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CLIENT ALERT

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SEC Proposes Regulation AB Amendments

The Securities and Exchange Commission ("SEC") has proposed revisions to the offering and disclosure process and reporting requirements for asset-backed securities ("ABS"). The 667-page proposal will be subject to a 90-day comment period following its publication in the *Federal Register*.

The proposal would effect three fundamental changes for ABS offerings:

- Enhanced disclosure requirements and a waiting period for investors to consider transaction-specific disclosure;
- Changes to the eligibility criteria for ABS shelf registrations; and
- Changes to the safe harbors applicable to private offerings and resales of ABS.

The first of the changes would require the disclosure of asset-level data for each asset in a pool, except with respect to credit cards, which would require grouped account-level data (based on groups of accounts with similar characteristics). The specified data required to be disclosed relate, in part, to the "terms of the assets, obligor characteristics, and underwriting of the asset" and will be required at the time of securitization and on an on-going basis thereafter. Such data would be required to be filed with the SEC as an exhibit in .xml format.

The issuer also would be required to file with the SEC a computer program in Python that reflects the cash flow provisions (often called the "waterfall") and the allocation of losses for the transaction. Finally, "new and improved" static pool information would be required to be filed with the SEC, and not, as is currently the case, merely on the issuer's website.

Additional disclosure includes requirements to (1) identify the amount of publicly securitized assets as to which the sponsor and any originators of 20 percent or more of the securitized pool received a repurchase demand in the preceding three years; (2) provide limited financial disclosure of any party obligated to repurchase an asset for breach of a representation or warranty; and (3) identify the sponsor's and any originators of 20 percent or more of the securitized pool's retained interest in the transaction.

The entire disclosure package (other than pricing information) would be required to be on file for five business days prior to the first sale. In addition, the disclosure package would no longer consist of a base prospectus and a supplement, but must be a fully integrated offering document.

The second significant change reflects an attempt to better align the interests of issuers and investors. As an initial matter, the SEC is proposing to eliminate the use

of credit ratings as an eligibility requirement for shelf registration and to substitute the following requirements:

- Risk retention;
- CEO certification;
- Representation and warranty opinion; and
- Continuing Exchange Act filings.

The SEC has proposed that in order to use a shelf registration, the sponsor must retain a vertical slice of each transaction at least equal to 5 percent of each tranche (or, in the case of a master trust, an originator's interest of 5 percent). The CEO of the depositor would be required to certify his or her expectation that the assets have characteristics that provide a reasonable basis to believe that they will produce, taking into account internal credit enhancement, cash flow at times and in amounts necessary to service payments on the securities. Quarterly, a third party will need to provide an opinion that any asset not repurchased because of an alleged breach of a representation or warranty did not, in fact, violate any representation or warranty. Finally, the issuer must agree to provide Exchange Act reports for so long as nonaffiliates of the issuer hold any ABS issued in transactions collateralized by the same pool of assets.

The SEC also is proposing specific ABS registration forms: Forms SF-1 and SF-3. If an issuer does not qualify to use Form SF-3 for ABS shelf offerings, it can use Form SF-1. In connection with these forms, the SEC proposes to expand the definition of ABS. In addition, the SEC seeks to impose restrictions on certain practices, including limiting prefunding to 10 percent (rather than 50 percent) of the offering amount.

The third change would significantly affect private offerings of ABS. A private issuer using Regulation D or Rule 144A for any "structured finance product" (a broader concept than the new proposed ABS definition) would have to covenant to provide to a requesting investor any information that would be required in a publicly registered offering, including continuing reports. The issuer's failure to do so would not only give rise to investor causes of action but also to SEC enforcement, through newly promulgated Rule 192. Finally, an issuer of a structured finance product in a Regulation D or Rule 144A offering will be obligated to provide notice of the offering to the SEC.

The SEC clearly proposed to tighten the requirements applicable to private offerings of ABS out of a concern that issuers would find the strictures imposed on public offerings too daunting. While the SEC commissioners generally supported the staff's proposals, they recognized that the proposals are controversial, and anticipate a number of comments. Commissioner Paredes did voice some concern that the new rules would (1) unduly burden ABS offerings at a time when the market is ill-equipped to deal with additional regulation and (2) increase the securitization costs for private-label issuers, thereby further benefitting those parties that are not required to register their asset-backed securities: Fannie Mae, Freddie Mac and Ginnie Mae, and originators who deal exclusively with them.

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