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SEC Adopts First of ABS Disclosure Regulations

BY THE SECURITIES LITIGATION PRACTICE

On January 20, 2011, the Securities and Exchange Commission ("SEC") voted on two sets of rules for asset-backed securities ("ABS"). The Commission approved both rules implementing aspects of section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] One rule affects disclosure by adding a requirement that ABS issuers[2] disclose the history of demands they received and repurchases made related to outstanding asset-backed securities. The second rule addresses issuer review of the underlying assets. All registered offerings of asset-backed securities after December 31, 2011 must comply with these rules.

Disclosure Rule for ABS Repurchases (Rule 15Ga-1):

The rule requires ABS issuers to file with the SEC a three-year repurchase history, as well as a history of repurchase requests received on outstanding asset-backed securities. The first filing is due February 14, 2012, after which issuers are required to file updated information on a quarterly basis regarding the repurchase histories for all outstanding ABS whether fulfilled or unfulfilled. This applies even if the securities were not SEC-registered as long as the underlying transaction agreements include a covenant to repurchase or replace a pool asset. In addition, an issuer in a registered ABS offering must disclose — in the body of a prospectus — repurchase history for the last three years for ABS of the same asset class as the securities being registered. This information must be included in registered offerings during a phase-in period commencing on February 14, 2012. In ongoing distribution reports on Form 10-D, issuers must disclose updated repurchase history for the particular, related asset pool.

The disclosure requirements apply to issuers of unregistered ABS, including municipal ABS. However, municipal ABS have an additional three-year phase-in period and may provide their information on EMMA, the Municipal Securities Rulemaking Board's centralized public database for information about municipal securities issuers and offerings.

More specifically, the required disclosures include specified information in tabular form concerning all assets originated or sold by the securitizer that were the subject to a repurchase or replacement demand. Required information includes (i) whether or not the transaction was registered under the Securities Act of 1933, (ii) the name of the originator, and (iii) the number, outstanding principal balance and percentage by principal balance of assets that were subject to a demand, in the aggregate and separately for assets that were repurchased or replaced, not repurchased or replaced or pending repurchase or replacement. A required narrative disclosure must state the reasons as to why any repurchase or replacement is pending. There is no exemption for *de minimis* demands or for originators below a certain percentage of assets in the pool. To the extent that information about such demands is not available, the disclosure must so state.

This rule also requires rating agencies to disclose, in any report accompanying a credit rating for an ABS transaction, the representations, warranties and enforcement mechanisms available to investors

and how they differ from those in issuances of similar securities. Rating agencies have a six-month phase-in period to prepare for the rule.

Issuer Review Rule (Rule 193 and Amendments to Regulation AB Item 1111):

The second rule passed on Thursday, implementing Section 7(d) of the Securities Act,[3] adopted amendments to Item 1111 of Regulation AB[4] and a new rule under the Securities Act of 1933.[5] Together, these require any issuer of registered ABS to perform a review of the assets underlying the ABS and to disclose the nature of its review along with findings and conclusions. Moreover, the rule introduces principle-based minimum standards for performing these reviews.[6] The rule now states that "the review must, at a minimum, be designed and effected to provide reasonable assurance that the prospectus disclosure about the assets is accurate in all material respects." The rule notes that the requirement to perform this review should not be confused with, and is not intended to change, the due diligence defense against liability under Securities Act Section 11 or the reasonable care defense against liability under Securities Act Section 12(a)(2).

Third parties may conduct the reviews rather than the issuer, provided that they are named in registration statements as "experts" in accordance with Section 7 and Rule 436 of the Securities Act.[7] Issuers must also disclose whether, and if so, how, any assets in the pool deviate from the disclosed underwriting criteria as well as the characteristics of those assets that did not meet the stated standards, including the entity that cleared them to be included in the pool.

The SEC postponed consideration of rules to implement Section 15(E)(s)(4)(A) of the Exchange Act, which requires issuers or underwriters of ABS to make publicly available the findings and conclusions of any third-party due diligence report that the issuer or underwriter obtains. Proposed rules to implement the Section 15(E)(s)(4) are anticipated later this year.

Issuers and others involved in asset-backed securitization are well advised to familiarize themselves with these new rules. Although these rules do not impose immediate disclosure requirements, the rules involve significant and mandatory new disclosures. Compliance with these rules will require information collection and planning in advance of the effective date. Further, issuers should carefully select the best party to conduct the mandatory reviews given the potential for expanded liability under the new rules. Parties must also watch for additional expected rules, as these may impose further obligations.

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[1] Pub. L. No. 111-203 (July 21, 2010). Section 943 of the Dodd-Frank Act requires the SEC to prescribe, not later than 180 days after the date of enactment, rules on the use of representations and warranties in the market for ABS.

[2] The new Exchange Act definition of "asset-backed security," as added by the Dodd-Frank Act is broader than the definition in Regulation AB, and encompasses any fixed-income or other security collateralized by any type of self-liquidating financial assets that allow the holder to receive payments that depend primarily on cash flow from the asset, including CMOs, CDOs, collateralized bond obligations and CDOs of ABSs and CDOs.

[3] 15 U.S.C. 77g, as added by Section 945 of the Dodd-Frank Act.

[4] The first change is an amendment to Item 1111(a)(7) of Regulation AB, requiring that an issuer of ABS disclose the nature of the review it conducts to satisfy Rule 193. The second change is the addition of Item 1111(a)(8), which requires disclosure of whether, and if so, how, any assets in the pool deviate from the disclosed underwriting criteria and data on the amount and characteristics of those assets that did not meet the disclosed standards.

[5] Rule 193, 17 C.F.R 230.193.

[6] A requirement that information in prospectus disclosures about the assets is "accurate in all material respects" did not appear in the October 2010 proposal, and resulted in two dissenting votes from the Commission. *See* Release Nos. 33-9148; 34-63029 (75 Fed. Reg. 62718 (October 13, 2010)).

[7] There are, however, some exceptions to this requirement.