News Bulletin

February 4, 2011

Securitization Update

On January 20, 2011, the Securities and Exchange Commission (the "SEC") adopted two final rules implementing Sections 943 and 945 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The rules aim to provide additional transparency and disclosure to asset-backed securities (ABS) investors, and enable investors to compare information across ABS issuers and offerings.

Reps and Warranties Rule

In order to implement Section 943 of the Dodd-Frank Act, the SEC adopted a rule entitled "Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," which amends the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to incorporate Rules 15Ga-1 and 17g-7 and Form ABS-15G, and amends Items 1104 and 1121 of Regulation AB under the Securities Act of 1933, as amended (the "Securities Act") (the "Reps and Warranties Rule").

Definition of "Asset-Backed Security"

The Reps and Warranties Rule generally applies to "asset-backed securities" as such term is broadly defined under the Exchange Act. The Exchange Act definition of ABS includes any fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including CLOs, CDOs and any security that the SEC, by rule, determines to be an ABS. The definition applies to both registered and unregistered ABS. It is important to note that this definition is considerably broader than the definition of "asset-backed security" under Regulation AB and includes, for example, securities that are otherwise exempt from registration pursuant to Rule 144A or Section 4(2), or guaranteed by a GSE or municipal entity.

NRSRO Reports

Rule 17g-7 requires each nationally recognized statistical rating organization ("NRSRO") issuing a credit rating on an ABS to provide a description of the representations and warranties and enforcement mechanisms in any report it issues accompanying a credit rating of any ABS. In addition to the description of representations and warranties, the NRSROs rating the ABS must compare the representations and warranties in the transaction being rated to those in other issuances of similar securities offered by the same issuer and other issuers in the industry. "Similar securities" is not defined; instead, the SEC states that the NRSROs should rely on industry standards and their experience with previously rated deals and knowledge of the markets generally to make such determination. For purposes of Rule 17g-7, a "credit rating" includes any expected or preliminary credit rating, including those in

pre-sale reports, and applies to both solicited and unsolicited credit ratings. NRSROs must begin complying with Rule 17g-7 six months from its effective date, which is 60 days after the rule is published in the Federal Register.

Repurchase History – Initial Disclosure Obligations

Rule 15Ga-1 requires any securitizer who, during the three-year period ending December 31, 2011, has issued registered or unregistered ABS (within the definition of "asset-backed security" under the Exchange Act) that includes a covenant to repurchase or replace an underlying asset for breach of a representation or warranty to file Form ABS-15G by February 14, 2012 if the securitizer has ABS outstanding as of December 31, 2011 that is held by non-affiliates. With respect to offshore transactions and issuers, the SEC indicates that if the securitizer is subject to the SEC's jurisdiction, the securitizer must provide the disclosures required by Rule 15Ga-1. The initial filing on Form ABS-15G must include all repurchase demands made prior to January 1, 2009, as well as any subsequent repurchase or replacement activity related to such demands that occurred during the three-year period (even if the initial demand was made prior to the 2009 cut-off period). If no repurchase demands have been made or subsequent repurchase or replacement activity has occurred during the applicable time period, the securitizer may simply "check-the-box" on Form ABS-15G to confirm that no repurchase activity has occurred.

For municipal issuers, the initial filing of Form ABS-15G must cover the three years ending December 31, 2014 and occur by February 14, 2015. The SEC extended the compliance period for municipal securitizers, acknowledging various factors that distinguish municipal ABS from typical ABS, to allow them time to observe how the rule operates for other securitizers and better prepare for implementation. Municipal securitizers may file Form ABS-15G on EMMA, the Municipal Securities Rulemaking Board's public database.

Repurchase History – Ongoing Disclosure Obligations

After the initial filing period, securitizers must file quarterly reports on Form ABS-15G for all ABS that the securitizer issues during that calendar quarter or for any outstanding ABS held by non-affiliates during that calendar quarter. The report must be filed no later than 45 calendar days after the end of each calendar quarter. If no repurchase demand, repurchase or replacement activity occurs in a given calendar quarter, a securitizer can "check-the-box" on Form ABS-15G and suspend its quarterly reporting requirements until repurchase demand, repurchase or replacement activity occurs. However, even if its quarterly reporting obligations are suspended, a securitizer must file a "check-the-box" Form ABS-15G annually to confirm that it has had no reportable activity during the previous calendar year.

Scope of Disclosure

Rule 15Ga-1 requires a securitizer to disclose any repurchase activity relating to applicable outstanding ABS, including (i) the assets that were subject to a repurchase demand, including investor repurchase demands upon a trustee; (ii) the assets that were repurchased or replaced; (iii) the assets that were not repurchased or replaced because the demand was withdrawn or rejected; and (iv) the assets that are pending repurchase or replacement due to a cure period or dispute. The information must be provided in tabular format and must be organized by asset class and listed by issuing entity in the order the issuing entity was formed. The securitizer must disclose the name of the originator and whether the issuance was registered. The final Rule 15Ga-1 also requires the securitizer to disclose the number, outstanding principal balance and percentage by principal balance of the assets originated by each originator in the pool at the time of securitization for each issuing entity. Despite urging by industry participants in comments on the proposed rule, the SEC does not limit disclosure of repurchase demands to those demands made in accordance with the terms of transaction documents. All requests, even those not properly authorized, must be included in the table.

In response to industry participant concerns, the SEC acknowledges that some historical information may not be available using reasonable effort or expense and has stated that a securitizer can still meet the requirements of Rule 15Ga-1 without complete information if it explains why certain information is not available and what steps it

took to try to obtain such information. With respect to investor repurchase demands upon a trustee, the SEC has stated that if a securitizer requests such information but cannot obtain such information for any time period prior to July 22, 2010 (the effective date of the Dodd-Frank Act), the securitizer must include a footnote stating the disclosures do not contain investor repurchase demands upon a trustee prior to such date. The SEC also urges securitizers to use footnotes to explain information contained in the table in Form ABS-15G if the securitizer believes such information would be helpful to investors.

Regulation AB Repurchase Disclosure

Items 1104 and 1121 of Regulation AB were amended to require that the same information required under Rule 15Ga-1 be disclosed in prospectuses and Form 10-D investor reports in the same tabular format with minor revisions. The repurchase history in the prospectus is limited to repurchases involving the same asset class as the ABS being offered for the prior three years and must not be more than 135 days old. The repurchase history in the investor reports to be filed on Form 10-D is limited to repurchases involving related pool assets. In both cases, the issuer must include a reference to the most recent Form ABS-15G filed by the securitizer and disclose the securitizer's Central Index Key number.

The compliance period for prospectus disclosures begins with the first bona fide offering of registered ABS on or after February 14, 2012. The compliance period for the new disclosures begins for any Form 10-Ds that are required to be filed after December 31, 2011. In addition to a delay in the compliance period, the SEC has provided phase-in periods for the disclosures required under Items 1104 and 1121. For prospectuses filed between February 14, 2012 and February 13, 2013, the look-back period will extend back only one year. For prospectuses filed between February 14, 2013 and February 13, 2014, the look-back period will extend back two years. After February 13, 2014, prospectuses must include the complete three-year period. Although the disclosure requirements for Form ABS 15-G are not subject to phase-in periods, the SEC decided to phase in the requirements under Items 1104 and 1121. This difference appears to be due to the strict liability standard under Sections 11 and 12 of the Securities Act for information contained in a registration statement which differs from the liability standards for periodic filings under the Exchange Act.

Issuer Review Rule

To implement Section 945 of the Dodd-Frank Act, the SEC adopted a rule entitled "Issuer Review of Assets in Offerings of Asset-Backed Securities" which amends the Securities Act to include Rule 193 and amends Item 1111 of Regulation AB (the "Issuer Review Rule"). The Issuer Review Rule requires an issuer or independent third party to perform a review of the assets underlying an ABS in a registered transaction and to disclose the result of such review in the prospectus. ABS issuers must comply with the Issuer Review Rule for all new registered offerings commencing with an initial bona fide offer after December 31, 2011. It is important to note that the Issuer Review Rule applies only to transactions registered under the Securities Act, whereas the Reps and Warranties Rule applies to registered and unregistered transactions.

Issuer Review

Rule 193 requires an issuer to perform a review of the assets that is designed and effected to provide reasonable assurance that the disclosure regarding the pool assets in the prospectus is accurate in all material respects. For purposes of Rule 193, the issuer may be either the sponsor or depositor. Because the review is to be performed for purposes of securitization, a review conducted to originate the assets or performed by an unaffiliated originator of the assets will not satisfy Rule 193. Rule 193 does not specify a particular type of review that is required; instead, the SEC acknowledges that the type of review may vary depending on the circumstances, including the type of assets being securitized and the sponsor's continued involvement in the securitization. The SEC states that, depending on the size of the asset pool, sampling of assets may be appropriate for the review, depending on the granularity of the asset pool and other facts and circumstances. If sampling is used, the issuer should disclose the

sampling size, the criteria for choosing the sample, and whether any assets deviate from the underwriting standards disclosed in the prospectus.

Reliance on Independent Third Party

Rule 193 permits the issuer to use an independent third party to perform the required asset review, provided that (i) the third party is named in the registration statement and consents to being named an "expert" pursuant to Section 7 and Rule 436 of the Securities Act, subjecting the third party to expert liability under Section 11 of the Securities Act; or (ii) the issuer attributes to itself the findings and conclusions of the independent third party review.

Disclosure of Review Findings

Item 1111 of Regulation AB requires an issuer to disclose in the prospectus the nature and findings of the asset review conducted under Rule 193. The requirements include the disclosure of (i) the identity of the party that performed the asset review, or whether that party is the issuer or an independent third party; (ii) whether sampling was used, and if so, what sampling technique was employed; (iii) the findings and conclusions of the review, including the criteria against which the assets were evaluated and how the assets compared to such criteria; and (iv) whether any assets in the pool deviate from underwriting criteria, and if so, the amount and characteristics of those assets and who made the decision to include such assets in the pool. In addition, if compensating or other factors were used, issuers will be required to provide data on the amount of assets in the pool or in the pool sample that are represented as meeting each factor and the amount of assets that do not meet those factors.

Publication of Third-Party Review Results

A new Section 15E(s)(4)(A) to implement Section 932 of the Dodd-Frank Act was proposed as part of the proposal of the Issuer Review Rule. The proposed new provision would have required issuers to make publicly available the findings and conclusions of independent third-party reviews for all registered and unregistered ABS offerings. The SEC will reconsider this provision later in the year with the rest of Section 15E.

"Reasonable Assurance" Minimum Standard of Review

The "reasonable assurance" test, which was not explicitly required under Section 945 of the Dodd-Frank Act or included in the proposed rule, does not require that a specific methodology be used to meet the rule's requirement, but the SEC noted that the minimum review standard applies to the asset pool characteristics that must be disclosed under 1111 of Regulation AB, as well as to asset credit quality and underwriting standards. The inclusion of the "reasonable assurance" test in the final rule prompted Commissioners Casey and Paredes to vote against adoption of the Issuer Review Rule. In statements at the open meeting of the SEC at which the Rules were adopted, both Commissioners expressed concerns that the minimum standard was unclear and unwarranted.

Additionally, we note that Section 11 of the Securities Act already imposes liability on any person who signs a registration statement that contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading; therefore, it is unclear what the principles-based minimum standard adds to the rule. The SEC acknowledges the existing strict liability standard under Section 11 in the adopting release and states that the minimum standard of review is meant to require issuers to review whether the disclosure regarding the asset pool is accurate in all material respects.

Because the minimum standard of review test is vague and the information required to be disclosed is intentionally broad to accommodate different asset classes, industry participants doubt that independent third parties hired to perform asset reviews would consent to being named as "experts" and exposed to Section 11 strict liability. This concern also was raised by Commissioner Paredes. Comparing the situation to the recent refusal by

NRSROs to allow issuers to use ratings in registration statements after NRSROs lost their exemption from "expert" status under a different provision of the Dodd-Frank Act, industry participants are concerned that important independent review information will no longer be available to investors if third parties are no longer willing to perform asset reviews or consent to their results being used by issuers.

Looking Forward

With so much focus on the securitization industry since the beginning of the financial crisis, many industry participants and outside commentators have stated that the market will not rebound until both issuers and investors have a better understanding of the precise rules and regulations that will be adopted under the new regulatory framework that has been set forth in the Dodd-Frank Act. Although the adoption and amendment of rules implementing Sections 943 and 945 of the Dodd-Frank Act have shed some light on the SEC's plans for regulating the securitization market, this is only the beginning. Risk retention rules, which could have a huge impact on the future of the market both in the U.S. and abroad, still must be proposed and adopted (by the SEC and a host of other federal agencies in a joint rulemaking), as well as new securitization conflict of interest rules and rating agency disclosure rules under Section 15E of the Securities Act.

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