



On February 5, 2024, Rule 192 became effective under the Securities Act of 1933. The rule will restrict financial institutions that are deemed to be Securitization Participants from being involved in transactions that would create a material conflict of interest in asset-backed securities (“ABS”). The rule is intended to protect investors from being financially harmed by individuals managing financial deals. Firms are expected to implement programs that comply with the requirements set forth by Rule 192 prior to June 9, 2025.

5 insights you should know

Securitization Participants: The SEC defines Securitization Participants as underwriters/ placement agents, initial purchasers, or sponsors of an ABS, which typically includes those firms that enter into agreement with an ABS issuer or selling security holders. Securitization Participant also includes affiliates or subsidiaries of those firms that have access to, or receive information about, the ABS or asset pool underlying the ABS prior to the closing.

Prohibited transactions: The rule will prohibit Securitization Participants from engaging in certain conflicted transactions, including short sales of ABS and the purchase of a credit default swap (CDS) or other credit derivative that entitles the Securitization Participant to receive certain ABS-related payments. The rule also prohibits the purchase or sale of any financial instrument (other than the relevant ABS) or entry into a transaction that is substantially the economic equivalent of a transaction.

Substantial the economic equivalent: Rule 192 does not expressly define “substantial economic equivalent” transactions; however, it considers transactions that include sizeable portions of the ABS asset pool or have characteristics that replicate the idiosyncratic credit risk of the ABS pool. If a transactions does replicate the economic mechanics of prohibited transactions for an ABS pool, it may be considered a conflicted transaction.

Rule exceptions: The rule provides exceptions for risk-mitigating hedging activities, bona fide market-making activities, and liquidity commitments. Certain conditions must be satisfied for a securitization participant to rely on exceptions, including the securitization participant’s establishment and enforcement of an internal compliance program reasonably designed to ensure the securitization participant’s compliance with the conditions of the exception.

Conflicted transactions: Conflicted transactions are prohibited transactions (or their substantial economic equivalents) where the materiality condition is met, and that do not align to an exception set forth by Rule 192. Firms are prohibited from engaging in conflicted transactions starting when the firm becomes a securitization participant related to an ABS and continuing until one year after the assets are first sold.

5 considerations to evaluate

1

Assess the impact to your business lines: Firms will be expected to establish Rule 192 compliance programs that are tailored to the specific risks of their business activities. Firms should assess the current state of relevant policies and procedures in their business lines as well as information flows across transaction desks, and revise policies and processes to avoid executing conflicted transactions.

2

Establish and maintain processes to evaluate facts and circumstances: Firms will need to evaluate whether transactions are substantial economic equivalents of conflicted transactions. In certain instances, a facts and circumstances evaluation will need to be completed to determine if a short position or CDS would be deemed to be substantially the economic equivalent of a conflicted transaction. Firms should consider how to conduct this analysis, including considering creating processes to conduct lookbacks for implicated transactions.

3

Leverage existing compliance programs: Similar to the Volcker Rule, Rule 192 will require compliance programs to account for exceptions and underlying conditions related to prohibited transactions. Firms should evaluate whether they can leverage existing Volcker compliance infrastructure, including policies, procedures, and control frameworks that govern proprietary trading activities.

4

Enhanced control room controls: Firms should ensure that the processes and procedures documentation explicitly references Rule 192 and includes detailed instructions for informing the control room in instances where it is acting as a Securitization Participant either during contracting or far enough in negotiations to have knowledge of the underlying securities in an ABS or CLO. Many firms may decide to enhance or expand control room restricted or watch lists, leveraging existing compliance management software to restrict trading in Rule 192-related securities.

5

Tailored surveillance and supervision: Firms may prepare for Rule 192 compliance by developing custom surveillance algorithms tailored to identify specific types of transactions or patterns of conflicted transactions. Additionally, firms should consider developing supervision and surveillance programs that evaluate transactions that could be the substantial economic equivalent of a conflicted transaction.

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¹ SEC, “Prohibition against conflicts of interest in certain securitizations,” November 27, 2023.