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A Guide to the SEC's Proposed Revisions to the Rules and Forms for Offerings of Asset-Backed Securities

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In a lengthy release that emphasizes the need for improved investor protection in the wake of the financial crisis, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") has put forward a set of new rules and forms and amendments to existing rules that would effect substantial changes in the offering process, disclosure and reporting for public offerings of asset-backed securities ("ABS"), and would for the first time heavily regulate private offerings of structured finance products, including ABS, to large institutional investors.

The SEC, in proposing a broad expansion and revision of federal regulation of offerings of ABS, said that "[t]he recent financial crisis highlighted that investors and other participants in the securitization market did not have the necessary tools to be able to fully understand the risk underlying those securities and did not value those securities properly or accurately."

"The severity of this lack of understanding and the extent to which it pervaded the market and impacted the U.S. and worldwide economy," the Commission said, "calls into question the efficacy of several aspects of our regulation of asset-backed securities."

The SEC proposal would, among other things:

- Modernize the public offering process by requiring that investors be provided with both a complete, standardized pool asset file and a computer program of the cash flow waterfall;
- Increase the amount of disclosure provided in public offerings and, in shelf offerings, the amount of time that investors would have to examine the disclosure – including a requirement that in a shelf offering a preliminary prospectus be filed with the SEC at least five business days before any securities are sold;
- Require that in any private offering of "structured finance products" made in reliance on Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), investors have the right to obtain all of the same initial and ongoing information that would have been required if the offering were SEC-registered;
- Require five percent risk retention, net of any hedges directly related to the retained exposure, by securitization sponsors (or their affiliates) as a condition to shelf eligibility, but not for individually registered or private offerings; and
- Eliminate the investment-grade rating requirement for shelf eligibility and impose new requirements, including (in addition to risk retention) periodic reporting for as long as third-party investors hold the securities, a certification of the depositor

regarding the characteristics of the pool assets, and a verification procedure for enforcement of loan-level representations and warranties.[1]

Significantly, the proposed rules would have the effect of creating three distinct regulatory regimes for offerings of asset-backed securities: individual registrations on Form SF-1, shelf registration on Form SF-3, and private offerings in reliance on Rule 144A. Under each regime, standards for disclosure and reporting, the method and timing of the offering, requirements for risk retention (if any), standards of SEC review, and sources of liability under the federal securities laws would differ. We have attached a summary comparison of these offering regimes as an Annex to this Alert.

The proposed new and revised rules and forms would apply only to offerings of ABS and other structured finance products that are issued after the implementation date of the final rules.[2] The Commission has indicated that a transition period of undetermined length, but possibly as long as one year, will be provided after the final rules are adopted.

The proposing release is available at http://www.sec.gov/rules/proposed/2010/33-9117.pdf. Below we have summarized certain of the most significant elements of the SEC's proposal.[3]

Disclosure in SEC-Registered Offerings

The Commission's proposed changes to disclosure requirements primarily focus on requiring that ABS issuers provide detailed, ongoing, asset-level or "grouped account" data regarding both the characteristics of the pool assets and related obligors and collateral, and the performance of the pool assets.

Asset-Level Disclosure

The SEC proposal would greatly expand the amount of information regarding the securitized asset pool that is made available to investors, both at the time of the initial offering and on an ongoing basis. Issuers of most types of ABS would be required to provide information responsive to the applicable standardized asset-level data points listed on a new Schedule L.[4] Many of these data points are intended to provide

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[1] Compliance with the shelf eligibility requirements would become more difficult and would need to be assessed more frequently, and failure to comply would result in more severe and immediate consequences, as described below.

[2] The proposed rules would apply to a resecuritization after the effective date without regard to whether the underlying securities were issued prior to the effective date.

[3] The proposed rules do not include any changes that would affect the application of the Investment Company Act of 1940, as amended (the "Investment Company Act"), to ABS issuers or the availability of exclusions or exemptions under the Investment Company Act.

[4] *See* proposed Items 1111(h) and 1111A of Regulation AB and Item 8(a) of proposed Form SF-3.

information about the borrower's ability to pay, as well as information regarding the characteristics of the receivable and any related collateral.

Schedule L would set forth general data requirements for assets underlying all SEC-registered ABS (other than the asset classes noted below) and specific data requirements for 10 asset classes: residential mortgage loans, commercial mortgage loans, auto loans, auto leases, equipment loans, equipment leases, student loans, floorplan financings, corporate debt and resecuritizations. ABS backed by credit card or charge card receivables or by utility stranded costs would be exempt from the asset-level disclosure requirement.[5] Issuers of credit card and charge card ABS instead would be required to provide grouped account data, described below; there would be no similar requirement for stranded cost ABS.[6]

The general data requirements for each asset would include, among other things, a unique identifying number, an indication as to whether the asset was originated under an exception to applicable underwriting criteria, the identity of the servicer and the servicing advance methodology, if applicable.

In order to protect the privacy of individual obligors, some asset-level data would be provided in the form of codes, categories or ranges. For example, geographic location would be shown by Metropolitan or Micropolitan Statistical Areas, and credit score, debt and income would be shown in ranges.

The asset-level or grouped account data would be filed on EDGAR in Extensible Mark-up Language, or XML,[7] which would permit investors to download the asset data directly into spreadsheets or databases for analysis. In a shelf offering, asset-level data as of a "recent practicable date" (defined as the "measurement date") would be provided with the preliminary prospectus; in each offering, asset-level data as of the cut-off date would be provided with the final prospectus.[8] In addition, the cut-off date data would be required to include certain updated delinquency information to address activity that could have occurred between the measurement date and the cut-off date.[9]

As described below, the asset-level disclosure required in distribution reports would differ significantly from the disclosure required in the initial offering.

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[5] *See* proposed Item 1111(h) of Regulation AB.

[6] *See* proposed Items 1111(i) and 1111B of Regulation AB and Item 8(a) of proposed Form SF-3.

[7] *See* proposed amendment to Rule 11 of Regulation S-T.

[8] Grouped account data would be required only as of the applicable measurement date. Asset-level and grouped account data would be filed on Form 8-K and incorporated by reference into the prospectus. *See* proposed Items 1111(h) and 1111(i) of Regulation AB and Item 6.06(a) of proposed Form 8-K.

[9] *See* Item 1(b) on Schedule L (proposed Item 1111A) of Regulation AB.

Residential Mortgage Loans

Schedule L would identify 137 additional data points for asset-level data regarding residential mortgage loans to be provided in the initial offering. Examples include: for a refinancing, the amount of cash received by the borrower; for a senior mortgage, the amount of any junior loan; for a junior mortgage, information on the senior loan; the borrower's credit score and income; and the amount of the borrower's monthly non-mortgage debt.

Other Asset Classes

Data on commercial mortgage loans would include, for example: detailed information regarding the mortgaged property and its revenues, operating expenses, net operating income and net cash flow; when a defeasance option is available; and the identity of the three largest tenants and their lease expiration dates.

Information regarding the residual value of the collateral would be required, among other items, for auto and equipment leases. For floorplan financing ABS issued by a master trust, detailed performance information of the type required in distribution reports would be required for assets that were part of the asset pool prior to the offering.

Asset-level disclosure requirements for resecuritizations are discussed below.

If the pool assets are of a type for which the SEC's proposed rules do not prescribe specific data points, the issuer would need to provide only the general data required by Schedule L.

Credit Card and Charge Card Receivables

According to the SEC, some credit card or charge card asset pools may include between 20 and 45 million accounts. Such an "overwhelming" volume of data was deemed not to be useful on an asset-level basis. Instead, the Commission has proposed that grouped account data, as set forth in a new Schedule CC, be filed as an alternative to asset-level data. This data would be created by compressing the asset-level data into groups organized by combinations of account characteristics.[10]

Expanded Asset Pool Disclosure

In addition to the proposed requirement for extensive asset-level disclosure, the SEC believes that disclosure regarding the pool assets as a whole is still important. The proposal would expand the scope of pool asset information required in the prospectus to include, among other things:[11]

- Specific data regarding the amount and characteristics of pool assets that were originated under exceptions to credit underwriting standards;

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[10] An Instruction to Schedule CC (proposed Item 1111B) of Regulation AB states that "the combination of all distributional groups should produce 14,256 grouped account data lines."

[11] *See* proposed amendments to Item 1111 of Regulation AB.

- If compensating factors regarding pool assets underwritten as exceptions to credit underwriting standards are disclosed, a description of those compensating factors and disclosure of the amount of assets in the pool not meeting those compensating factors;
- Disclosure regarding steps taken by originators to verify information used in credit underwriting of pool assets;
- A description of the provisions in the transaction documents governing modification of the terms of pool assets; and
- Disclosure of whether or not a representation and warranty as to fraud is provided.

The Commission also states in the proposing release its view that existing Item 1111 of Regulation AB should be interpreted as requiring statistical information in the prospectus regarding "risk layering" – the bundling of multiple non-traditional features into a single loan product.

Static Pool Information

Because of perceived inconsistencies among ABS issuers in disclosure of static pool information, the SEC is proposing several changes, including:

- A narrative description of the static pool information presented, the methodology used in the calculations, a description of terms or abbreviations used and a description of how the static pool assets differ from the assets included in the securitized pool;[12]
- If applicable, an explanation of why an issuer has not provided static pool information or has provided alternative disclosure;[13]
- For amortizing pools, calculation of delinquencies and losses in accordance with a specified standard;[14] and
- Also for amortizing pools, a graphical presentation of delinquency, loss and prepayment data.[15]

Under the proposed rules, the SEC would no longer permit issuers to satisfy the SEC filing requirement by posting static pool information to an internet web site; rather, this information would be required to be filed on EDGAR.[16]

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[12] *See* proposed amendment to Item 1105 of Regulation AB.

[13] *See* proposed Item 1105(c) of Regulation AB.

[14] *See* proposed amendment to Item 1105(a)(3)(ii) of Regulation AB.

[15] *See* proposed Item 1105(a)(3)(iv) of Regulation AB.

[16] Static pool data, which would be filed on Form 8-K and incorporated by reference into the prospectus, could be filed in portable document format (pdf). *See* proposed amendment to Rule 312 of Regulation S-T.

Cash Flow Waterfall

Virtually all issuers would be required to file with the SEC a computer program of the flow of funds (or "waterfall"), using a programming language called Python, at the time of the filing of the preliminary and final prospectuses with respect to a registration statement on Form SF-3 or, with respect to a registration statement on Form SF-1, by the time of effectiveness of such registration statement.[17] It is expected that investors would be able to download the program and run it on their computers.[18] Credit card master trusts would be required to report changes to the waterfall program on Form 8-K and file the updated program with the SEC, together with an updated file of grouped account data.[19]

The computer program would allow potential investors to analyze the impact on the flow of funds of changes in the asset-level or grouped account data. The program would be able to pull information from the asset-level or grouped account data and allow the user to input the user's assumptions regarding the future performance and cash flows of the pool assets. The resulting output would indicate the cash flows associated with the ABS, including, among other things, the amount and timing of principal and interest payments on the ABS.

Repurchase or Substitution of Pool Assets

Prospectus disclosure would be required, for the sponsor and each originator that originated 20 percent or more of the pool assets, of the amount (if material), on a pool-by-pool basis, of publicly securitized assets originated or securitized by that party that were the subject of a demand to repurchase or replace over the preceding three years, together with the percentage of that amount not then repurchased or replaced.[20] Of those assets not repurchased or replaced, disclosure would be required as to whether the third-party opinion or certificate described below had been provided to the trustee.[21]

Information regarding the financial condition of the sponsor or any 20 percent originator would be required if there is a material risk that the party's financial

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[17] The filing would need to include sample expected outputs for each ABS tranche, so that investors could confirm that the program is working correctly, and the prospectus would need to include disclosure regarding the filing of the program. *See* proposed Item 1113(h) of Regulation AB, proposed Rule 314 of Regulation S-T and proposed Item 6.07 of Form 8-K.

[18] Proposed Item 1100(g) of Regulation AB would also require that a prospectus contain in one location information describing the cash flow waterfall, including any related defined terms.

[19] *See* proposed Item 1113(h)(5) of Regulation AB.

[20] *See* proposed Items 1104(f) and 1110(c) of Regulation AB.

[21] Nothing in the proposed rules would impose any substantive requirement that a securitization include any particular representations and warranties or provisions for repurchase or replacement of pool assets that are found to be in breach of representations and warranties.

condition could materially affect its ability to repurchase defective assets or, in the case of an originator, its origination of pool assets.[22]

Servicers

Annual reports filed by ABS issuers are required to contain, among other things, a platform-level assessment of compliance with the Regulation AB servicing criteria by each servicer and each other party participating in the servicing function ("PPSF"), together with an accountant's attestation of each such assessment. Material instances of noncompliance with the servicing criteria that are identified in the assessment must be disclosed in the body of the annual report on Form 10-K. However, because the assessment is performed on a servicer's or PPSF's entire servicing platform for similar assets (or some permitted segment of the platform), it may not be clear whether reported instances of noncompliance with the servicing criteria are relevant to a particular issuer or its ABS. The SEC proposes to enhance this disclosure by requiring that the annual report disclose whether identified instances of noncompliance involved the servicing of the related pool assets. Also required would be disclosure regarding any steps taken to remedy a material instance of noncompliance.[23]

The Commission states its view that Item 1108(b)(2) of Regulation AB requires disclosure in the prospectus of any material instances of noncompliance noted in the annual assessment or attestation reports required under Item 1122 of Regulation AB or in the annual servicer compliance statement required under Item 1123, together with any steps taken to remedy the noncompliance and the current status of any such remedial steps.

Originators

Currently, an originator that originated less than 10 percent of an asset pool need not be identified in the prospectus. The SEC has proposed that if the cumulative amount

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[22] The SEC requests comment as to whether the requirements for disclosure of financial information regarding transaction parties should be greatly increased, such as by expanding the definition of "significant obligor" to include any party obligated to repurchase pool assets due to breaches of representations and warranties, or by requiring disclosure of servicers' financial statements. Disclosure of summary financial information or audited financial statements is required for any significant obligor. *See* Item 1112 of Regulation AB.

[23] *See* proposed amendment to Item 1122(c) of Regulation AB. The SEC would also amend Item 1122 to codify a prior SEC staff telephone interpretation regarding the scope of the annual assessment of compliance. The servicing platform addressed by an assessment should generally include all ABS transactions, taken as a whole, involving the same asset type as those that are the subject of the annual report. The servicing platform may be limited in ways that reflect actual servicing practices, but may not be "artificially designed." An instruction to amended Item 1122 would provide that any limitation on the scope of the servicing platform must be disclosed in the assessment. *Cf.* the Division of Corporation Finance's Manual of Publicly Available Interpretations on Regulation AB and Related Rules, Interpretation 17.03.

of assets originated by parties other than the sponsor is 10 percent or more of the pool, every originator would be required to be identified.[24]

Economic Interest in the Transaction

In a shelf offering, the nature and amount of the risk retained by the sponsor or its affiliate would be required to be disclosed in the prospectus. In an offering registered on Form SF-1, the prospectus would be required to state that the sponsor is not required to retain any risk in the securities and may sell any interest that is initially retained at any time.[25]

In addition, a prospectus would be required to include disclosure of any interest retained in the transaction by the sponsor, servicer or 20 percent originator.[26] The Commission suggests in the proposing release that this disclosure could include, for example, ownership by a servicer of second lien mortgage loans that are related to first lien mortgage loans included in the asset pool.

Resecuritizations

The proposed rules would require disclosure of the same asset-level data for the assets underlying resecuritized ABS as would be required in a primary securitization of those assets – both in the initial offering and on an ongoing basis.[27] In addition to the required cash flow waterfall computer program for the ABS issued in a resecuritization, a computer program of the flow of funds would need to be filed for each underlying security. It appears that these requirements would apply no matter how many ABS were included in a resecuritization pool or how small the concentration of a particular class of ABS was in a resecuritization pool.

Registration of ABS Offerings; the Offering Process

The SEC proposes to create a separate registration scheme for ABS, and to substantially increase the requirements for eligibility for shelf registration and the frequency with which compliance would be assessed.

New Forms SF-1 and SF-3

Currently, most offerings of ABS are registered for the shelf on Form S-3, and individual offerings of ABS are registered on Form S-1. Offerings of securities that do not meet the Regulation AB definition of "asset-backed security" are ineligible for shelf registration and may only be registered on Form S-1. Forms S-3 and S-1 are also used for registration of offerings of corporate securities. The SEC proposal would create new

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[24] *See* proposed amendment to Item 1110(a) of Regulation AB.

[25] *See* proposed Item 1104(e) of Regulation AB.

[26] *See* Item 6 of proposed Form SF-1, Item 6 of proposed Form SF-3, and proposed Items 1104(e), 1108(e) and 1110(b)(3) of Regulation AB.

[27] *See* Item 11(b) on Schedule L (proposed Item 1111A) of Regulation AB.

forms that would be tailored for ABS offerings – Form SF-3, for shelf registration of ABS, and Form SF-1, for individual registrations by ABS issuers not eligible to use Form SF-3.[28]

Issuers that use Form SF-3 would be subject to strict eligibility requirements, described below, and the offering process requirements in shelf offerings would differ materially from current practice. Significantly, the obligations of ABS issuers to file periodic reports would be greatly expanded for shelf offerings, though not for offerings using Form SF-1.[29] However, the up-front disclosure requirements under the two new forms would be substantially the same.

Eligibility for Shelf Registration

Eligibility of ABS for registration on Form SF-3 would be conditioned on, among other things, satisfaction of various new criteria.

Currently, offerings of ABS may be eligible for shelf registration if, among other criteria, the securities will be rated investment grade by at least one nationally recognized statistical rating organization ("NRSRO").[30] Consistent with the SEC's ongoing effort to remove references to NRSRO credit ratings from its rules in order to reduce the risk of undue reliance on ratings, this requirement would be eliminated and replaced with the new eligibility criteria described below.[31]

In addition, existing shelf eligibility criteria other than the rating requirement would continue to apply.[32] Compliance with the existing requirement that all periodic reports

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[28] Offerings of securities not satisfying the Regulation AB definition of "asset-backed security" could still be registered on Form S-1.

[29] Legislation passed by the House of Representatives and pending in the Senate would give the SEC the authority to require life-of-transaction periodic reporting for all ABS sold in registered offerings.

[30] *See* General Instruction I.B.2 of Form S-3.

[31] The SEC requests comment on, among other things, whether shelf eligibility should be conditioned on the nature of the pool assets or the capital structure of the securitization. For example, the Commission asks whether shelf offerings of ABS should be backed by pool assets that are seasoned for a minimum period of time, or whether the number of tranches of ABS should be limited.

[32] These requirements include:

- The securities proposed to be registered must satisfy the definition of "asset-backed security" in Regulation AB;
- Less than 20 percent (by principal balance) of the asset pool may be delinquent in payment on the closing date;
- For ABS evidencing interests in or secured by leases other than motor vehicle leases, less than 20 percent (by dollar volume) of the securitized pool balance may be attributable to the residual value of the leased property; and
- While the revolving period in a securitization of revolving assets may be of unlimited duration, the revolving period in a securitization of fixed assets must (currently) not exceed

required to have been filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the 12 months (and any portion of a month) immediately prior to the filing of the registration statement have been timely filed[33] would need to be periodically verified, in addition to the following:[34]

- The continued satisfaction by the sponsor of any Form SF-3 risk retention requirement;
- The filing of periodic reports not required by statute but undertaken to be filed as a condition to shelf eligibility, as described below;
- The timely filing of the certifications of the depositor's CEO, as described below; and
- The timely filing of the transaction documents for each shelf takedown no later than the date on which the final prospectus was required to be filed.[35]

Failure to satisfy the ongoing eligibility requirements under the proposed rules by the depositor or any issuing entity established by the depositor or any of its affiliates, or failure by the sponsor to satisfy the risk retention requirement, could render a depositor unable to use an effective shelf registration statement – unlike under current rules, which assess shelf eligibility only at the time that a registration statement is filed.

Risk Retention

In each shelf offering of ABS, the sponsor or an affiliate of the sponsor would be required to retain, at a minimum, a net economic interest equal to either:[36]

- Five percent of the nominal amount of each tranche of securities sold to investors,[37] net of hedge positions "directly related" to the retained securities – a so-called "vertical slice"; or

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three years. The revolving period for fixed assets would be limited to one year under the proposed rules.

[33] This requirement applies to each issuing entity formed by the depositor or any affiliate of the depositor in a securitization of the same asset class contemplated by the registrant. Certain types of current reports on Form 8-K that are specified in current Form S-3 and proposed Form SF-3 need not have been filed timely in order for an ABS issuer to maintain shelf eligibility. These exceptions currently include, among others, reports pursuant to Item 6.05 regarding a change in a material characteristic of the asset pool. As discussed below, the SEC proposes to repeal the exception for reports filed under Item 6.05 of Form 8-K.

[34] *See* General Instruction I.A of proposed Form SF-3. The proposed rules also include certain disclosure requirements relating to the shelf eligibility criteria.

[35] Although all material transaction documents would be required to be filed by the date that the final prospectus must be filed, only the failure to timely file the transaction documents that include the required provision relating to third-party verification regarding repurchase obligations, as described below, would jeopardize shelf eligibility. *See* proposed amendment to Item 1100(f) of Regulation AB and General Instruction I.A.2(a) of proposed Form SF-3.

[36] *See* General Instruction I.B.1 of proposed Form SF-3.

- In a revolving asset master trust, as an alternative at the sponsor's election, an originator's interest of five percent of the nominal amount of the securitized exposures, net of hedge positions "directly related" to the retained securities;
    - provided, that the originator's interest and the securities sold to investors are backed by the same pool of receivables, and payments of the originator's interest are not less than five percent of the securities held by investors collectively.

Hedge positions that are not directly related to the sponsor's retained exposure would not be required to be netted. These include "hedges related to overall market movements, such as movements of market interest rates, currency exchange rates, or of the overall value of a particular broad category of asset-backed securities." For example, "holding a security tied to the return of a subprime ABX.HE index would not be a hedge on a particular tranche of a subprime RMBS sold by the sponsor unless that tranche itself was in the index."

In addition to the risk retention requirement proposed by the SEC, legislation passed by the House of Representatives and a separate bill under consideration in the Senate would generally require retention of risk by a "securitizer" or originator in most securitizations, but would permit regulators some flexibility in applying risk retention standards.[38]

Commitment to File Ongoing Periodic Reports

Under current law, most publicly registered term securitizations cease filing periodic reports under the Exchange Act after the calendar year in which the securities were issued.[39] Under the SEC proposal, when filing a shelf registration statement, the issuer

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[37] Although not entirely clear, it appears that the risk retention requirement would apply to classes of securities that were part of the same issuance even if those classes were sold in a concurrent private placement.

[38] Financial market reform legislation being considered by the Senate would require most securitizers to "retain an economic interest in a material 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." In general, the minimum credit risk retention would be five percent (reduced from 10 percent in the previous draft Senate bill and now consistent with the five percent minimum risk retention proposed in legislation passed by the House) and the risk could not be hedged, directly or indirectly. But the Senate bill provides that the risk retention requirement for any particular asset could be less than five percent if the originator of the asset were to meet underwriting standards to be specified in implementing regulations to be issued jointly by the SEC, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Unlike the Senate bill, the House bill would require risk retention above five percent if credit underwriting or due diligence is insufficient. A "securitizer" for purposes of both bills would generally be the issuer or the sponsor.

[39] For most ABS issuers other than master trusts, the obligation to file periodic reports under Section 15(d) of the Exchange Act is automatically suspended at the beginning of the issuer's second fiscal year if, as is almost always the case, the issuer's securities are held of record by fewer than 300 persons. However, financial market reform legislation passed by the House and

would be required to undertake to file the periodic reports that would have been required if reporting had not been suspended for as long as securities of the issuer are held by third parties. This undertaking would have to be disclosed in the prospectus.

The prospectus would also be required to disclose any failure during the preceding year to timely file a periodic report for any issuing entity established by the depositor or any affiliate of the depositor, regardless of whether the report was required to be filed by statute or by virtue of the undertaking described above.

Certification by the CEO of the Depositor

The chief executive officer of the depositor would be required to certify, for each shelf offering, that to his or her knowledge "the securitized assets backing the issue have characteristics that provide a reasonable basis to believe that they will produce, taking into account internal credit enhancements, cash flows at times and in amounts necessary to service any payments of the securities as described in the prospectus."[40] The text of the certification would not be permitted to be altered.[41]

The Commission states in the proposing release that any "issues" that may arise in connection with delivery of the certification should be addressed through disclosure in the prospectus. For example, according to the Commission, to the extent that the prospectus describes the risk that cash flows will not be sufficient to make payments on the securities, the disclosure would be "taken into consideration" in signing the required certification.

The SEC notes that a CEO who provides a false certification could be subject to action by the Commission under Section 17 of the Securities Act, an anti-fraud provision.[42]

Third-Party Verification Regarding Repurchase Obligations

For any ABS offered via a shelf registration statement, the transaction documents would be required to provide that the party that is obligated to repurchase pool assets that are in material breach of a representations and warranties must provide to the securitization trustee, on at least a quarterly basis, a certificate or opinion of an unaffiliated third party regarding pool assets not repurchased or substituted for after a demand for such was made. If the obligated party did not repurchase a pool asset on the basis of its assertion that the representations and warranties were not breached,

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being considered by the Senate would exempt all ABS from this provision and grant the SEC authority to determine when ABS issuers should be permitted to suspend reporting.

[40] The Commission requests comment on whether the CEO should be permitted to consider external enhancement, such as insurance or a derivative, in making the certification.

[41] The CEO's certification would be required to be filed on Form 8-K as an exhibit to the registration statement. The CEO would also be required to certify that he or she has reviewed the prospectus and the necessary documents for the certification.

[42] Of course, the depositor's CEO is required to sign the registration statement, and is therefore potentially subject to liability for material misstatements or omissions.

the third-party certificate or opinion would be required to state that the affected pool asset was not in breach.

It is not clear what the consequences would be if the required certificate or opinion were not, or could not be, provided, except that such failures would be required to be disclosed in the distribution report for the related period and, if material, in prospectuses for future offerings, as described above.

More Frequent Evaluation of Shelf Eligibility

Under current rules, shelf eligibility for ABS is determined at the time that the registration statement is filed. Under the Commission's proposal, an ABS shelf issuer:

- Would need to evaluate annually, as of the 90th day after the end of the depositor's fiscal year, whether all periodic reports required under the Exchange Act had been timely filed by the depositor or (with respect to ABS backed by the same asset class) any issuing entity established by the depositor or any of its affiliates;[43] and
- Would need to evaluate quarterly whether the depositor or (with respect to ABS backed by the same asset class) any issuing entity established by the depositor or any of its affiliates, or the sponsor, in the case of the risk retention provision, had satisfied the requirements for risk retention, filing of periodic reports pursuant to the undertaking described above, timely filing of the CEO certification, and timely filing of documents containing provisions regarding third-party review of repurchase requests.[44]

Preliminary Prospectuses in Shelf Offerings

Under current rules, neither delivery nor filing of a preliminary prospectus is required in shelf offerings of ABS. The SEC proposal would require that a preliminary prospectus that contains all required disclosure other than pricing-related information[45] be filed

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[43] Failure to timely file even one required Exchange Act report would render the depositor unable to use the registration statement for a full year after the delinquent report was filed. *See* proposed Rule 401(g)(4)(ii) of Regulation C.

[44] If the risk retention requirement were not satisfied as of the end of a fiscal quarter of the depositor, the shelf registration statement could not be utilized until after the end of the fiscal quarter in which the failure was corrected. If a CEO certification or transaction document were not timely filed in any fiscal quarter, the shelf registration statement could not be utilized until a full year after such documents were filed. Unlike periodic reports required to be filed pursuant to the Exchange Act, periodic reports required to be filed by virtue of the undertaking would not need to be filed on a timely basis in order to satisfy the quarterly shelf eligibility requirement. However, if the requirement to file periodic reports by virtue of the undertaking were not satisfied as of the end of a fiscal quarter, the shelf registration statement could not be utilized until after the end of the fiscal quarter in which such failure was corrected. *See* proposed Rule 401(g)(4)(i) of Regulation C.

[45] A preliminary prospectus could omit information with respect to the offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, or other matters dependent upon the offering price.

with the SEC at least five business days before the first contract of sale is entered into with an investor.[46]

- If there is any material change in the information contained in the preliminary prospectus, a new preliminary prospectus would be required to be filed and another five business days would need to elapse before the first contract of sale.[47]

The current exemption of most shelf offerings of ABS from the requirement that a preliminary prospectus be delivered at least 48 hours before a confirmation of sale is sent would be repealed.[48]

Use of Integrated Prospectus in Shelf Offerings

In a shelf offering, disclosure is generally presented in the form of a base prospectus and a prospectus supplement. The base prospectus, which is filed with the SEC prior to effectiveness of the registration statement, describes generally the types of assets that may be securitized and the structures that may be used, and provides information about future offerings that is known at the time the registration statement is filed, including general tax and ERISA disclosure and risk factors relating to investment in the ABS. The prospectus supplement describes the specific terms of the securities that are offered.[49] Together, these two documents constitute the final prospectus that is filed with the SEC for each shelf offering.

The proposed rules would eliminate this method of providing disclosure in ABS shelf offerings, requiring instead that shelf registrants file a single form of prospectus before a registration statement becomes effective, and file a single preliminary prospectus and a single final prospectus for each shelf takedown that includes all required disclosure in one integrated document.[50]

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[46] Or, if used earlier, by the second business day after first use of the preliminary prospectus. Although ambiguously drafted, what is presumably intended here is that the filing must be made on the earlier of the date that is five business days before the first sale or two business days after first use. *See* proposed Rules 424(h) and 430D(a)(1) of Regulation C. This preliminary prospectus requirement could not be satisfied by filing a free writing prospectus, although free writing prospectuses could continue to be used in shelf offerings of ABS.

[47] *See* proposed Rule 430D(a)(2) of Regulation C.

[48] *See* proposed amendment to Rule 15c2-8(b) under the Exchange Act.

[49] Currently, when a shelf registration statement is filed it includes one or more forms of prospectus supplement that outline the format of transaction-specific disclosure that may be provided at the time of a shelf takedown.

[50] *See* proposed Rule 430D of Regulation C. According to the Commission, the current practice of providing a prospectus supplement accompanied by an often-lengthy base prospectus "has resulted in unwieldy documents with excessive and inapplicable disclosure" that is "often overwhelming and is burdensome for investors to navigate."

Limitations on Content of Shelf Registration Statement

Shelf issuers would no longer be permitted to include multiple base prospectuses to register offerings of different asset classes in a single registration statement. Multiple depositors sharing a single registration statement would also no longer be permitted. Each separate asset class would require a separate registration statement filed by a single depositor.[51]

Pay As You Go

The Commission acknowledges in the proposing release that managing multiple registration statements for different asset classes, as described above, would be burdensome.[52] As an accommodation, the SEC has proposed allowing ABS shelf issuers to pay filing fees at the time of each offering, rather than paying in advance at the time the registration statement becomes effective as is currently required.[53]

Timely Filing of Final Transaction Documents

Regulation AB would be revised to explicitly require that the material transaction documents required to be filed as exhibits to the registration statement must be filed, together with any attachments or schedules, no later than the date on which the final prospectus is required to be filed.[54] This filing would generally be accomplished by filing the agreements under cover of Form 8-K and incorporating them by reference into the prospectus. Such documents must be in final form, except that "prices, signatures and similar matters" may be omitted.

The SEC requests comment as to whether the transaction documents should be filed even sooner – such as at the time that the preliminary prospectus is filed in a shelf offering.

Periodic Reporting

As discussed above, the SEC's proposed changes to the requirements for shelf eligibility would greatly expand reporting obligations for shelf-registered ABS. Other changes to the reporting requirements are summarized below.

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[51] Under the proposed rules, resecuritizations of ABS would be considered to be a separate asset class.

[52] The principal reason for including multiple asset classes within a single registration statement is to permit offerings of ABS backed by any of the various types of assets to draw on the same aggregate amount of registered securities, known as "shelf capacity." This reduces the risk that registered shelf capacity ends up stranded if business or market conditions are unfavorable for offerings of a particular type of ABS.

[53] The fee would be paid at the time that the preliminary prospectus is filed, at whatever fee rate is applicable at that time. *See* proposed Rules 456(c)(1) and 457(s) of Regulation C.

[54] *See* proposed amendment to Item 1100(f) of Regulation AB.

Distribution Reports

Ongoing reporting of asset-level performance data and grouped account data would be required at the time of filing of each distribution report on Form 10-D pursuant to new Schedule L-D (for asset-level data) or new Schedule CC (for grouped account data).[55] This information would differ from the asset-level data provided in the initial offering, focusing on matters related to whether an obligor is making payments as scheduled, the efforts being made by the servicer to collect amounts past due, and any losses that may be incurred by investors.

For residential mortgage loans, for example, some of the required data would include: whether the servicer is pursuing a loss mitigation strategy, and if so what type of strategy; detailed information on any loan modifications; information regarding forbearance or repayment plans; and detailed information regarding foreclosure proceedings and any real estate owned.

The distribution report would be required to include (if material) information on any demands for repurchase or replacement of pool assets due to material breaches of representations and warranties during the applicable period, the percentage of that amount not then repurchased or replaced, and whether the third party certificate or opinion described above was provided to the trustee with respect to those pool assets not repurchased or replaced.[56]

Reports on Form 8-K

Currently, if any material characteristic of the asset pool at the time of issuance of the ABS differs by five percent or more from the description of the asset pool in the prospectus, the issuer must file certain disclosure regarding the actual asset pool under Item 6.05 of Form 8-K. The SEC proposes to reduce this reporting threshold to one percent.

Any other changes to the asset pool, including the number of assets added or substituted, would also need to be disclosed.[57] Any such report on Form 8-K would be accompanied by updated asset-level data or grouped account data, as applicable.[58]

Private Offerings of Structured Finance Products

The proposed regulations would apply the disclosure requirements for registered offerings to the most active and liquid private market for ABS, the Rule 144A market, as

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[55] *See* proposed Items 1121(d) and (e) of Regulation AB and proposed Item 1A of Form 10-D.

[56] *See* proposed Item 1121(c) of Regulation AB.

[57] Even though contemplated at the time of offering, the Commission said in the proposing release that "the investment of cash collections and reserve funds may be a material change to the asset pool."

[58] Currently, failure to timely file a report under Item 6.05 of Form 8-K does not result in loss of shelf eligibility. The SEC proposes to repeal this exception.

well as to offerings made in reliance on Rule 506 of Regulation D under the Securities Act. The entire broad category of "structured finance products," defined below, would be covered.[59]

Rule 144A provides a safe harbor exemption from registration for resales of securities to large institutional investors that qualify as "qualified institutional buyers."[60] Rule 506 under Regulation D, infrequently relied upon in structured finance transactions, provides a private offering safe harbor exemption from registration for sales of securities by issuers.

The new disclosure requirements would not apply to private sales of ABS made in reliance on the statutory exemptions provided by Sections 4(1) and 4(2) of the Securities Act, but the availability of such an exemption from registration would be less certain, and restrictions on transfer of securities in reliance on the statutory exemptions would be more burdensome, than in the case of Rule 144A resales. The proposed requirements would also not apply to sales of ABS and other structured finance products outside the United States in reliance on the Regulation S safe harbor, discussed below.

"Structured Finance Product" Defined

The proposed rules define "structured finance product" broadly to include:[61]

(i) a synthetic asset-backed security; or

(ii) a fixed-income or other security collateralized by any pool of self liquidating financial assets, such as loans, leases, mortgages, and secured or unsecured receivables, which entitles the security holders to receive payments that depend on the cash flow from the assets, including –

(A) an asset-backed security as used in Item 1101(c) of Regulation AB,

(B) a collateralized mortgage obligation,

(C) a collateralized debt obligation,

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[59] "Securitization in the private, unregistered market played a significant role in the financial crisis," the Commission said in the proposing release. "In particular, the CDO market has been cited as central to the crisis." The SEC requests comment as to whether it should further restrict the private markets for structured finance products, including by requiring that the initial investors hold the securities for a minimum period of time before resale in reliance on Rule 144A.

[60] A seller of securities that satisfies the requirements of Rule 144A will not be deemed to be an underwriter within the meaning of Sections 2(a)(11) or 4(1) of the Securities Act.

[61] *See* proposed Rule 144A(a)(8) under the Securities Act and proposed Rule 501(i) of Regulation D.

(D) a collateralized bond obligation,

(E) a collateralized debt obligation of asset-backed securities,

(F) a collateralized debt obligation of collateralized debt obligations, or

(G) a security that at the time of the offering is commonly known as an asset-backed security or a structured finance product.

This definition is intended to encompass "the wide range of securitization products that are sold in the private markets," according to the Commission.

Whether covered bonds would be captured by the new definition of structured finance product is unclear.[62] Asset-backed commercial paper ("ABCP") is intended to be covered by the definition of structured finance product; however, ABCP is frequently sold in reliance on a statutory exemption from registration.

Rule 144A and Regulation D Offerings

In the proposing release, the SEC is particularly critical of the role that it says collateralized debt obligations ("CDOs") played in the financial crisis. "Some have concluded," the Commission says, "that the events of the financial crisis have demonstrated that a lack of understanding of CDOs and other privately offered structured finance products by investors, rating agencies and other market participants may have significant consequences to the entire financial system." According to the SEC, "the ratings of these products proved inaccurate, which significantly contributed to the financial crisis." As a result, "information about those assets and the structure of the vehicle is critical to an informed investment decision." The SEC proposes to ensure that the needed information is available by substantially expanding the information requirement under Rule 144A.

Currently, Rule 144A requires that with respect to an ABS issuer that is not a reporting company under the Exchange Act, security holders and prospective purchasers have the right to obtain from the issuer, upon request, "basic, material information concerning the structure of the securities and distributions thereon, the nature, performance and servicing of the assets supporting the securities, and any credit enhancement mechanism associated with the securities."[63] But this, according to the

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[62] The SEC does not mention covered bonds in the proposing release.

[63] Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities under Rules 144 and 145, Securities Act Release No. 33-6862 (April 23, 1990). ABS issuers generally satisfy this requirement by agreeing to provide at the request of any securityholder or prospective transferee:

- A copy of the offering document (including any supplements);
- Copies of the operative documents (including any amendments);
- Copies of the annual certifications and reports of the servicers for the most recent year;

Commission, may provide investors with only "a minimal amount of information about their investment."

Under the SEC's proposal, reliance on the Rule 144A safe harbor in connection with the sale of structured finance products would require that a transaction document grant to security holders or prospective purchasers of securities the right to obtain from the issuer, upon request, the same information that would be required to be provided in an offering registered on Form SF-1 or Form S-1 and the ongoing information that would be required if the issuer were required to file reports under the Exchange Act.[64]

In a sale by an issuer in reliance on Regulation D, only the initial offering information would be required.[65] In a resale in reliance on Rule 144, the same requirements regarding initial and ongoing information would apply as would be applicable in a Rule 144A resale.[66]

If a structured finance product would satisfy the Regulation AB definition of asset-backed security, the disclosure otherwise required in a registered offering on Form SF-1 would be required. For offerings of other structured finance products, the broader information requirements of Form S-1 would apply, in which case the issuer (according to the Commission) would need to provide the disclosure required under Regulation AB regarding the pool assets and transaction parties as well as additional information required under Regulation S-K that would vary depending upon the nature of the structured finance products.[67]

As a result, for securities such as CDOs, collateralized loan obligations, or various types of synthetic securities, it is unclear precisely what disclosure requirements would apply. The SEC provides little guidance in the proposing release, other than the following: "For a managed CDO offering, we would expect disclosure regarding the asset and collateral managers, including fees and related party transaction information, their objectives and strategies, any interest that they have retained in the

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- Copies of the distribution date reports provided to securityholders during the preceding year; and
- Other information, to the extent available, that is directly related to the performance of the pool assets and payments on the securities.

[64] Although the Commission did not say this explicitly in the proposing release, it appears that in a Rule 144A offering the issuer would be obligated to provide, upon request, updated disclosure on an ongoing basis for as long as third-party investors hold the securities – even though an issuer of ABS registered on Form SF-1 would in most cases be entitled to suspend reporting after the first year. *See* proposed Rule 144A(d)(4)(iii) under the Securities Act.

[65] *See* proposed amendment to Rule 502(b) of Regulation D.

[66] These requirements would apply only in the case of resales by affiliates of the issuer or resales by non-affiliates within the first year after the initial sale by the issuer, and only if the seller were relying on the Rule 144 safe harbor.

[67] How the disclosure requirements of Regulation AB would apply to such transactions is unclear. This raises the counterintuitive possibility that issuers may need to consult with the SEC staff regarding disclosure required in an offering exempt from registration.

transaction or underlying assets, and substitution, reinvestment and management parameters. For a synthetic CDO offering, we would expect, among other things, disclosure of the differences between the spreads on synthetic assets and the market prices for the assets, the process for obtaining the credit default swap or other synthetic assets, and the internal rate of return to equity if that was a consideration in the structuring of the transaction."

Public Notice of Offering

In offerings of structured finance products eligible for resale under Rule 144A, the issuer would be required to file a public notice with the SEC that would include, among other things, the identities of the principal transaction parties, a description of the type of securities being offered and their structure, a brief description of the asset pool, the date of the initial sale and resale, and the amount offered or sold in the initial offering.[68] The notice would be required to be filed within 15 days after the initial sale of securities, and would include an undertaking to provide a copy of the offering materials to the SEC upon request.

Failure to file the required notice would not jeopardize the availability of the Rule 144A safe harbor for the related offering, but would make future offerings of structured finance products by the issuer or its affiliates ineligible for Rule 144A until the required notice had been filed.

The existing form that is filed in connection with Regulation D offerings, Form D, would be revised to capture the information described above.

Enforcement

New Rule 192 would provide a basis for the Commission to bring an enforcement action against an issuer of structured finance products that fails to comply with a covenant in a transaction document to provide information to investors in a Rule 144A or Regulation D offering.[69]

Regulation S Offerings

The SEC proposal would not make any changes to the Regulation S safe harbor exemption from registration for offerings and sales of securities outside the United States. However, the SEC requests comment as to whether the proposed changes to Rule 144A would make it more likely that issuers would sell structured finance products to non-U.S. investors, and whether the Commission should therefore adopt changes to Regulation S similar to those proposed for Rule 144A.

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[68] *See* proposed Rule 144A(f) under the Securities Act.

[69] *See* proposed Rule 192 under the Securities Act. Failure to provide the offering information might also form the basis for an action against the issuer for securities fraud.

Other Aspects of the Proposal

Changes to Definition of Asset-Backed Security [70]

The proposal would further limit the extent to which SEC-registered ABS may deviate from the "discrete pool" requirement in the definition of "asset-backed security" by reducing the maximum amount of prefunding from 50 percent of the offering proceeds (or the aggregate principal balance of the total asset pool whose cash flows support the ABS, in the case of a master trust) to 10 percent.[71] The Commission said it is concerned that without this change, asset pools may be "not sufficiently developed at the time of an offering," such that investors may not receive adequate information about the pool assets and ABS before making an investment decision.

Master trust structures could be used only to hold assets arising out of revolving accounts.[72] The SEC would also impose stricter limits on the use of revolving structures for non-revolving assets, which is not a common structuring technique, including reducing the maximum length of the revolving period from three years to one year.[73]

Who Must Sign the Registration Statement

Currently, a registration statement for ABS must be signed by the depositor, the depositor's principal executive officer or officers, the principal financial officer, and the controller or principal accounting officer, as well as by at least a majority of the depositor's board of directors or persons performing similar functions. However, an ABS depositor generally does not require a controller or principal accounting officer for any other purpose, and the SEC has determined that such signatures "serve no purpose." Under the proposed rules, an ABS registration statement would be required to be signed by the depositor's senior officer in charge of securitization, rather than by its controller or principal accounting officer.

Opportunity for Public Comment

Comments on the SEC's proposal may be submitted until 90 days after the date on which the proposed rules were published in the Federal Register.

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[70] Currently, Regulation AB defines "asset-backed security" generally as "a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert to cash within a finite term period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases." This basic definition is further qualified by a series of conditions set forth in Item 1100(c) of Regulation AB.

[71] *See* proposed amendment to Item 1101(c)(3)(ii) of Regulation AB.

[72] *See* proposed Item 1101(c)(3)(i) of Regulation AB.

[73] *See* proposed amendment to Item 1101(c)(3)(iii) of Regulation AB.

Annex: Summary Comparison of Proposed ABS Offering Regimes

	Offerings Registered on Form SF-1	Offerings Registered on Form SF-3	Rule 144A Offerings
Filing with SEC; Review Process	Registration statement is filed with the SEC and subject to possible SEC staff review prior to effectiveness.	Registration statement is filed with the SEC and subject to possible SEC staff review prior to effectiveness. Shelf takedowns permitted at any time without prior filing or SEC staff review, subject to strict ongoing requirements for shelf eligibility.	Offerings may be made at any time. Public notice of the offering must be filed with the SEC within 15 days after the initial sale. The issuer must undertake to provide the offering documents to the SEC upon request.
Offering Process	Sales of securities, including contracts of sale, not permitted until the registration statement is declared effective by the SEC. Strict limits apply to pre-effective written communications with investors.	Under an effective shelf registration statement, offerings may be conducted at any time. Free writing prospectuses may be disseminated to investors (subject to filing requirements), but a complete preliminary prospectus must be filed with the SEC at least 5 businesses days before a contract of sale is entered into.	Contracts of sale may be entered into at any time. Transaction documents must entitle investors to receive required disclosure upon request.
Risk Retention	Not required.	Retention of minimum five percent "vertical slice" or (for a revolving asset master trust, at the sponsor's option) originator's interest required as condition to shelf eligibility.	Not required.
Required Disclosure	Regulation AB disclosure requirements must be satisfied.	Regulation AB disclosure requirements must be satisfied.	Disclosure that would be required in an offering registered on Form SF-1 (for ABS) or S-1 (for other structured finance products) must be made available upon request.
Requirements for Ongoing Reporting	Exchange Act requirements apply. Reporting may be suspended after issuer's first fiscal year to the extent permitted under Section 15(d) of the Exchange Act.	Exchange Act requirements apply. In addition, as a condition to shelf eligibility the issuer would be required to continue to file periodic reports for as long as third-party investors hold securities.	Transaction documents must entitle investors to receive on an ongoing basis, upon request, the same information that would be provided if the issuer were required to file reports under the Exchange Act.

Issuers of ABS offered pursuant to a registration statement are potentially subject to civil liability for materially false or misleading disclosure under Sections 11, 12(a)(2) and 17(a) of the Securities Act, as well as Rule 10b-5 under the Exchange Act. Such issuers, to the extent required under the Exchange Act to file periodic reports, may also be liable for materially false or misleading statements in periodic reports under Section 18 of the Exchange Act, and may be subject to administrative sanction by the SEC for failure to comply with Exchange Act reporting requirements. Any periodic report, whether filed pursuant to the requirements of the Exchange Act or pursuant to the undertaking proposed by the SEC to be required of ABS shelf registrants, could potentially subject issuers to liability for materially false or misleading disclosure under Rule 10b-5.

Issuers of ABS offered in reliance on the Rule 144A resale safe harbor are potentially subject to civil liability for materially false or misleading disclosure under Rule 10b-5, and would, under the proposed rules, be subject to an enforcement action by the SEC under proposed Rule 192 for failure to provide the initial or ongoing information described under "Private Offerings of Structured Finance Products" in this Alert.

The above descriptions are abbreviated summaries and are not intended to address all relevant legal issues.

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