News Bulletin

August 1, 2011

ABS Shelf Eligibility Re-Proposal

SEC Revisits Regulation AB II

On July 26, 2011, the Securities and Exchange Commission ("SEC") re-proposed rules relating to registrant and transaction requirements for the shelf registration of asset-backed securities ("ABS") and changes to exhibit filing deadlines under Regulation AB (the "Reg AB II Re-Proposal"). In addition, the SEC also requested additional comment on its proposal to require asset-level information about the pool assets, and has deferred its proposal to require the filing of a computerized waterfall cash flow program for each securitization. The comment period expires 60 days following publication in the Federal Register.

Background

Regulation AB governs disclosure and reporting requirements for SEC-registered securitization transactions and was initially adopted in December 2004 in an environment in which the securitization market was large and still growing rapidly. At that time the SEC's adoption of Regulation AB was largely grounded in its view that the securitization market had become so significant to the economy that additional regulatory attention was warranted. By 2009, the securitization market had fallen from $1.114 trillion dollar volume of U.S. mortgage-backed securities ("MBS") issuance in 2005 to $331 billion in 2009, only 29% of 2005 volume (and almost all of the 2009 MBS issuances were sponsored or subsidized by the U.S. government).

Securitization has been identified by the American public and many politicians as being a contributor to, or even the principal cause of, the global financial meltdown. Accordingly, a number of political and regulatory bodies have targeted securitization for extensive "reform." On April 7, 2010, the SEC joined the reform bandwagon by proposing substantial revisions to Regulation AB (the "April 2010 Reg AB II Proposal"). The proposed overhaul of Regulation AB was seen as an attempt to fix the securitization market by providing greater investor protection and restoring investor confidence. The April 2010 Reg AB II Proposal would have, among other things, revised the shelf offering process for ABS and required ABS issuers to provide prospective investors with significantly more time to make investment decisions than under the current rules. The April 2010 Reg AB II Proposal also would have revised the eligibility criteria that must be satisfied for an issuer to use a shelf registration statement to eliminate the use of credit ratings.

In addition, the April 2010 Reg AB II Proposal included a substantial overhaul of the current ABS disclosure requirements with regard to both cash flows (that is, the "waterfall") and asset pool composition, including detailed disclosure, for most deals, of asset characteristics on an asset-by-asset basis. Finally, the April 2010 Reg AB II Proposal would have revised Rule 144A under the Securities Act of 1933, as amended (the "Securities Act") and Rule 506 of Regulation D to require for structured finance products the provision of information to investors similar to the information to be required on a shelf registration statement form.

However, since the April 2010 Reg AB II Proposal was released, the Dodd-Frank Act was enacted. A number of provisions in the April 2010 Reg AB II Proposal have been addressed by rules promulgated or proposed pursuant to the Dodd-Frank Act. Therefore, in the Reg AB II Re-Proposal, the SEC is revising and re-proposing certain provisions contained in the April 2010 Reg AB II Proposal and requesting comment on others. In some instances, the SEC is eliminating provisions in their entirety. For a more detailed discussion of the April 2010 Reg AB II Proposal, see our news bulletin, Historic Changes Proposed for ABS Offerings.

Offering Process

The April 2010 Reg AB II Proposal aimed to give investors more time to study a transaction and make an investment decision by requiring that a preliminary prospectus be filed at least five business days prior to the first sale of securities in the offering or, if used earlier, within two business days of first use for each takedown off of a shelf. The preliminary prospectus would need to be a single prospectus (i.e., not using a base and supplement format) and would need to include all the information omitted from the form of prospectus in the registration statement other than pricing information. In the Reg AB II Re-Proposal, the SEC stated that this new time period for filing is still under consideration and that commenters generally either supported the increased amount of time or requested that the time period for filing be shortened to possibly two business days prior to the first sale of securities in the offering.

The April 2010 Reg AB II Proposal also proposed that transaction documents be filed no later than the date of the final prospectus. However, as a result of comments to the proposal, the SEC has re-proposed this requirement but with a shorter time period for filing. The Reg AB II Re-Proposal would require that the underlying transaction documents, in substantially final form, be filed and made part of the registration statement by the date the preliminary prospectus is required to be filed. If the exhibits filed remain unchanged at the time the final prospectus is required to be filed, then an issuer would not be required to re-file the same exhibits.

Shelf Registration

Under the current regulation, issuances that meet certain eligibility and transaction criteria qualify for shelf registration. One such criterion under the current rule is meeting certain credit rating requirements. The April 2010 Reg AB II Proposal proposed replacing the credit rating requirements with risk retention, CEO certification, repurchase disclosure and Exchange Act reporting requirements. The SEC's decision to replace the credit rating requirements was part of a broader effort to decrease reliance on credit ratings, which were viewed as a significant factor in investor decision-making and the financial crisis, and has since been mandated under the Dodd-Frank Act.

The SEC is reconsidering the April 2010 Reg AB II Proposal's proposed shelf registration eligibility criteria in light of recent rules promulgated or proposed pursuant to the Dodd-Frank Act. The major shelf eligibility changes from the April 2010 Reg AB II Proposal are the elimination of the risk retention requirement, the elimination of the legal opinion requirement relating to repurchase obligations, and the revisions to the CEO certification language requirement relating to the ability of assets to produce sufficient cash flow to service payments due on the securities. Below is a comparison chart setting forth the proposed criteria in the April 2010 Reg AB II Proposal and the proposed criteria in the Reg AB II Re-Proposal.

April 2010 Reg AB II Proposal	Reg AB II Re-Proposal
Risk Retention	
The retention of a minimum of 5% of the nominal amount of each tranche of securities issued, net of the hedge positions, both at the time of issuance and on an ongoing basis; or for revolving trusts, the same minimum of 5% risk retention, both at the time of origination and on an ongoing basis	No longer required due to risk retention requirements to be adopted pursuant to the Dodd-Frank Act
Certification	
A certificate filed at the time of each offering off of a shelf registration statement, or takedown, by the CEO of the depositor or sponsor, as applicable, that to the CEO's knowledge, the assets in the pool have characteristics that provide a reasonable basis to believe that the assets, taking into account internal credit enhancements, will produce cash flow sufficient to service any payments due and payable on the securities as described in the prospectus	The certificate requirement has been amended so that it can be signed by either the CEO of the depositor *or an executive officer in charge of securitization of the depositor* The certification language has been amended to state that the *structure of the securitization*, taking into account internal credit enhancements, *is designed to produce, but is not guaranteed by the certification to produce*, cash flow sufficient to service any payments due and payable on the securities as described in the prospectus
Repurchase Obligation	
A provision in the pooling and servicing agreement ("PSA") must require the party obligated to repurchase the assets for breach of representations and warranties to furnish quarterly an opinion of an independent third party regarding whether the obligated party acted consistently with the terms of the PSA with respect to any loans that the trustee put back to the obligated party for violation of representations and warranties and that were not repurchased	Replaces the third-party opinion requirement with a provision in the transaction documents requiring a "credit risk manager" appointed by the trustee to perform an asset review upon the occurrence of certain trigger events: when credit enhancement requirements are not met; or at the direction of investors pursuant to the processes provided in the transaction documents Transaction documents must require credit risk manager to provide report of findings and conclusions to trustee Prospectus and ongoing reports must disclose information about credit risk manager Re-Proposal requests comment on whether additional trigger events should be included Re-Proposal does not include specific procedures to be followed related to the review

	or repurchase process
Exchange Act Reporting	
An undertaking by the issuer to file Exchange Act reports so long as non-affiliates of the depositor or sponsor, as applicable, hold any securities that were sold in registered transactions backed by the same pool of assets	No longer required due to Dodd-Frank Act's elimination of the exemption for ABS ongoing reporting requirement
Investor Communications	
Not addressed	Transaction documents must include a provision that requires the issuer to provide a notice in a public filing that an investor requests to communicate with other investors

Disclosure of Asset-Level Information

Section 942 of the Dodd-Frank Act requires the SEC to establish rules relating to asset-level disclosure and reporting for ABS issuances. The SEC believes many of the requirements under the Dodd-Frank Act would be met by implementing the asset-level information disclosure requirements proposed in the April 2010 Reg AB II Proposal. The SEC is requesting feedback from commenters on whether they believe the April 2010 Reg AB II Proposal requirements satisfy the requirements under Section 942 of the Dodd-Frank Act and if there is additional information that should be disclosed, or any privacy concerns related to disclosing certain borrower information, that the SEC should reconsider. The SEC is also seeking comment as to whether the same asset-level information should be considered across all asset classes, or if the SEC should reconsider the type of data, and the manner in which it is provided, by asset class to account for differences across the various classes. Based on the Reg AB II Re-Proposal language, it appears that the SEC intends to issue a final rule with respect to asset-level data disclosure similar to the April 2010 Reg AB II Proposal.

In addition, the SEC is reconsidering when, and how much, asset-level data disclosure should be required for privately issued structured products. Based on comments received in response to the April 2010 Reg AB II Proposal, the SEC is considering limiting asset-level data disclosure in private placements to assets of an asset class for which there are asset-level reporting requirements in Regulation AB, namely RMBS, CMBS, automobile loans or leases, equipment loans or leases, student loans, floorplan financings, and resecuritizations.

Waterfall Computer Program

The SEC is also reconsidering the proposed waterfall computer program requirement proposed under the April 2010 Reg AB II Proposal, and is planning to re-propose the requirement separately from adopting requirements for shelf eligibility, offering process and disclosures. Under the April 2010 Reg AB II Proposal, issuers would have been required to file a waterfall computer program giving effect to the contractual cash flow provisions of the securities in the form of downloadable source code in Python, a computer programming language that would allow the user to programmatically input information from the asset data file and conduct their own evaluations of ABS. The computer program would have had to be filed with the SEC at the same time as the preliminary and final prospectuses, and would be considered part of the prospectuses for liability purposes. Many commenters stated that the requirement lacked clarity, increased federal securities law liability, and would create a huge cost burden on issuers and/or investors. It is not clear from the Reg AB II Re-Proposal if, or when, the SEC will re-propose this requirement.

Contacts

Melissa D. Beck
(212) 336-4319
mbeck@mofo.com

Kenneth E. Kohler
(213) 892-5815
kkohler@mofo.com

Jerry R. Marlatt
(212) 468-8024
jmarlatt@mofo.com

About Morrison & Foerster

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for eight straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.