LATHAM & WATKINS LLP

Decoding the Risk Retention Sponsor Definition: A Practical Guide to Identifying the Sponsor Under the US Credit Risk Retention Rules

Key considerations when determining which party bears the risk retention obligation in securitization transactions subject to Regulation RR.

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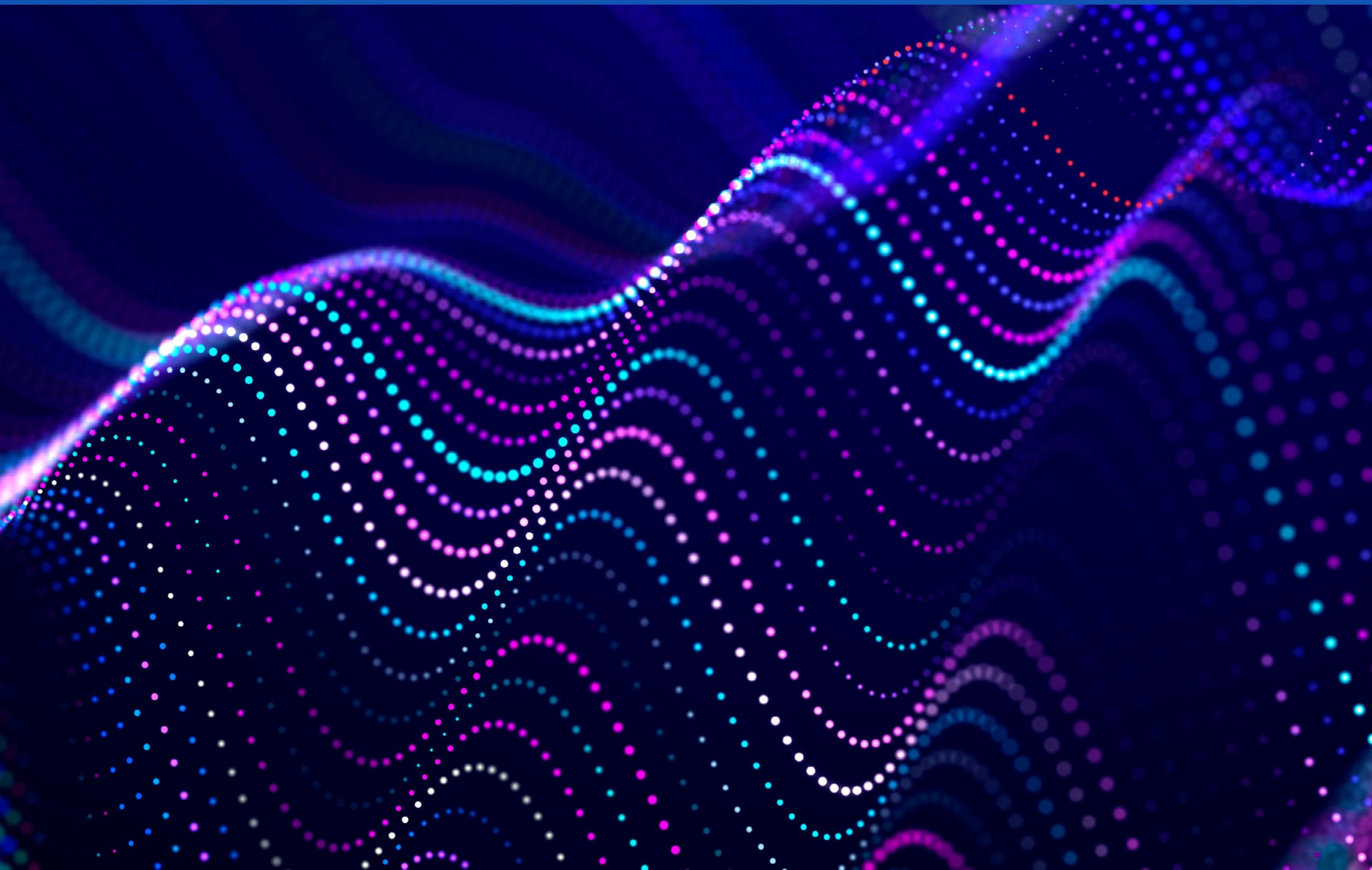

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1. Executive Summary

Credit risk retention requires the sponsor of a securitization transaction to retain at least 5% of the credit risk of the securitized assets, and prohibits hedging, transferring, or financing that retained interest in ways that would shift the economic exposure away from the retaining party. Determining which party is the sponsor may seem challenging in transactions that do not resemble a traditional securitization; however, the term "sponsor" is rooted in decades of application of the securities laws to a variety of securitization structures.

This report provides a practical framework for identifying which party or parties would be the sponsor under the US Credit Risk Retention (CRR) rules in Regulation RR,[1] and sets out factors to consider when selecting the entity that will be the retention holder.

Who should read this. This guide is for structured finance teams at sponsors, issuers, underwriters, arrangers, placement agents, portfolio managers, and investors, as well as the counsel and compliance professionals who advise them. Identifying the sponsor and selecting the retention holder at the outset is critical because these decisions shape the transaction's structure and economics. Because more than one party may qualify as a sponsor, and because each such party must ensure that the risk retention requirement is satisfied, the analysis matters even to participants who do not expect to hold the retained interest themselves.

The interpretive approach. Neither the Securities Act of 1933 (Securities Act) nor the Securities Exchange Act of 1934 (Exchange Act) defines "sponsor," and the term does not appear in the statutory provision that imposes risk retention. We interpret the CRR definitions in the context of their "regulatory DNA" — the interlocking definitions of securitizer, sponsor, depositor, issuer, and issuing entity developed through Regulation AB and refined across the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) rulemaking record.

The statutory "securitizer" definition has two prongs: (i) the issuer of an asset-backed security (interpreted as the depositor), and (ii) the person who "organizes and initiates" the transaction by selling or transferring assets to the issuer (substantially the Regulation AB sponsor). In practice, CRR applies to the sponsor because the depositor is typically controlled or funded by the sponsor.

A four-step framework. We recommend analyzing every transaction in the following sequence:

1. Determine whether the security is an Exchange Act ABS
CRR's retention obligation applies only where a transaction involves the issuance of asset-backed securities (ABS) as defined in the Exchange Act — commonly referred to as "Exchange Act ABS" — making this classification the gating question. If the instrument is not an Exchange Act ABS, then CRR imposes no retention obligation. We address this threshold question in detail in our companion report, "Decoding the Exchange Act ABS Definition: A Practical Guide to Classifying Structured Finance Transactions."[2]

2. Identify the sponsor or sponsors
The sponsor is the party that "organizes and initiates" the transaction through active participation in decisions expected to affect the credit quality of the assets — in short, the brains or mastermind of the transaction that will result in a securities issuance.

3. Determine who will hold the retained risk
The retention may be held by the sponsor itself, a majority-owned affiliate of the sponsor (any entity other than the issuing entity that directly or indirectly majority controls, is majority controlled by, or is under common majority control with the sponsor), an originator in the limited circumstances the rules permit, or, in commercial mortgage-backed securities (CMBS), a qualified third-party purchaser.

4. Understand the prohibitions
The retaining party generally may not hedge or transfer the retained interest in ways that reduce its required credit exposure, and may not pledge it as collateral for any non-recourse financing, although full-recourse pledges and ordinary-course hedges of non-credit risks such as interest-rate or currency risk remain permitted. These constraints overlap with, but are not identical to, the conflicts-of-interest prohibitions of Securities Act Rule 192.

The LSTA decision and its limits. In its 2018 decision in Loan Syndications & Trading Ass'n v. Sec. & Exch. Comm'n (the LSTA decision),[3] the United States Court of Appeals for the District of Columbia Circuit vacated CRR insofar as it treated open-market collateralized loan obligation (CLO) managers as securitizers. The holding is narrow: it is confined to open-market CLO managers and cannot be relied on in balance sheet CLOs.

What this means for market participants. Sponsor identification should be undertaken as a facts-and-circumstances analysis at the outset of structuring, focusing on economic substance rather than transactional labels. Moreover, sponsor identification should test whether more than one party could be deemed a sponsor before a single designation is finalized. Given the complexity of these determinations and their compliance consequences, market participants should seek advice on applying this analytical approach to specific transactions.

How this report is organized. This report develops each step of the four-step framework in detail. We begin with the scope and threshold questions that govern whether CRR applies and the policy rationale that forms the basis of the risk retention regime. We then trace the regulatory history of the "securitizer" and "sponsor" definitions through the Regulation AB and risk retention rulemaking record, describe the four-step framework, and work through structural examples spanning single- and multiple-sponsor traditional ABS, CLOs, revolving pool master trusts, and credit-focused investment vehicles. We close with a set of unifying principles and the related regulatory obligations triggered by Exchange Act ABS classification.

2. Scope and Threshold Questions

CRR applies to securitizations involving "asset-backed securities" as defined in the Exchange Act,[4] making Exchange Act ABS classification the gating question: If the securities issued do not fall within the Exchange Act ABS definition, CRR does not apply.

The definition of Exchange Act ABS can be difficult to apply in practice, particularly as transaction structures have grown more complex. In February 2026, we published a companion report, "Decoding the Exchange Act ABS Definition: A Practical Guide to Classifying Structured Finance Transactions," which provides a practical framework for analyzing this definition, including a comprehensive analysis of its regulatory origins, textual requirements, and application to common and emerging structures. We refer to this companion report herein as our "Exchange Act ABS Guide."

Not all securitized products fall within the Exchange Act ABS definition, and those that do not are outside CRR's scope; we address the threshold determination, including examples of products that fall outside the definition, under Section 5.2 (Step One: Determine Whether the Security Is an Exchange Act ABS). The securities law framework also includes other definitions of "asset-backed security" that are not referenced in the CRR rule but are used to implement other rules.[5]

Assuming that the Exchange Act ABS determination has been made, the next step is to identify which securitization party is obligated to hold 5% of the credit risk of the assets collateralizing the Exchange Act ABS in accordance with CRR.

3. Policy Rationale for Credit Risk Retention

As noted by the Financial Crisis Inquiry Commission in its 2011 report on the causes of the 2007–09 financial crisis, "[f]rom the speculators who flipped houses to the mortgage brokers who scouted the loans, to the lenders who issued the mortgages, to the financial firms that created the mortgage-backed securities, collateralized debt obligations (CDOs), CDOs squared, and synthetic CDOs: no one in this pipeline of toxic mortgages had enough skin in the game. They all believed they could off-load their risks on a moment's notice to the next person in line."[6]

Under the originate-to-distribute model that dominated pre-crisis securitization, originators and sponsors could transfer virtually all credit risk to investors without regard to the future economic performance of the loans that were transferred. This created a misalignment of interests between the parties that originated or structured the transaction and those that bore the ultimate credit risk, which in turn diminished incentives to maintain underwriting discipline.

This misalignment of interests served as the backdrop for Congress's enactment of Section 941 of the Dodd-Frank Act.[7] Section 941 required the Securities and Exchange Commission (SEC), the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (the Agencies) to jointly adopt rules obligating "securitizers to retain an economic interest in a material portion of the credit risk for any asset that securitizers transfer, sell, or convey to a third party."[8]

In the CRR Adopting Release,[9] the Agencies acknowledged that, by requiring sponsors to retain credit exposure to the securitized assets, risk retention is intended to ensure that sponsors have "skin in the game" and thus are economically motivated to be more judicious in their selection of loans being securitized, thereby helping to produce asset-backed securities collateralized by loans with higher underwriting standards.[10]

This policy foundation serves as the touchstone for interpreting who qualifies as a securitizer under Exchange Act ABS-related rules, and specifically which party bears the obligation to retain 5% of the credit risk when issuing an Exchange Act ABS.

4. Regulatory History: Tracing the Evolution of the Securitizer Definition

4.1 The Securitizer Definition in the Dodd-Frank Act

The "securitizer" definition was added to the securities law framework in 2010, when Congress imposed new regulatory obligations on the securitization market.

Section 941 of the Dodd-Frank Act defines securitizer as:

- an issuer of an asset-backed security; or
- a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.[11]

In addition to the requirement to adopt rules implementing risk retention, the Dodd-Frank Act references "securitizer" in Section 943, which required the SEC to adopt rules relating to representations and warranties in ABS offerings.

The SEC first interpreted the definition of "securitizer" in 2011, when the SEC adopted rules to implement Section 943. In the adopting release for those rules, the SEC noted that, with respect to registered transactions and the definitions of transaction parties in Regulation AB, sponsors and depositors both fall within the statutory definition of "securitizer."[12] In an accompanying footnote, the SEC stated, "We interpret the term 'issuer' in Section 15G(a)(3)(A) to refer to the depositor of an asset-backed security. This treatment is consistent with our historical regulatory approach to that term, including the Securities Act and the rules promulgated under the Securities Act and the Exchange Act."[13]

Any interpretive exercise of the terms "securitizer," "sponsor," "depositor," and "issuer" should also consider the broader regulatory framework, because all of these definitions are constructed from regulatory DNA. Below we discuss the foundations of these definitions in the securities law framework to provide context and an analytical framework to interpret the definitions in the CRR rules.

4.2 The Issuer, aka Depositor, but Not the Issuing Entity

The definition of the term "issuer" in Section 2(a)(4) of the Securities Act is, in relevant part:

> "every person who issues or proposes to issue any security; except that with respect to… collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions)… the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued."[14]

In 2004, through Regulation AB, the SEC codified the securities law framework as it applies to registered offerings of asset-backed securities.[15] In the 2004 Regulation AB Adopting Release, the SEC explained that asset-backed securities and ABS issuers differ from corporate securities and operating companies, and Regulation AB was designed to consolidate and codify staff positions and industry practice.[16] As a result, the SEC adopted Securities Act Rule 191[17] to make clear that the "depositor" is the "issuer" for purposes of Section 2(a)(4) of the Securities Act and related obligations and liability.

Accordingly, the SEC also adopted the definition of "depositor" as:

> "[the person] who receives or purchases and transfers or sells the pool assets to the issuing entity. For asset-backed securities transactions where there is not an intermediate transfer of the assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust."[18]

The SEC also adopted identical text in Exchange Act Rule 3b-19[19] to mirror the treatment of the definition of "issuer" in Section 3(a)(8) of the Exchange Act[20] because the Exchange Act definition mirrors the Securities Act, in relevant part.

Therefore, it is reasonable to analyze the reference to "issuer" in the text of the Exchange Act's "securitizer" definition consistently with the regulatory framework that existed at the time the securities laws were amended by the Dodd-Frank Act and that still exists today.

The issuer, however, should not be confused with the issuing entity. In Regulation AB, the term "issuing entity" is defined as "the trust or other entity created at the direction of the sponsor or depositor that owns or holds the pool assets and in whose name the asset-backed securities supported or serviced by the pool assets are issued."[21]

In the securities law framework, the issuing entity is the legal entity that exists to issue the asset-backed securities to investors. As a general matter, the issuing entity is designed to have no business or management (e.g., C-suite or board of directors), and is structured to create legal and credit separation from third parties.[22] Therefore, it is reasonable to interpret the reference to "an unincorporated investment trust not having a board of directors" in the definition of "issuer" under the Securities Act and Exchange Act consistent with "issuing entity" as defined in Regulation AB.

What if there is no intermediate transfer of assets between the sponsor and the issuing entity? The depositor definition addresses this situation by designating the sponsor as depositor, and accordingly the issuer of the security. We discuss the Regulation AB "sponsor" definition in more detail below. As recognition that a trust would not be the appropriate party to impose securities law obligations and liability, if a trust is transferring or selling the assets to the issuing entity, the rules look through to the depositor of that trust.

But what do these terms mean in practice?

The terms designate that the depositor, the one "who receives or purchases and transfers or sells the pool assets to the issuing entity" as "issuer" is one of the persons responsible for securities law compliance. The securities law framework does not recognize the issuing entity, or the trust, as the party to attach securities law obligations and liabilities, as it is merely the legal vessel that the issuer utilizes to effectuate a securities transaction.

As a result, the person who fits the "issuer" definition under the regulatory framework is also a person who meets the definition of "securitizer" in Section 15G(a)(3) and, based on the facts and circumstances of the transaction, compliance with CRR may be required.

4.3 The Sponsor

Neither the Securities Act nor the Exchange Act defines the term "sponsor." However, the terms "sponsor" and "sponsorship" are used in various contexts throughout the Exchange Act, but not in the section that imposes risk retention. In the Securities Act, the term "sponsor" appears in Section 27B — which directs the SEC to adopt rules addressing conflicts of interest arising in certain securitization transactions — but it is not defined. Therefore, we must look to the regulatory DNA to help interpret the term "sponsor" within the SEC's securitization regulatory framework.

In the 2004 Regulation AB Adopting Release, the SEC explained that sponsors of asset-backed securities often include banks, mortgage companies, finance companies, investment banks, and other entities that originate or acquire and package financial assets for resale as ABS.[23] The SEC adopted the definition of "sponsor" as the person "who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."

As discussed above, the issuer is explicitly referenced in the statutes as subject to certain Securities Act and Exchange Act obligations and liabilities; however, the sponsor is subject to the securities laws because of the role it plays in a securities transaction. Therefore, statute or rule references to "any person" or "every person" would include the "sponsor," as appropriate. For example, under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, it is unlawful for any person to engage in any act that would operate as a fraud. In post-financial crisis enforcement cases, the SEC charged various sponsors (in addition to depositors) with fraud in connection with misrepresenting or failing to disclose certain information to investors.

4.4 The Securitizer and Sponsor Under Credit Risk Retention

As discussed above, Exchange Act Section 15G required the Agencies to "jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party."[24] The Agencies discussed the two-prong definition of "securitizer" and the fact that the second prong is substantially identical to the definition of a "sponsor" of a securitization transaction in Regulation AB.[25] With respect to the first prong, the Agencies interpret the reference to an "issuer of an asset-backed security" as referring to the "depositor" of the securitization transaction, consistent with how the term has been defined and used under the securities laws.[26]

While the Agencies noted that CRR generally applies to the "sponsor" of a securitization transaction, the definition of "sponsor" effectively includes the depositor of the securitization transaction because the depositor is typically either controlled or funded by the sponsor.[27] The Agencies concluded that applying CRR to the sponsor substantively aligns with the definition of "securitizer" in Section 15G of the Exchange Act.

The Agencies also provided some guidance on the definition of "sponsor."[28] For example, the "organizes and initiates" criteria in the definitions of "securitizer" and "sponsor" are critical to making the determination of whether a person meets those definitions. In order to qualify, the party must have actively participated in the organization and initiation activities that would be expected to impact the quality of the securitized assets, typically through underwriting and/or asset selection.

The Agencies contrasted this position with a party who does not engage in this type of active participation and noted that such a party is not an acceptable holder of credit risk retention because its participation does not result in the more direct alignment of incentives achieved by requiring the party with underwriting or asset selection authority to retain risk. Thus, for example, an entity that (i) serves only as a pass-through conduit for assets that are transferred into a securitization vehicle, or that (ii) only purchases assets at the direction of an independent asset or investment manager, only pre-approves the purchase of assets before selection, or only approves the purchase of assets after such purchase has been made would not qualify as a "sponsor." See Section 5.4 (Step Three: Determine Who Will Hold the Retained Risk).

The comparison illustrates that, while both depositors and sponsors meet the definition of "securitizer," the Agencies intended for the obligation to flow to any person who "organizes and initiates" the transaction. Note, however, that CRR permits a securitizer or sponsor to satisfy its obligation by holding the retention through a majority-owned affiliate (other than the issuing entity).

The Agencies ultimately adopted definitions of "depositor," "issuing entity," and "sponsor" in the CRR rule that are substantially similar to the corresponding definitions in Regulation AB, and the CRR rule references the depositor and sponsor in the rule's definition of "securitizer." The substance and application of the "organizes and initiates" standard — including the Agencies' guidance on what activities do and do not satisfy it, and the possibility that more than one party qualifies — is developed in Section 5.3 (Step Two: Identify the Sponsor or Sponsors).

4.5 The LSTA Decision Limits the Sponsor Definition for Open-Market CLOs

Having parsed the statutory text and the Agencies' gloss on the "securitizer" definition, we turn to the most consequential judicial construction of that definition. In the LSTA decision, the D.C. Circuit vacated CRR insofar as it treated open-market CLO managers as "securitizers" obligated to retain credit risk.[29]

In the CRR Adopting Release, the Agencies described two general types of CLOs: open-market CLOs and balance sheet CLOs. As described by commenters, a balance sheet CLO securitizes loans already held by a single institution or its affiliates in a portfolio (including assets originated by the institution or its affiliate), while an open-market CLO securitizes assets purchased on the secondary market in accordance with investment guidelines. In response to concerns by commenters, the final rule included an alternative method of risk retention for open-market CLOs.

The LSTA's suit was grounded in the argument that open-market CLO managers do not fall within the statutory definition of "securitizer" because they neither originate the underlying loans nor transfer their own assets into the securitization. Rather, CLO managers simply purchase already-existing loans from unaffiliated third parties on the open market through arm's-length transactions, an activity that is fundamentally different from the originate-to-distribute model that CRR was intended to address.

The court explained that CLO managers are not direct or indirect agents of the originators, but rather negotiate their contracts with investors, usually with compensation based on performance. The court's analysis centered on the ordinary meaning of "transfer" and "retain." Those words, the court explained, "refer to an entity that at some point possesses or owns the assets it is securitizing and can therefore *continue* to hold some portion of those assets or the credit risk those assets represent."[30] An open-market CLO manager never holds the securitized loans; it directs a special-purpose issuer to purchase loans in the secondary market with investor capital. Because a manager cannot retain risk in an asset it never owned, the court reasoned, the Agencies' construction impermissibly "turns 'retain' a credit risk into 'obtain' a credit risk." Therefore, for a CLO manager to be covered by the second prong of the statutory definition, the party "must actually be a transferor, relinquishing ownership or control of assets to an issuer."[31]

The court also addressed the Agencies' reliance on the statutory phrase "directly or indirectly, including through an affiliate" to cover CLO managers' activities. The court rejected that reading and concluded that the language ensures that transferors cannot avoid the rule by interposing affiliates or depositors; it is an anti-evasion provision, not an expansion of the term "transfer" to reach non-owners directing purchases. Thus, a sponsor transferring assets through an affiliated depositor remains a transferor, while a CLO manager directing an unaffiliated issuer to purchase assets in the open market from third parties is not.

The court also addressed the Agencies' concern that excluding CLO managers from the rule could be extended to other re-securitized ABS (so-called "CDO squared"), creating opportunities to evade regulation. The court explained that this concern ignores that many, if not most, of the primary securitizations that produce ABS are now subject to the rule and the improved underwriting standards that flow from it, and moreover that any open-market CLO manager must, by definition, have acquired the ABS in open-market purchases at the direction of investors.

The practical consequence is that the manager of a pure open-market CLO is not a securitizer and need not retain credit risk. Therefore, in a standard open-market CLO, it is reasonable to conclude that no party qualifies as a sponsor and no party is required to hold risk retention. The court observed that this result traces to the Agencies' choice to read clause (A)'s "issuer" as the depositor rather than the issuing entity, thereby "defin[ing] a whole class of securitizers—the issuing entities—out of Congress's statute."[32]

Because the LSTA decision turns on whether a transaction participant actually transfers assets to the issuer, reliance on the LSTA decision for CLO structures that do not conform to the conventional open-market CLO model presents interpretive and potential regulatory risk. For example, a CLO manager that holds loans on its own balance sheet before transferring them to the issuing entity falls outside the open-market paradigm the court addressed. In this example, reliance on the LSTA decision is less secure.

Key Takeaways

- An analysis of which securitization parties or entities meet the CRR definitions of "securitizer," "sponsor," "issuer," and "issuing entity" is necessary to understand who is responsible for compliance with CRR. Any interpretation should consider how these terms are also used within the regulatory framework for securitizations.
- The LSTA decision limits the scope of "securitizer" to exclude open-market CLO managers.
- Parties should assess whether more than one party could be deemed a securitizer or sponsor to ensure compliance.

5. Applying the Four-Step Framework

Section 15G of the Exchange Act[33] directed the Agencies to jointly prescribe regulations to require any "securitizer to retain an economic interest in a portion of the credit risk for any asset the securitizer, through the issuance of an asset backed security, transfers, sells or conveys to a third-party."[34] Section 15G generally requires the securitizer of ABS to retain not less than 5% of the credit risk of the assets collateralizing the ABS and prohibits a securitizer from hedging and transferring the retained risk. Section 15G includes a variety of exemptions from these requirements. On October 22, 2014, the Agencies jointly adopted Regulation RR to implement the statutory mandate.

CRR requires the sponsor of a securitization transaction (or a majority-owned affiliate of the sponsor) to retain an economic interest in the credit risk of the securitized assets of not less than 5%.[35] The general requirement is that a sponsor must retain an eligible vertical interest or an eligible horizontal residual interest, or any combination thereof.

Standard Risk Retention Options

For most securitization transactions, risk retention will be in one of these three standard forms:[36]

- **Eligible Vertical Interest (EVI):** A single vertical security or an interest in each class of ABS interests in the issuing entity issued as part of the securitization transaction that constitutes the same proportion of each such class.

- **Eligible Horizontal Residual Interest (EHRI):** An interest in a single class or multiple classes in the issuing entity that is the first to absorb losses prior to amounts payable to any other ABS interest, determined using the fair value measurement framework under GAAP. In lieu of retaining all or part of an EHRI, a sponsor may establish and fund an eligible horizontal cash reserve account.

- **Combination of EVI and EHRI:** If both EVI and EHRI are held, the percentage of the fair value of the EHRI and the percentage of the EVI must equal at least 5%.

Other Risk Retention Options

In addition to the three standard forms of risk retention, CRR also provides a menu of options for other permissible forms of risk retention for specific asset classes and structures:

- **Revolving Pool Securitizations:** The sponsor keeps at least 5% of the total unpaid principal of all outstanding investor ABS interests. This retained interest must be backed by the same pool of assets and must absorb losses alongside (or before) the investor ABS interests.[37]

- **Asset-Backed Commercial Paper (ABCP) Conduits:** The seller of the underlying assets retains credit risk as required under the standard or revolving pool rules. The ABCP conduit sponsor must approve each asset seller, oversee the conduit's operations, and monitor the underlying assets.[38]

- **Commercial Mortgage-Backed Securities (CMBS):** Instead of the sponsor, up to two third-party "B-piece" buyers may purchase and hold the required 5% first-loss ABS interest. These buyers must pay cash, independently review the loans, and be unaffiliated with the deal parties.[39]

- **Municipal Bond Repackaging Securitizations (Tender Option Bonds):** The sponsor may satisfy retention by holding: (i) the standard 5% vertical or horizontal ABS interest; (ii) an ABS interest that starts as first-loss but converts to a vertical slice if certain events occur (e.g., issuer bankruptcy or credit downgrade); or (iii) municipal bonds from the same issuance worth 5% of the bonds placed in the tender option bond (TOB) trust.[40]

CRR includes total and partial exemptions and exceptions for specified assets and transaction types, including certain qualifying loan securitizations and certain government-related or federally guaranteed securitizations.[41]

5.1 Analytical Framework for Determining Whether CRR Applies and Identifying the Sponsor

The following four-step analytical framework provides a decision process for determining whether credit risk retention applies to a given securitization transaction and, if so, identifying the party that bears the retention obligation as sponsor.

5.2 Step One: Determine Whether the Security Is an Exchange Act ABS

Section 3(a)(79) of the Exchange Act defines an asset-backed security as "a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset." When making this determination, it is important to look through formal labels and intermediate entities to the economic substance of the transaction.

There are two key questions:

1. Are the underlying assets self-liquidating financial assets that convert into cash by their terms within a finite period?

2. Do payments to investors depend primarily on cash flows from those assets, rather than on sponsor credit, active management, or other sources?

If the answers to both questions are yes, then the Exchange Act ABS definition is likely satisfied.

Several types of securitized products do not fall within the definition of Exchange Act ABS and are therefore outside CRR's scope entirely. For example, synthetic securitizations are not Exchange Act ABS because returns are primarily based on the performance of assets or indices not included in the ABS.[42] Similarly, in response to an interpretive request from Latham & Watkins, the staff of the SEC's Division of Corporation Finance concurred that securities issued in data center securitizations of the type described in the request are not Exchange Act ABS, because the securitized assets — which include the data center facilities and related real property, components, and contracts — are not self-liquidating financial assets.[43]

For a comprehensive discussion of the Exchange Act ABS definition and its application in practice, see our Exchange Act ABS Guide.

5.3 Step Two: Identify the Sponsor or Sponsors

As described above, a sponsor of a securitization transaction is defined as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."[44] It was defined in a manner consistent with the definition of the term "sponsor" in Regulation AB.[45]

One way to think of the sponsor is the person who is the brains or mastermind of the transaction that will result in a securities issuance — the driving force behind getting the deal done. This is consistent with the discussion above, where we note that while the term "sponsor" is not explicitly referenced in the Securities Act or the Exchange Act, the sponsor of a securitization is subject to the securities laws because of the role it plays in the transaction.

What does it mean to organize and initiate?

The Agencies' view, as stated in the CRR Adopting Release, is that as a securitizer or sponsor, the party must have actively participated in the organization and initiation activities that would be expected to impact the quality of the securitized assets underlying the asset-backed securitization transaction, typically through underwriting and/or asset selection.[46] The Agencies believed this interpretation of the statutory language "organize and initiate" is reasonable because it further accomplishes the statutory goals of risk retention — alignment of the incentives of the sponsor of the securitization transaction with the investors and improvement in the underwriting and selection of the securitized assets.

Common activities that support the sponsor determination include:

- structuring the securitization, including establishing the issuing entity and the transaction's legal and economic framework;
- selecting the service providers, such as the underwriters, placement agents, trustees, servicers, due diligence providers, and negotiating the related arrangements; and
- selecting the assets and causing the transfer of the assets, either directly or indirectly, to the issuing entity.

What is not organizing and initiating?

As the Agencies note, without active participation, the holder of retention could merely be a speculative investor with no ability to influence underwriting or asset selection.[47] A holder that does not engage in this type of active participation would not achieve the alignment of incentives sought by the rule. The Agencies provided examples of activities that are insufficient to constitute organizing and initiating, including:

- serving only as a pass-through conduit for assets transferred into a securitization vehicle;
- purchasing assets only at the direction of an independent asset or investment manager;
- pre-approving asset purchases before asset selection;
- approving asset purchases only after the purchases have been made; and
- negotiating underwriting criteria or asset selection criteria or acting merely as a "rubber stamp" for decisions made by other transaction parties.

The Agencies noted that these activities do not sufficiently distinguish passive investment from the level of active participation expected of a sponsor or securitizer. If the designated entity is not in fact the party that organized and initiated the transaction, or if a second party also qualifies and no party ensures compliance, the transaction may fail to satisfy the retention requirement notwithstanding the designation.

Accordingly, it is necessary to determine whether more than one person participating in the transaction could be a sponsor because the CRR obligation flows from the statute to any party that organizes and initiates the transaction. CRR requires that one party be designated to hold the retained risk and prohibits multiple sponsors from dividing the required risk retention because the Agencies believed doing so would dilute the economic risk being retained and, as a result, reduce the intended alignment of interests between the sponsor and the investors.[48] CRR requires that each sponsor be responsible for ensuring that at least one of the sponsors of the securitization transaction complies with the retention requirements.[49]

In the case of multiple sponsors, a written representation by the designated sponsor that it will comply with the requirements of CRR is typically provided (e.g., in the purchase agreement or offering documents), and the remaining sponsors will represent that they will ensure compliance with CRR. Even if one sponsor is identified, an analysis should be undertaken of the facts and circumstances to determine whether another party could be deemed a sponsor.

There is one potential alternative to divide the risk among multiple sponsors, if one key condition is met: If the sponsors also happen to be originators of the underlying assets, division of retained risk is permissible among originators as described in Section 5.4 (Step Three: Determine Who Will Hold the Retained Risk).

Can a party rely on the LSTA decision to avoid sponsor status?

It must be noted that the LSTA decision should not be invoked more broadly than its rationale supports. The holding is confined to open-market CLO managers, and the decision supplies its own limiting principle by distinguishing open-market CLOs — which acquire assets through arm's-length negotiations and secondary-market trading at the direction of the CLO's investors — from balance sheet CLOs created by originators or the original holders of the underlying loans. The decision also considers that open-market CLO managers are not direct or indirect agents of the originators, but rather negotiate their contracts with investors, usually with compensation based on performance.

In considering whether to rely on the LSTA decision to avoid sponsor status, careful analysis must be undertaken of factors that drove the court's analysis, including:

- whether the organizing party retained the assets (directly or indirectly);
- whether the CLO manager is acting at the direction of investors and is acquiring assets through arm's-length open-market acquisitions; and
- whether the CLO manager is a direct or indirect agent of the originators.

Finally, a conclusion that no party is a securitizer after the LSTA decision disposes only of the risk retention obligation; it does not remove the transaction from the broader Dodd-Frank Act framework. If the instrument is an Exchange Act ABS, other obligations attaching to that classification may continue to apply.

5.4 Step Three: Determine Who Will Hold the Retained Risk

Under CRR, the following parties may hold risk retention:

- the sponsor itself;
- an originator, in limited circumstances where the rules permit;
- a qualified third-party purchaser, available only in CMBS transactions; or
- a majority-owned affiliate of any of the above.

Is the sponsor entity itself obligated to hold the required retained risk?

CRR obligates the sponsor to retain credit risk; however, a sponsor may elect to hold its required risk retention through a majority-owned affiliate (MOA). There are several factors to consider, and there are a variety of benefits to holding through an MOA. For example:

- A dedicated MOA retention vehicle can isolate the retained interest from the sponsor's other assets and liabilities, providing structural clarity and facilitating balance-sheet management.
- Holding retention through an MOA can simplify financing arrangements because the retained interest resides in a single-purpose entity that lenders can underwrite and monitor more efficiently.
- Where multiple securitization programs share a common sponsor, using a single MOA (or a family of related MOAs) as the retention holder can centralize compliance obligations and reduce administrative burdens across transactions.
- Structuring the retention holder as an MOA may provide favorable accounting treatment, allowing the sponsor to avoid consolidating the retained interest in certain circumstances while maintaining the control required under the CRR rules.

Note one important exception to the general flexibility provided by the MOA: Where a sponsor relies on the separate revolving pool securitization option (discussed under Section 6.4 (Revolving Pool Securitizations (Master Trusts)), the seller's interest may be held only through a wholly owned affiliate — a deliberately stricter standard than the majority-control test that governs MOAs elsewhere in the rule. Structuring teams accustomed to the MOA standard should confirm which standard applies to the retention option being used.

Given the complexity of the MOA analysis, market participants should seek advice at the outset of structuring.

How is majority-owned affiliate status determined?

As discussed above, the base risk retention requirement expressly permits an MOA of the sponsor to retain the economic interest. Under the CRR regulation, a "majority-owned affiliate" of a person is an entity (other than the issuing entity) that, directly or indirectly, majority controls, is majority controlled by, or is under common majority control with, such person.[50] "Majority control" means ownership of more than 50% of the equity of an entity, or ownership of any other controlling financial interest in the entity, as determined under GAAP.

Two threshold points follow directly from this definition:

- **The issuing entity is excluded.** An MOA can never be the issuing entity itself.
- **The relationship can run in any direction.** The controlling relationship may be one in which (i) the MOA controls the sponsor, (ii) the MOA is controlled by the sponsor, or (iii) the MOA shares common control with the sponsor. In each case, this may be established directly or indirectly.

The majority-control prong can be satisfied in either of two independent ways:

	MOA Test	What It Requires
1	Equity ownership	Ownership of **more than 50% of the equity** of the entity.
2	Controlling financial interest	Ownership of **any other controlling financial interest** in the entity, **as determined under GAAP**. This is an alternative to a bare majority-equity stake.

Because the "controlling financial interest" test is measured under GAAP, this becomes a GAAP consolidation/control question. Internal structuring teams should consult with accountants at the outset for the MOA determination and evaluate accounting treatment for the overall organization. Counsel will rely on the accounting determination that the sponsor's interest with respect to the MOA constitutes a controlling financial interest under GAAP as part of analyzing compliance with CRR.

In general, we observe that the GAAP analysis considers the sponsor's power to direct the activities of the MOA that most significantly impact the MOA's economic performance, such as through controlling voting and other rights, the obligation to absorb losses of the MOA, or the right to receive benefits from the MOA that could potentially be significant to the MOA.

Another key structuring point is that the CRR rules do not require an MOA to be solely or wholly owned by the sponsor or its affiliates. Accordingly, an unaffiliated third party's stake in the MOA is not inconsistent with MOA status so long as the MOA continues to satisfy the majority-control test above. This structuring technique has been used by sponsors across asset classes to hold their required CRR interest. To ensure compliance with CRR (including rules around hedging, transfer, and financing prohibitions), the retained interest must be held by an entity that is and remains a majority-owned affiliate.

In summary, an entity can be an MOA if the following are established:

- The entity is not the issuing entity.
- The sponsor either (i) owns more than 50% of the entity's equity, or (ii) holds any other controlling financial interest in the entity as determined under GAAP.
- The control relationship may be direct or indirect, and may run to, from, or in common with the person.
- Full/sole ownership is not required; a minority third-party interest is permissible so long as the majority-control test continues to be met.

Where reliance is on the "controlling financial interest" branch (rather than majority equity), this analysis should be supported by a GAAP determination (which is typically conducted by the sponsor's external accountants or financial consultants) and by governance rights demonstrating control (e.g., directing/controlling certificate holder status).

When can an originator hold risk retention?

Credit risk in securitized assets may also be retained and held by an originator (or its majority-owned affiliate).[51] An "originator" is defined as a person who (i) through an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security; and (ii) sells the asset directly or indirectly to a securitizer or issuing entity.[52] This option may be preferable when there are multiple originators of underlying assets, each contributing a sizable amount of assets, such as for mortgage-backed securitizations.

A sponsor may allocate a portion of its risk retention obligation to an originator of one or more of the securitized assets, provided the following conditions are satisfied at the closing of the securitization transaction:[53]

- **Same manner and proportion**. The originator must acquire the eligible interest from the sponsor and retain it in the same manner and proportion (as between horizontal and vertical interests) as the sponsor would otherwise be required to hold.
- **Pro rata cap**. The ratio of eligible interests acquired by the originator to the total percentage otherwise required to be retained by the sponsor cannot exceed the ratio of the unpaid principal balance of assets originated by that originator to the unpaid principal balance of all securitized assets in the transaction.
- **Minimum 20% threshold**. The originator must acquire and retain at least 20% of the aggregate risk retention amount otherwise required to be retained by the sponsor.
- **Dollar-for-dollar purchase**. The originator must purchase the eligible interests from the sponsor at a price equal to, on a dollar-for-dollar basis, the amount by which the sponsor's required risk retention is reduced — paid in cash or as a reduction in the price received by the originator for assets sold to the sponsor or depositor.
- **Hedging, transfer, and pledging restrictions**. The originator and its affiliates must comply with the hedging and transfer restrictions as if the originator were the retaining sponsor.
- **Disclosure**. The sponsor must disclose the name and form of organization of the originator; the form, amount, and nature of the interest retained; and the method of payment.

The retaining sponsor remains responsible for compliance and must maintain policies and procedures to monitor the originator's ongoing compliance.

When can a third party hold risk retention?

A sponsor may satisfy some or all of its risk retention requirements for a CMBS transaction if a third-party purchaser (or its majority-owned affiliate) purchases and holds an eligible horizontal residual interest in the same form, amount, and manner as the sponsor would otherwise be required to retain subject to the following conditions:[54]

- **Maximum two purchasers**. No more than two third-party purchasers may hold an eligible horizontal residual interest at any time; if there are two, their interests must be pari passu.
- **Collateral composition**. The transaction must be collateralized solely by commercial real estate loans and servicing assets.

- **Cash funding / no affiliated financing**. Each third-party purchaser must pay cash at closing and may not obtain financing from any party to (or affiliate of a party to) the securitization transaction, other than a person who is a party solely as an investor.

- **Independent credit review**. Each third-party purchaser must independently review the credit risk of each securitized asset prior to the sale of the ABS, including underwriting standards, collateral, and expected cash flows.

- **No affiliation with transaction parties**. No third-party purchaser may be affiliated with any party to the securitization (sponsor, depositor, servicer, etc.), other than investors. However, a third-party purchaser may be affiliated with a special servicer for the transaction.

- **Hedging and transfer restrictions**. Each third-party purchaser and its affiliates must comply with the hedging and transfer restrictions as if it were the retaining sponsor, until each CRE loan collateralizing outstanding ABS interests has been defeased.

- **Transfer timing**. An initial third-party purchaser (or sponsor holding an eligible horizontal residual interest under this section) may transfer its interest to a subsequent third-party purchaser on or after five years from closing. A subsequent third-party purchaser may transfer at any time, provided the acquiring purchaser complies with the applicable requirements.

- **Sponsor duty to comply**. The retaining sponsor remains responsible for compliance by each initial and subsequent third-party purchaser and must maintain monitoring policies and notify ABS interest holders of any noncompliance.

5.5 Step Four: Understand the Prohibitions

In general, the party retaining the risk may not enter into any transaction, agreement, derivative, or other arrangement if payments under that arrangement are materially related to the credit risk of the retained interest or the underlying securitized assets and the arrangement would reduce or eliminate the retaining party's required exposure to that credit risk. Ordinary-course hedges that address risks other than credit risk, such as interest rate or currency risk, are permitted. The rules also prohibit pledging of the retained interest, unless the related financing is full recourse to the sponsor or retaining party.[55]

Relatedly, Securities Act Rule 192[56] also prohibits certain participants, including sponsors, from engaging in transactions that create a material conflict of interest with investors in an ABS transaction. The risk retention prohibitions and Rule 192 can overlap; however, they are not identical as they serve different purposes. The risk retention rules require the sponsor to retain credit risk, while Rule 192 applies to a broader category of securitization participants and prohibits betting against the securitization transaction. Given the complexity and relationship of the rules, securitization participants should seek advice on how to navigate the rules' compliance requirements.

Transfers of the retained interest to a majority-owned affiliate of the sponsor are permitted so long as the transferee is and remains a majority-owned affiliate. A transfer to an unaffiliated third party is not permitted and would violate the transfer prohibition.

In situations where the sponsor is acquired or merged with another entity, careful analysis must be undertaken to ensure that the determination of the ultimate holder of the retained interest is in compliance with CRR.

6. Structure Examples: Common Securitization Transactions

To translate the foregoing analysis into practice, this section examines several common securitization structures and applies the sponsor identification framework to each.

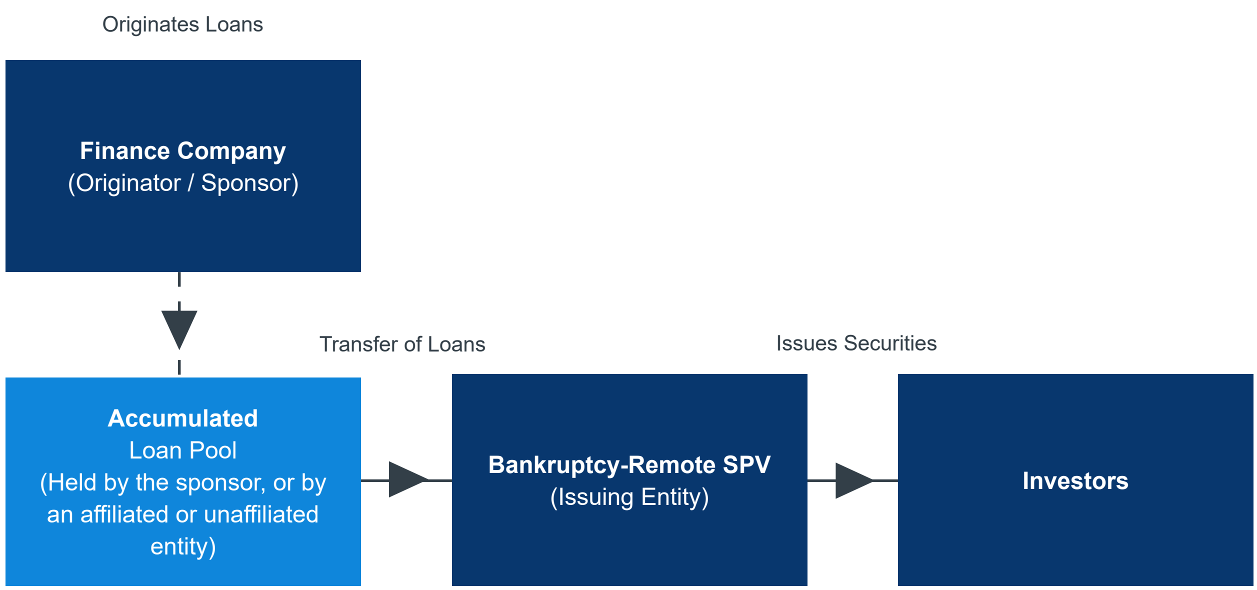
6.1 Single Sponsor in Traditional ABS

Transaction Profile

A company originates or acquires self-liquidating financial assets (such as auto loans, residential mortgages, or commercial mortgages) and transfers such assets to an issuing entity that issues securities to investors.

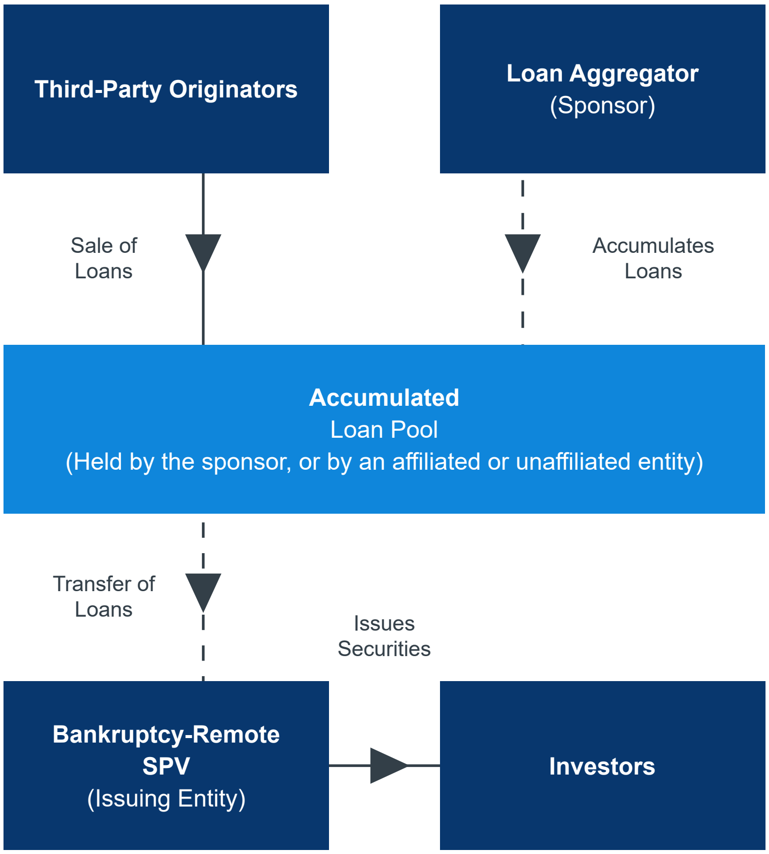
Sponsor Analysis

It is relatively simple to determine the sponsor in traditional ABS. For example, an automobile finance company originates loans and accumulates them for the purpose of securitization. The automobile finance company then transfers, or causes the transfer of, the accumulated auto loans into a bankruptcy-remote special purpose vehicle (SPV) that, in turn, issues securities to investors. Because the automobile finance company organized and initiated the securitization transaction by selling or transferring assets (either directly or indirectly, including through an affiliate) to the issuing entity, the automobile finance company is the sponsor. Below is an illustration of this economic arrangement.



Sponsor Conclusion: The automobile finance company is the **sponsor** because it organized and initiated the securitization transaction by selling or transferring assets, directly or indirectly (including through an affiliate), to the issuing entity.

In a variation of the example, a loan aggregator purchases loans from third-party originators and holds the loans it accumulates in an affiliate SPV. Once the aggregator has accumulated a sufficient volume of loans, it will transfer the loans, or deposit them, into a bankruptcy-remote SPV that, in turn, issues securities to investors. Because the loan aggregator organized and initiated the securitization transaction by transferring assets (indirectly, through an affiliate) to the issuing entity, the loan aggregator is the sponsor. Below is an illustration of this economic arrangement.



Sponsor Conclusion: The loan aggregator is the **sponsor** because it organized and initiated the securitization transaction by transferring assets, directly or indirectly (including through an affiliate), to the issuing entity.

Key Factors

The analysis should confirm that the party being designated as sponsor both (i) actively participated in structuring, asset selection, or underwriting; and (ii) owned or held the assets (directly or through affiliates) before their transfer into the structure. The interposition of an affiliated depositor between the sponsor and the issuing entity does not change the result. The statutory phrase "directly or indirectly, including through an affiliate" ensures that a sponsor cannot avoid securitizer status by transferring through affiliates.

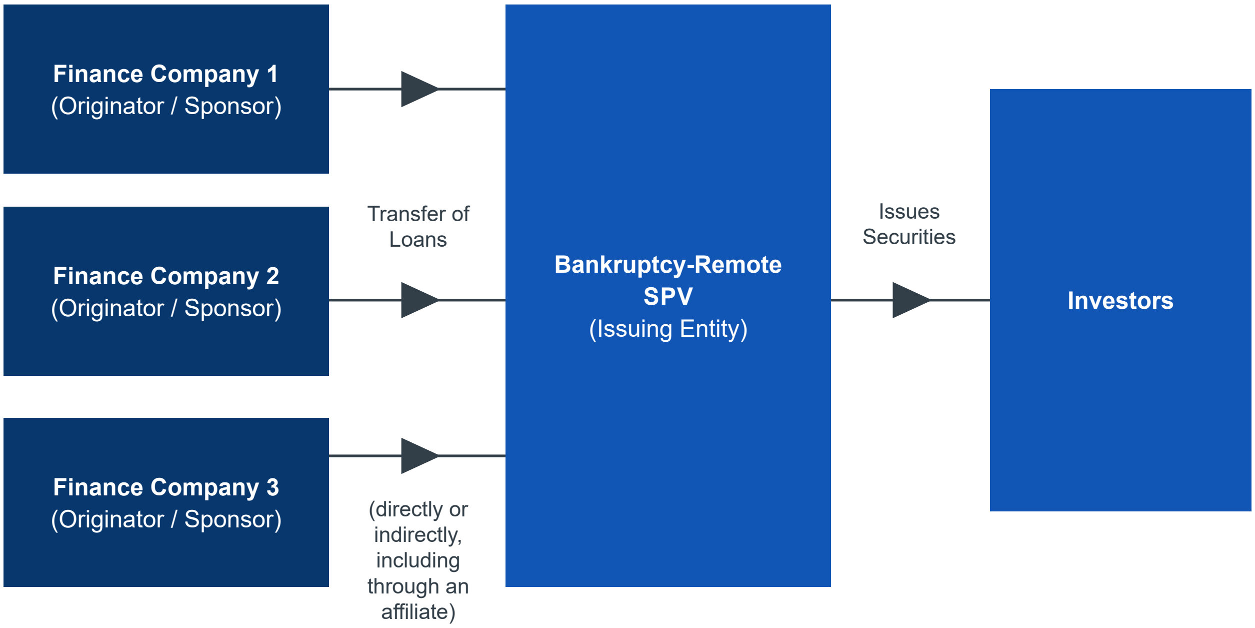
Conclusion

In a traditional single-sponsor ABS, the originator or aggregator that accumulates the assets and causes their transfer into the issuing entity is the sponsor and bears the retention obligation, which it may satisfy itself or through an MOA.

6.2 Multiple Sponsors in Traditional ABS

Transaction Profile

Multiple originators or holders of self-liquidating financial assets transfer such assets into a common issuing entity that issues securities to investors. This fact pattern is typical in securitizations of commercial mortgages, where several mortgage finance companies or banks often contribute loans to a single securitization.



Sponsor Conclusion: Each mortgage finance company is the **sponsor** because each organized and initiated the securitization transaction by selling or transferring assets, directly or indirectly (including through an affiliate), to the issuing entity.

Sponsor Analysis

The sponsor analysis for each transferring party is the same as in a single-sponsor traditional ABS: Each party that organizes and initiates the transaction by selling or transferring its accumulated loans into the issuing entity is a sponsor.

For example, where three different mortgage finance companies originate loans and transfer, or cause the transfer of, their respective accumulated loans into the common issuing entity, each mortgage finance company is a sponsor.

What distinguishes the multiple sponsor case is the compliance mechanics. As discussed in Section 5.3 (Step Two: Identify the Sponsor or Sponsors), CRR requires that each sponsor be responsible for ensuring that at least one of the sponsors of the securitization transaction complies with the retention requirements. Only one sponsor is permitted to hold the retained risk — the rule prohibits splitting the required retention among multiple sponsors. In practice, the designated retaining sponsor provides a written representation that it will comply with CRR, and the remaining sponsors represent that they will ensure such compliance.

Key Factors

Before finalizing the designation, each participant should confirm that the designated sponsor is in fact a party that organized and initiated the transaction; a designation of the wrong entity does not satisfy the rule. Where the sponsors are also originators of the underlying assets, the originator allocation option described in Section 5.4 (Step Three: Determine Who Will Hold the Retained Risk) may be available to divide the retention obligation among the originator/sponsors, subject to the same-form, pro rata cap, 20% minimum, and other conditions of that option.

Conclusion

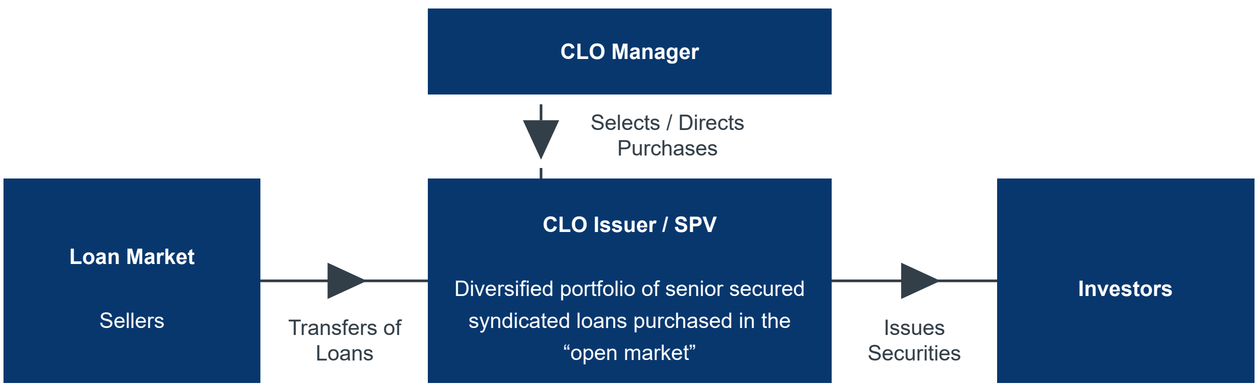
In multi-sponsor transactions, every party that organizes and initiates by transferring assets is a sponsor with a compliance obligation, even though only one (or, under the originator option, multiple originators) will hold the retained interest. The designation and supporting representations should be settled early in structuring.

6.3 Collateralized Loan Obligations

Transaction Profile

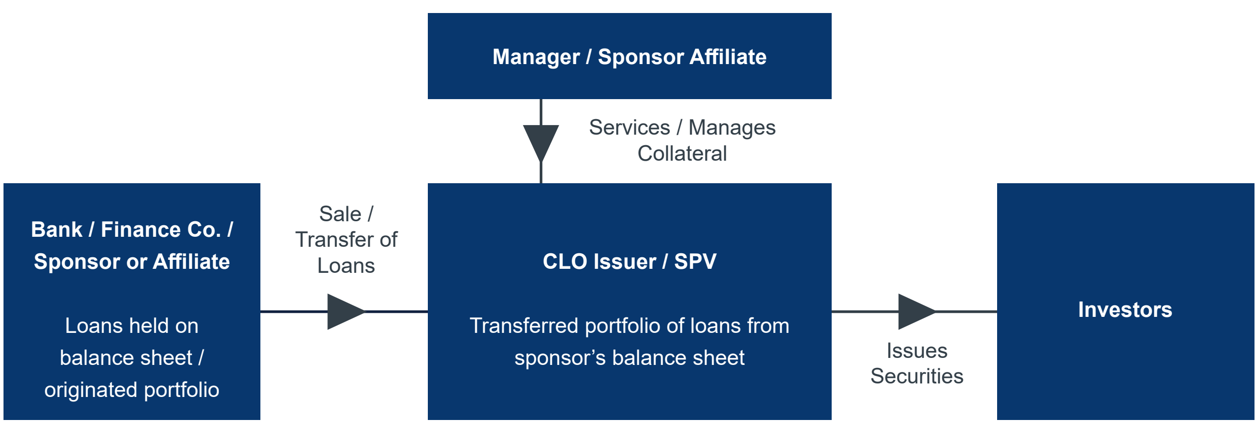
A CLO is a securitization backed by corporate loans. In an open-market CLO, a designated CLO manager actively acquires loans in arm's-length negotiations and from secondary market trading. The collateral manager oversees the management of the portfolio of corporate debt for the CLO. A balance sheet CLO is similar to traditional ABS, where an originator or aggregator transfers loans off its own balance sheet into an SPV that issues securities to investors.

Open-Market CLO



Collateral source: open-market / arm's-length loan purchases where the manager directs acquisitions but does not hold loans on its balance sheet

Balance Sheet CLO



Collateral source: loans already held by one institution or its affiliates, which are transferred from sponsor's existing portfolio

Simplified illustration; transaction-specific parties and retention structures vary

Sponsor Analysis

The sponsor analysis differs by CLO type. For a balance sheet CLO, the sponsor is the originator or aggregator that transfers loans from its balance sheet — the same analysis that applies to traditional ABS.

For an open-market CLO, as discussed in Section 4 (Regulatory History: Tracing the Evolution of the Securitizer Definition), the D.C. Circuit's LSTA decision controls: a party must "actually be a transferor, relinquishing ownership or control of assets to an issuer" to qualify as a "securitizer" under Section 15G. Because open-market CLO managers direct the issuer to purchase loans in the secondary market but never hold those loans themselves, they are not transferors, and because the seller of the loans is not involved in organizing and initiating the transaction, the seller is not a securitizer either. Therefore, it is reasonable to conclude that in a standard open-market CLO, no party qualifies as a sponsor, and no party is required to hold risk retention.

The LSTA decision is a narrow holding that should not be extended where asset ownership or origination by affiliates is present — it does not apply where the manager causes assets to be transferred from an affiliate's balance sheet.

Key Factors

For CLO structures between the open-market and balance sheet paradigms, an evaluation should consider whether: (i) the organizing party ever retained the assets (directly or indirectly), (ii) the CLO manager is acting at the direction of investors and acquiring assets through arm's-length open-market acquisitions, and (iii) the CLO manager is a direct or indirect agent of the originators.

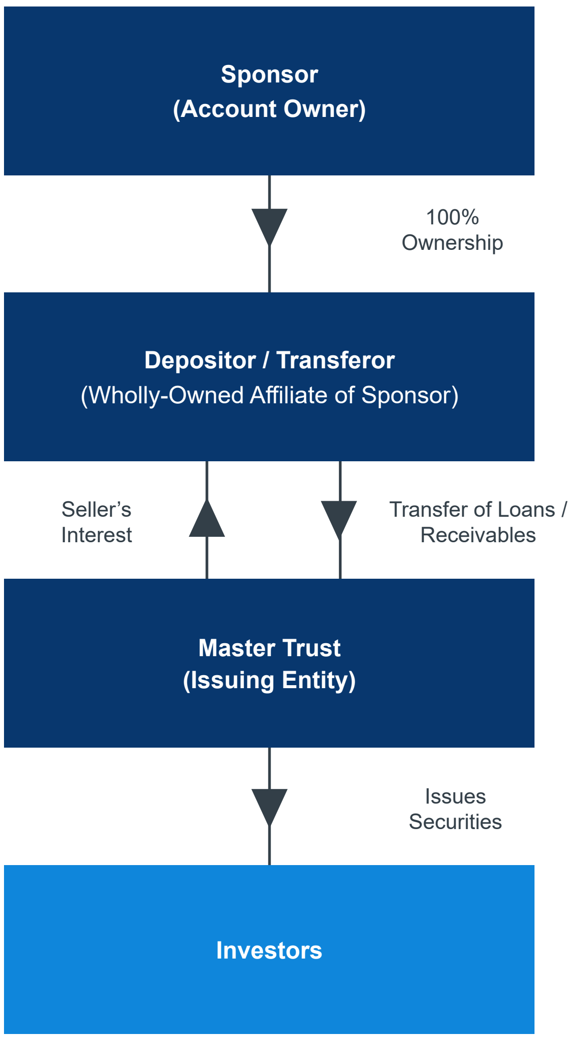
Conclusion

Balance sheet CLOs follow the traditional ABS analysis, where the sponsor would be the party that retained the loans and transferred them to the CLO. In a standard open-market CLO, a CLO manager is not a securitizer following the LSTA decision, but the other Exchange Act ABS obligations discussed at the end of this report continue to apply to the transaction. In particular, the same open-market CLO manager that is not a "securitizer" for risk retention purposes may nonetheless be a "sponsor" subject to the Securities Act Rule 192 conflicts-of-interest prohibition, which reaches parties with contractual authority over the composition of the asset pool without regard to whether they transfer assets. The risk retention and Rule 192 analyses are distinct and should be run separately.

6.4 Revolving Pool Securitizations (Master Trusts)

Transaction Profile

In revolving pool securitizations, assets may be added to and removed from the issuing entity, and securities may be issued from time to time. The common revolving pool cross-collateralizes all the securities that are issued. This structure is known as a master trust and is commonly used in securitizations of corporate loans, credit card receivables, floorplan receivables, or trade receivables.



Retention Form: The sponsor/depositor satisfies risk retention by maintaining a seller's interest.

Sponsor Analysis

The sponsor is the party transferring an interest in the self-liquidating receivables and actively organizing the program.

For example, in credit card securitizations, the sponsor is the bank that originated the credit card accounts and transfers the related receivables into the master trust. In trade receivable securitizations, the sponsor is the corporate originator — that is, the company that generates trade receivables in the ordinary course of its business by selling goods or services to its customers on credit terms.

In addition to the standard horizontal and vertical risk retention options, CRR includes a separate option for revolving pool securitizations, including master trusts, that is intended to reflect the way those structures issue multiple series of ABS backed by a changing common pool of assets over time.

At a high level, the sponsor of a qualifying master trust may satisfy the risk retention requirement by retaining (directly or through a wholly owned affiliate) a “seller’s interest” equal to at least 5% of the aggregate unpaid principal balance of the outstanding investor ABS interests, which generally represents the sponsor’s retained undivided interest in the common collateral pool. The seller’s interest must be collateralized by the securitized assets and related servicing assets held by the issuing entity. The seller’s interest must also rank pari passu with, or be partially or fully subordinated to, the investor interests with respect to distributions and losses before early amortization.

Key Factors

Note the affiliate standard. Unlike the general rule, which permits retention through any majority-owned affiliate, the seller’s interest option permits holding only through a wholly owned affiliate. A structure that parks the seller’s interest in a majority-owned (but not wholly owned) affiliate does not satisfy the revolving pool option, even though the majority-owned affiliate entity could hold standard vertical or horizontal retention. The sponsor should also confirm that the transaction satisfies the option’s structural conditions, including the pari passu or subordinated ranking of the seller’s interest.

Conclusion

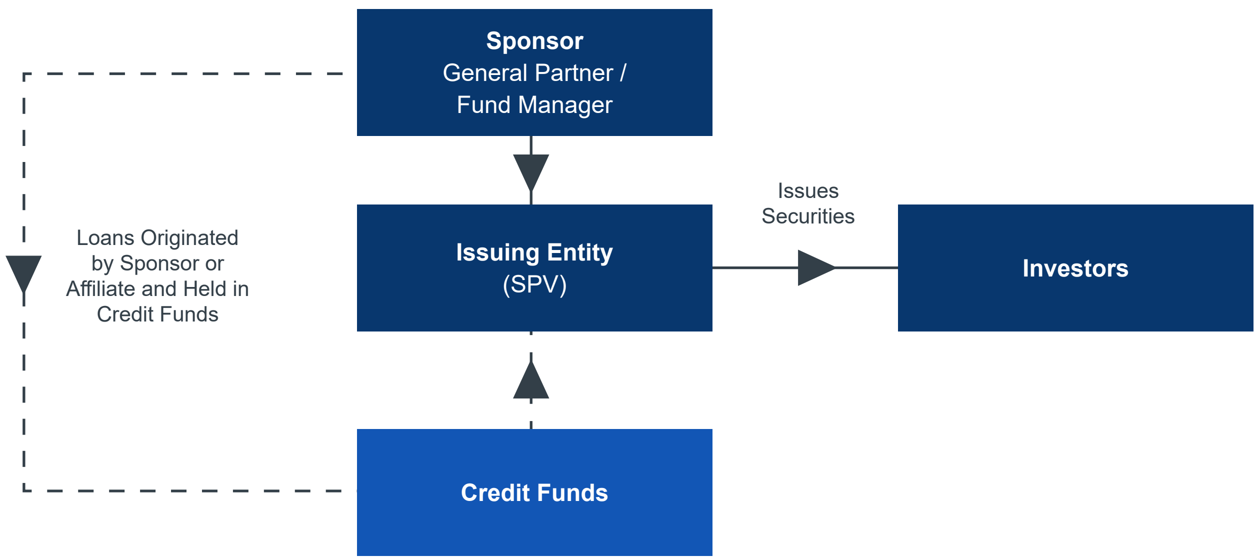
In master trust structures, the account-originating bank or corporate originator that transfers receivables and organizes the program is the sponsor, and the seller’s interest option provides a retention form adapted to revolving pools — subject to the stricter wholly owned affiliate standard.

6.5 Credit-Focused Investment Vehicles

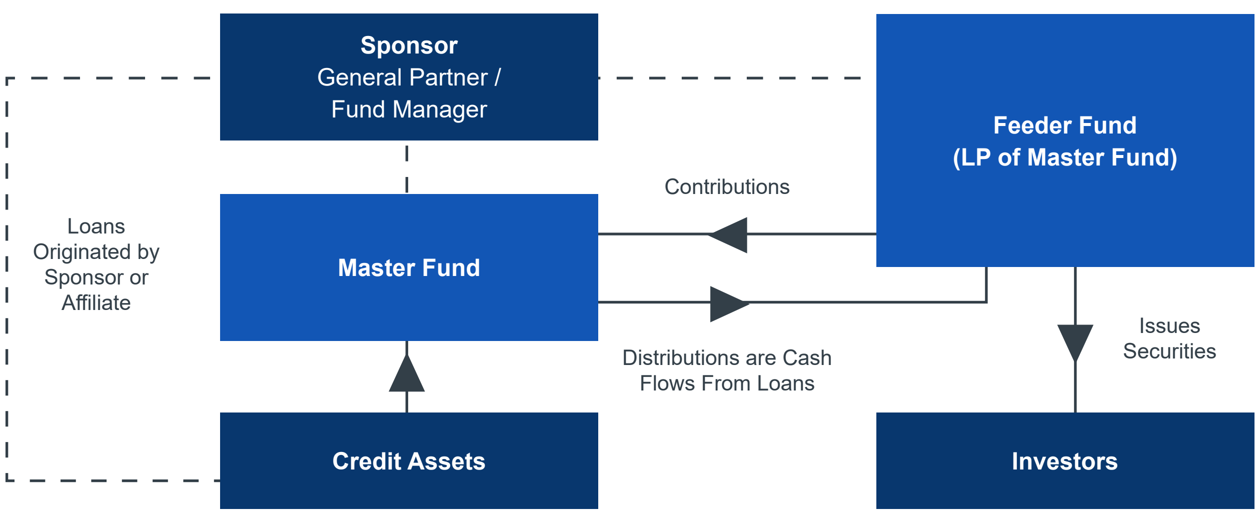
Transaction Profile

Credit-focused investment vehicles — such as credit-focused rated-note feeder funds or collateralized fund obligations (CFOs) that invest in or hold interests in credit funds, corporate loans, bonds, or other credit instruments — can constitute Exchange Act ABS where investor payments depend primarily on cash flows from underlying debt instruments. The classification analysis for credit-focused investment vehicles is addressed in our Exchange Act ABS Guide.[57] The structure may include multiple intermediate LP interests that serve to pass through cash flows to the investor.[58]

CFO



Rated Note Feeder



Sponsor Analysis

In a credit focused CFO, the sponsor is typically the entity that organizes and initiates the transaction and contributes the fund interests into the structure. For example, the general partner or fund manager may contribute affiliated credit fund interests into the issuing entity. By depositing these credit-focused fund interests into the issuing entity, the general partner or fund manager is indirectly transferring the underlying loans (self-liquidating financial assets) to the issuing entity, thereby transferring credit risk to the investors. Similarly, in the case of a credit-focused rated-note feeder fund, the general partner or fund manager organizes the fund structure.

In some cases, an affiliate of the general partner or fund manager originates the underlying loans. When the fund manager or its affiliate both originates the loans and contributes them to the securitization structure, this arrangement represents a fund-based form of the originate-to-distribute model. This example addresses that common case.

Key Factors

- The identification of a sponsor should be relatively straightforward because the general partner or fund manager is generally performing the activities of organizing and initiating.
- The fund may issue delayed draw notes that are funded over time through capital calls. In this case, we believe that the sponsor may satisfy its risk retention obligation by funding its proportionate share of the retained interest at the time of each capital call, rather than funding the entire retention amount upfront. This approach aligns the sponsor's economic exposure with the timing of investor capital contributions.

Conclusion

In credit-focused CFOs and rated-note feeders, the general partner or fund manager that organizes and initiates the transaction and contributes the affiliated credit assets, directly or indirectly through affiliates, is the sponsor.

7. Unifying Principles

ABS structures differ in form, but the principles that support the sponsor determination approach run through all of them. The following principles hold across each structure:

The analysis is sequenced and cumulative. Analyze whether the security is an Exchange Act ABS; identify the sponsor or sponsors; determine which sponsor will hold the risk and how it will be held; and observe the hedging, transfer, and financing prohibitions for as long as the requirement applies (e.g., until the ABS interests are paid in full or a specified sunset period). Each step depends on the one before it, and skipping or mislabeling a step can leave the retention requirement unsatisfied notwithstanding the parties' intentions.

The sponsor is identified by functional substance, not labels. The sponsor is the person who is the brains or mastermind of the transaction that will result in a securities issuance — the driving force behind getting the deal done. In practice, the sponsor is the entity or entities that organize and initiate the securitization transaction through active participation in decisions expected to affect the credit quality of the securitized assets — typically underwriting or asset selection — and that cause the assets to be transferred to the issuing entity. The analysis looks through transactional labels and intermediate entities to functional reality. A party is not a sponsor if it is merely a pass-through entity acting at the direction of others.

Test for more than one sponsor. Because the obligation flows by operation of the statute to every party that organizes and initiates, the analysis should test whether more than one party qualifies and should settle the designation early. If there are multiple sponsors, one sponsor holds the retained interest, and every other qualifying sponsor must ensure that at least one sponsor complies.

The sponsor must remain the holder of the retention. The retained interest can be transferred only as permitted by the rule. Be mindful that transfers between affiliates satisfy the majority-owned affiliate definition, or in the case of master trusts, the wholly owned affiliate definition. Any financing of risk retention must be full-recourse to the sponsor or affiliate, respectively.

8. Related Regulatory Obligations Triggered by Exchange Act ABS Classification

While this report focuses on identifying the securitizer for risk retention purposes, market participants should be aware that Exchange Act ABS classification triggers a broader suite of Dodd-Frank Act regulatory obligations. Even where risk retention does not apply — for example, because a transaction qualifies for an exemption or because no party is a securitizer after the LSTA decision — other Exchange Act ABS rules may still impose compliance obligations, including:

- prohibitions on conflicts of interest under Rule 192;
- disclosures required by Rules 15Ga-1, 15Ga-2, and 17g-10; and
- Rule 17g-5 website and postings.

For a comprehensive discussion of these rules and allocation of compliance responsibilities among market participants, see our Exchange Act ABS Guide.[59]

9. Conclusion

Determining who bears the risk retention obligation is a sequenced inquiry, and the sequence matters. The gating question is whether the securities are Exchange Act ABS at all; only then does the sponsor analysis begin. That analysis is best understood through the regulatory DNA of the operative definitions: Under the statute, the "securitizer" is either the depositor (which acts as issuer) or the sponsor (a term borrowed from Regulation AB). In practice, the risk retention obligation falls on whoever organizes and initiates the transaction.

The remaining steps matter too. Only certain entities can hold the retained interest, and the rules differ depending on the risk retention option. In a multi-sponsor transaction, the designation imposes compliance obligations on every qualifying sponsor. The rules also limit hedging, transferring, and financing the retained interest for as long as the requirement is in effect. Getting the sponsor designation wrong, or naming an entity that did not actually organize and initiate the deal, can mean the retention requirement goes unmet, even if that was not the parties' intent. The consequences can include regulatory violations, breach of contract, and disclosure failures.

Navigating risk retention compliance requires counsel that combines technical sophistication with practical understanding of structuring, compliance, and enforcement dynamics. Latham brings together premier structured finance, capital markets, and regulatory practices in financial centers worldwide. This deep market knowledge, developed through extensive work advising sponsors, issuers, underwriters, and investors on novel securitization transactions, enables clients to navigate these complex questions with confidence.

About the Decoding Series

This report is the second in our series of practical guides to complex questions in structured finance regulation, following "Decoding the Exchange Act ABS Definition: A Practical Guide to Classifying Structured Finance Transactions." Rather than simply restate the rules, each report decodes them by tracing the regulatory DNA of the key definitions and translating a doctrinal deep dive into practical, structured guidance.

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Endnotes

1 *See Credit Risk Retention, 17 CFR Part 246 (Regulation RR).*

2 *See* Latham & Watkins LLP, Decoding the Exchange Act ABS Definition: A Practical Guide to Classifying Structured Finance Transactions (Feb. 2026) (Exchange Act ABS Guide).

3 *Loan Syndications & Trading Ass'n v. Sec. & Exch. Comm'n*, 882 F.3d 220 (D.C. Cir. 2018).

4 *See* Section 3(a)(79) of the Exchange Act [15 U.S.C. 78c(a)(79)].

5 *See, e.g.,* the definition of "asset-backed security" under Regulation AB (17 CFR 229.1101(c)); the definition of "asset-backed security" under Rule 192 (17 CFR 230.192); and the requirements of Rule 17g-5 that apply to "a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction" (17 CFR 240.17g-5).

6 *See* Fin. Crisis Inquiry Comm'n, The Financial Crisis Inquiry Report (2011).

7 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 941, 124 Stat. 1376, 1891 (2010).

8 *See* Joint Explanatory Statement of the Committee of Conference, Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. Rep. No. 111-517, at 872 (2010) (Conf. Rep.).

9 Credit Risk Retention, Exchange Act Release No. 34-73407 (Oct. 22, 2014) [79 FR 77602 (Dec. 24, 2014)] (CRR Adopting Release).

10 *See* CRR Adopting Release, 79 FR at 77706.

11 *See* Section 15G(a)(3) of the Exchange Act [15 U.S.C. 78o-11(a)(3)].

12 *See* Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Securities Act Release No. 33-9175 (Jan. 20, 2011) [76 FR 4489, 4491 (Jan. 26, 2011)] (Section 943 Adopting Release).

13 *See* Section 943 Adopting Release, 76 FR at 4491 n.22.

14 15 U.S.C. 77b(a)(4)

15 *See* Asset-Backed Securities, Securities Act Release No. 33-8518 (Dec. 22, 2004) [70 FR 1506 (Jan. 7, 2005)] (2004 Regulation AB Adopting Release).

16 2004 Regulation AB Adopting Release, 70 FR at 1508.

17 17 CFR 230.191

18 *See* 17 CFR 229.1101(e)

19 *See* 17 CFR 240.3b-19

20 *See* 15 U.S.C. 78c(a)(8)

21 17 CFR 229.1101(f)

22 *See* 2004 Regulation AB Adopting Release, 70 FR at 1511.

23 *See* 2004 Regulation AB Adopting Release, 70 FR at 1511.

24 15 U.S.C. 78o-11(b)(1)

25 *See* CRR Adopting Release, 79 FR at 77608.

26 *See* CRR Adopting Release, 79 FR at 77609.

27 *See* CRR Adopting Release, 79 FR at 77609.

28 *See* CRR Adopting Release, 79 FR at 77609.

29 *Loan Syndications & Trading Ass'n,* 882 F.3d at 229.

30 *Loan Syndications & Trading Ass'n,* 882 F.3d at 223.

31 *Loan Syndications & Trading Ass'n,* 882 F.3d at 225.

32 *Loan Syndications & Trading Ass'n,* 882 F.3d at 227.

33 Section 941(b) of the Dodd-Frank Act amended the Exchange Act to add Section 15G.

34 Section 15G(b)(2) of the Exchange Act.

35 17 CFR 246.3

36 17 CFR 246.4

37 17 CFR 246.5

38 17 CFR 246.6

39 17 CFR 246.7

40 17 CFR 246.10

41 17 CFR 246.8, 246.13–246.21

42 *See* Exchange Act ABS Guide at 7, 10.

43 *See* Latham & Watkins LLP — Data Center Securitizations, SEC Division of Corporation Finance, Office of Structured Finance (July 29, 2026).

44 17 CFR 246.2

45 *See* Item 1101(l) of Regulation AB [17 CFR 229.1101(l)].

46 *See* CRR Adopting Release, 79 FR at 77609.

47 *See* CRR Adopting Release, 79 FR at 77609.

48 *See* CRR Adopting Release, 79 FR at 77611.

49 17 CFR 246.3(b)

50 17 CFR 246.2

51 17 CFR 246.11

52 17 CFR 246.2

53 17 CFR 246.11

54 17 CFR 246.7

55 17 CFR 246.12

56 *See* 17 CFR 230.192; *see also* Prohibition Against Conflicts of Interest in Certain Securitizations, Securities Act Release No. 33-11254 (Nov. 27, 2023) [88 FR 85396 (Dec. 7, 2023)].

57 *See* Exchange Act ABS Guide at 16.

58 *See* Exchange Act ABS Guide at 8.

59 *See* Exchange Act ABS Guide at 17–20.

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