



Update: House Passes Securitization Reform

On December 11, 2009, the House of Representatives passed the Wall Street Reform and Consumer Protection Act Of 2009 (the "Wall Street Reform Bill").¹ The Wall Street Reform Bill consolidates and revises numerous financial reform bills that were introduced in the House of Representatives over the past few months. Title I of the Wall Street Reform Bill contains a revised version of the Financial Stability and Improvement Act of 2009 that was originally released on October 27, 2009.² Subtitle F of Title I of the Wall Street Reform Bill (also referred to as the Credit Risk Retention Act of 2009) relates specifically to asset-backed securitization reform (the "House ABS Bill") and was also revised to address issues raised by industry participants after release of the October draft (the "October ABS Proposal"). The differences between the House ABS Bill and the October ABS Proposal are outlined below.

For a discussion of the October ABS Proposal and securitization reform bills released by the Senate and the Obama Administration, please see our client alert, "[The Latest Proposals for Securitization Reform.](#)"

Credit Retention - Altering Incentive Structures

Under both the House ABS Bill and the October ABS Proposal, the applicable banking regulations and the federal securities laws would be amended to require creditors to retain an economic interest in a material portion of credit risk for any loan they originate and transfer, sell, or convey to a third party. In the event that a securitizer of asset-backed securities chooses to securitize assets for which the creditor has not retained the required level of credit risk, the securitizer must retain an economic interest in a material portion of such credit risk.

However, the House ABS Bill and the October ABS Proposal differ as to how much risk must be retained by the creditor or securitizer. Under the House ABS Bill, a minimum of 5% of the credit risk would be retained by creditors or securitizers. The 5% credit risk retention could be adjusted if certain underwriting or due diligence standards set by the applicable federal banking agencies and the Securities and Exchange Commission (the "SEC," and together with the federal banking agencies, the "Agencies") are met. In cases where the Agencies determine that minimum underwriting or due diligence standards are not met, the minimum credit risk retained by the creditor or securitizer may be set above 5%. In addition to providing for credit risk retention adjustments if certain underwriting or due diligence standards set by the Agencies are met, the House ABS Bill provides for credit risk adjustments for loans with reduced credit risk, such as loans that meet certain interest rate thresholds, loans that are fully amortizing, and loans that are included in a securitization which a third party purchaser specifically negotiates for the purchase of, and retains, the first-loss position.

¹ Available at http://docs.house.gov/rules/finserv/111_hr_finsrv.pdf (last viewed on December 9, 2009). The Wall Street Reform Bill, H.R. 4173, contains several revisions to the October 27, 2009 proposal which are noted where relevant to securitization reform in footnotes throughout this article.

² Available at http://www.house.gov/apps/list/press/financialsvcs_dem/title_i_discussion_draft_final.pdf (last viewed on November 11, 2009).

Under the October ABS Proposal, creditors or securitizers would have been required to maintain a minimum of 10% of the credit risk. The 10% credit risk retention could be adjusted if certain underwriting or due diligence standards set by the Agencies were met. In such cases, the creditor or securitizer would be required to retain as little as 5% of the credit risk. In cases where the Agencies determined that minimum underwriting or due diligence standards were not met, the minimum credit risk retained by the creditor or securitizer could be set above 10%. The October ABS Proposal did not contain a provision providing for adjustments for loans with reduced credit risk.

Other credit risk retention measures remain unchanged in the House ABS Bill, such as (1) prohibiting a creditor or securitizer from directly or indirectly hedging or otherwise transferring the credit risk it is required to retain; (2) setting the minimum holding period for the risk retained; and (3) specifying the type of credit risk retained.

Both the House ABS Bill and the October ABS Proposal also grant the Agencies the authority to jointly exempt or adjust some or all of the above requirements if the exemption or adjustment is consistent with the purpose of ensuring high quality underwriting standards for creditors, facilitating appropriate risk management practices by such creditors, improving access for consumers to credit on reasonable terms, or otherwise serving the public interest. In addition, the House ABS Bill expressly excludes certain loans from the credit risk retention requirements. The exclusions apply to loans insured, guaranteed or administered by the Secretary of Education, the Secretary of Agriculture, the Secretary of Veterans Affairs, or the Small Business Administration, as well as loans made, insured, guaranteed, or purchased by any person that is subject to the supervision of the Farm Credit Administration. The October ABS Proposal did not grant express exemptions for certain types of loans or assets based on the entity that issued such loans or assets.

SEC Reporting and Registration - Increased Issuer and Credit Rating Agency Transparency

Both the House ABS Bill and the October ABS Proposal require amendments to the federal securities laws to increase disclosure obligations for issuers of asset-backed securities. Such disclosures would include asset-level or loan-level data regarding the assets backing the securities for each class or tranche of security issued. Such data would also include unique identifiers identifying loan brokers or originators, broker or originator compensation and the amount of risk retention of the originator or securitizer. In addition, both require credit rating agencies to explain representations and warranties made with regard to asset-backed securities in any credit rating report, and require originators to disclose fulfilled repurchase requests across all securitizations.

Response to the Securitization Industry

After the House Financial Services Committee released the October ABS Proposal, the American Securitization Forum (the "ASF") submitted a mark-up of the discussion draft to the committee.³ The major issues raised by the ASF included the blanket requirements and restrictions that do not take into account the various types of asset-backed security products or structures, or the various types of economic risk involved in such products and structures. The ASF also addressed concerns about the impact the proposal could have on the U.S.'s position in global financial markets. The proposed 10% credit risk retention requirement was much higher than the 5% risk retention requirement proposed in various foreign jurisdictions, and ASF was concerned that the difference would put U.S. industry participants at a competitive disadvantage and create market inconsistencies.

In addition to decreasing the minimum credit risk retention requirement, granting authority to decrease credit risk retention for less risky loans, and including express exemptions for loans issued by certain government agencies, the House ABS Bill also addresses industry concerns about the global competitive effects of the risk retention requirements by ordering a study and report on the macroeconomic effects of the risk retention requirements. The study requires the Financial Services Oversight Council to take a retrospective look at whether

³ A copy of the mark-up and a summary of ASF's positions are available at <http://www.americansecuritization.com/story.aspx?id=3741> (last viewed on November 11, 2009).

risk retention requirements could have averted losses and whether proactive adjustments to risk retention requirements and mortgage origination requirements could reduce the chances of another financial crisis tied to the housing industry. The Chairman of the Financial Services Oversight Council must issue a report within 180 days from the date of enactment of the Wall Street Reform Bill.

Next Steps

The House ABS Bill was passed on December 11, 2009. However, it is not yet clear when the Senate will vote on similar provisions. As securitization reform is currently part of broader financial reform legislation, it appears unlikely that Congress will enact legislation before the end of 2009. However, given the similar provisions contained in the House ABS bill and the Senate proposal released in November, industry participants should be on notice as to what to expect even before finalization of new securitization rules.

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