 in which I requested two separate meetings with DSIO staff.

The first meeting that I asked you to schedule in my email of 7 May 2017 was to discuss margin posting against an uncleared swap with RAC provisions and a flip clause. Today's email is my second request for such a meeting.

The second meeting that I asked you to schedule in my email of 7 May 2017 was to discuss my CFTC/OMB submission of 4 May 2017.

My email of 7 May 2017 and today's email are each posted as an article on my LinkedIn profile.\

The email of 7 May 2017 can be accessed with this link.

Today's email can be accessed with this link. PWIPC (Persistent Well-Informed Private Citizen) To CFTC: "Deny SFIG Request for Margin Exemption for ABS Swaps"

PWIPC (Persistent Well-Informed Private Citizen) To CFTC: "Deny SFIG Request for Margin Exemption for ABS Swaps&...

From: Bill Harrington <wjharrington@yahoo.com> To: Chris Kirkpatrick <ckirkpatrick@cftc.gov>; Thomas...

I will call Monday 17 July to schedule a meeting to discuss margin posting against an uncleared swap with RAC provisions and a flip clause. This call will be my third request for such a meeting.

If the CFTC is granting SFIG staff and members a seventh meeting in 2017—a meeting that will misinform Acting Chair Giancarlo and Commissioner Bowen no less—DSIO staff can grant one meeting to a Persistent Well-Informed Private Citizen.

Best regards,

Bill Harrington 917-680-1465

Bill Harrington has been assessing derivative contracts in the structured finance sector for 17 years, most recently at Debtwire ABS and previously at Moody's Investors Service. He has filed evaluations of the capitalization and ratings of derivative contracts and asset-backed securities with US and European regulators and with credit rating agencies. Bill also worked as a structurer of fixed-income and FX derivative contracts at Merrill Lynch and a currency analyst at Wharton Econometrics. Bill has an MBA from The Wharton School and a BA in Economics from the University of Pennsylvania.