

Clients & Friends Memo

At Long Last – SEC Adopts Final Regulation AB II

September 5, 2014

On August 27, 2014 the Securities and Exchange Commission (the “SEC”) approved final rules relating to asset-backed securities (“ABS”) disclosure and registration (the “Final Rules”)¹. The Final Rules are contained in a final release², which was published on September 4, 2014 on the SEC’s website (the “Final Release”). The Final Rules represent the culmination of a lengthy rulemaking process, which began with the publication by the SEC in early 2010 of proposed rules³ (the “2010 Proposal”)⁴ and the subsequent re-proposal in 2011 of a portion of the proposed rules⁵ (the “2011 Re-Proposal” and, collectively with the 2010 Proposal, the “Proposed Rules”)⁶. Although the Final Rules would make changes not only to Regulation AB, but to various other rules, regulations and forms under the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”), they have become popularly known as “Regulation AB II.”

¹ For a brief summary of the open meeting at which the Final Rules were adopted, see <http://www.cadwalader.com/resources/clients-friends-memos/sec-adopts-regulation-ab-ii>

² Release Nos. 33-9638; 34-72982.

³ Securities Act Release No. 33-9117 (Apr. 7, 2010), 75 FR 23328.

⁴ Cadwalader’s memorandum describing the 2010 Proposal is available at <http://www.cadwalader.com/resources/clients-friends-memos/sec-proposes-significant-enhancements-to-regulation-of-asset-backed-securities>. The Proposed Rules proposed (1) various changes to the eligibility requirements for use of a shelf registration statement by issuers of ABS, including the creation of two new registration statements under the Securities Act for exclusive use with ABS, (2) changes to the disclosure requirements of Regulation AB, most notably to mandate the disclosure of loan level information about securitized asset pools and the filing of a “waterfall program” used to structure the ABS cash flows, (3) changes to the periodic reporting requirements applicable to ABS, including the requirement to file updated loan-level information on the status of the individual assets in the pool and (4) requiring exempt ABS offerings made in reliance on Securities Act Rule 144A or Regulation D to comply with the line item disclosure requirements of Regulation AB, which are currently only mandatory for registered offerings.

⁵ Securities Act Release No. 33-9244 (July 26, 2011), 76 FR 47948.

⁶ The 2011 Re-Proposal primarily modified certain proposed shelf registration eligibility criteria for ABS in light of the adoption, subsequent to the 2010 Proposal, of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), whose requirements relating to ABS, including risk retention, repurchase history reporting and elimination of the ability to cease Exchange Act reporting, overlapped many of the elements first proposed by the SEC in the 2010 Proposal.

I. THE BIG PICTURE--WHAT THE FINAL RULES DO AND DON'T DO...AND WHEN

The policy objective underlying the Final Rules is to address some of the weaknesses exposed in the ABS markets during the recent financial crisis by (1) providing more information to investors about the assets underlying ABS, thereby allowing them to perform their own due diligence and reduce reliance on credit ratings, (2) ensuring that investors in registered ABS have adequate time to review the transaction structure and collateral characteristics before making an investment decision and (3) ensuring that ABS issued under a shelf registration statement, which allows rapid access to capital markets but without prior SEC staff review, are designed by issuers with greater oversight and care. The Final Rules adopt, with modifications reflecting some of the comments received by the SEC, most of the elements of the Proposed Rules with respect to the registration and offering of ABS, as well as enhanced disclosure and periodic reporting with respect to registered ABS, most significantly mandating, for the first time, initial and ongoing asset-level reporting with respect to the assets underlying the most common types of ABS.

Although the Final Rules contain many significant changes to the public ABS registration and offering process and to required disclosures for registered ABS, the SEC did not adopt two of the most controversial elements of the Proposed Rules, namely (1) the proposed requirement that issuers make available the same information in private offerings conducted under Rule 144A or Regulation D as is required by Regulation AB in registered offerings and (2) the proposed requirement to file a waterfall program reflecting the contractual cash flow of the ABS that could be used by investors to output cash flows using their selected interest rate, prepayment and default assumptions together with the asset-level data supplied by the issuer. In addition, as described in Part III.A below, the Final Rules impose initial and ongoing asset-level disclosures only on ABS backed by certain asset classes, rather than on all ABS as had been proposed in the Proposed Rules.

Note: While these proposals were not adopted, in the Final Release the SEC expressly states that the proposals remain open, leaving open the possibility that they could be implemented in the future. In addition, during their remarks at the open meeting in which the Final Rules were adopted, at least one SEC commissioner made comments supportive of adopting most of these proposals at a future date. It seems likely to us that, given the addition by Section 942 of the Dodd-Frank Act of Section 7(c) to the Securities Act, mandating the SEC to require issuers to disclose asset-level data if necessary for investors to perform due diligence, the SEC may eventually prescribe loan-level disclosure for asset classes other than those addressed in the Final Rules. Whether efforts to extend Regulation AB disclosures to private transactions again pick up momentum may depend on the success of the investor protections added by the Final Rules and the extent, if any, to which transactions shift into the private markets to avoid some of the elements of the Final Rules.

The Final Rules will become effective 60 days after publication in the Federal Register. Compliance with the Final Rules, including registration on the new ABS-specific registration forms, will be required not later than one year after the effective date, except for the requirement to provide asset-level information, which will be required not later than two years after the effective date.

II. REVISIONS TO SECURITIES ACT REGISTRATION AND OFFERING PROCEDURES

A. New Registration Forms

In order to better tailor registration forms to the requirements for ABS and to differentiate ABS offerings from other offerings, the Final Rules adopt two new forms of Securities Act registration statements, designated Form SF-1 (for non-shelf offerings) and Form SF-3 (for shelf offerings)⁷. Forms S-1 and S-3 will no longer be available to issuers of ABS. In addition, in order to prevent circumvention of the new shelf eligibility requirements described below for ABS, the Final Rules eliminate the long-standing rule that separately permitted shelf registration of “mortgage related securities”⁸.

B. Shelf Eligibility Criteria—New Transaction Requirements

New Form SF-3 eliminates the investment grade requirement that had been a condition to use of Form S-3 for ABS and replaces it with four new transaction requirements for shelf eligibility that are intended to reduce investor reliance on ratings, increase the oversight of ABS and provide substantive investor protection by enhancing the enforcement of their rights under the transaction documents and their ability to communicate with each other for the purpose of exercising those rights. The new transaction requirements are:

- a certification at the time of each offering by the chief executive officer of the depositor regarding the disclosure in the prospectus and the structure of the transaction;

⁷ The ability to use the registration forms for ABS turns on whether a security meets the definition of “asset-backed security” contained in Item 1101 of Regulation AB. Under that definition as it currently exists, an offering involving prefunding currently must have a prefunding period not exceeding one year and the amount of prefunding may not exceed 50% of the proceeds of the offering (or of the total asset pool supporting the securities, in the case of master trusts). The Final Rules amend the definition of “asset-backed security” to reduce the maximum prefunding percentage to 25%.

⁸ Securities Act Rule 415(a)(1)(vii). That rule, which predated the expansion of Form S-3 to allow registration of any ABS rated in the four highest rating categories, has been little used in the past two decades because of the limitation in the definition of mortgage related security to securities rated in the two highest rating categories.

- a provision in the underlying transaction documents requiring a review of pool assets for compliance with representations and warranties upon the occurrence of specified triggers;
- a provision in the underlying transaction documents providing a dispute resolution mechanism for pool asset repurchase requests; and
- a provision in the underlying transaction documents requiring that investor communication requests be included in the issuing entity's periodic reports on Form 10-D.

The following is a more detailed summary of each of the new transaction requirements:

1. **CEO Certification:** The chief executive officer of the depositor⁹ is required to sign a certification for each offering, dated as of the date of the final prospectus, that states verbatim:

I [identify the certifying individual] certify as of [the date of the final prospectus under § 230.424 of this chapter] that:

1. I have reviewed the prospectus relating to [title of all securities, the offer and sale of which are registered] (the "securities") and am familiar with, in all material respects, the following: the characteristics of the securitized assets underlying the offering (the "securitized assets"), the structure of the securitization, and all material underlying transaction agreements as described in the prospectus;
2. Based on my knowledge, the prospectus does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading;
3. Based on my knowledge, the prospectus and other information included in the registration statement of which it is a part fairly present, in all material respects, the characteristics of the securitized assets, the structure of the securitization and the risks of ownership of the securities, including the risks relating to the securitized assets that would affect the cash flows available to service payments or distributions on the securities in accordance with their terms;

⁹ In a rare instance of walking back a liberalized proposal from the 2011 Reproposal, which would have permitted the certification to be signed by the executive officer in charge of the securitization, the SEC states in the Final Release that the certification must be made by the CEO of the depositor because the certification should be signed by a signatory to the registration statement and, as an officer of the depositor at the highest level, the CEO should have oversight of, and be accountable for, the structuring of the transaction and the prospectus disclosure, even if the CEO doesn't personally undertake credit analysis and relies on the work of others to structure the transaction.

4. Based on my knowledge, taking into account all material aspects of the characteristics of the securitized assets, the structure of the securitization, and the related risks as described in the prospectus, there is a reasonable basis to conclude that the securitization is structured to produce, but is not guaranteed by this certification to produce, expected cash flows at times and in amounts to service scheduled payments of interest and the ultimate repayment of principal on the securities (or other scheduled or required distributions on the securities, however denominated) in accordance with their terms as described in the prospectus; and
5. The foregoing certifications are given subject to any and all defenses available to me under the federal securities laws, including any and all defenses available to an executive officer that signed the registration statement of which the prospectus referred to in this certification is part.

The text of the certification is not permitted to be altered in any way. In the Final Release, the SEC notes that any issues in the certification should be taken into account in the prospectus disclosure since the certification is qualified by reference to the prospectus disclosures. The certification, which is a required exhibit to Form SF-3, must be filed as an exhibit to a current report on Form 8-K along with the final transaction documents no later than the date on which the final prospectus is required to be filed¹⁰.

Note: The SEC has attempted to ameliorate some of the commenters' concerns about increased CEO liability for matters beyond his or her expertise and the wording in the Proposed Rules that suggested to some that the certification could be taken as a guaranty of performance by adding materiality qualifiers, strengthening the language that states that the certification is not a guaranty, acknowledging that external, as well as internal, credit enhancements may be taken into consideration by the CEO, removing references to the sufficiency of cash flows and noting that, unlike a Sarbanes-Oxley certification, this certification does not carry potential criminal liability. However, the SEC acknowledged that the certification will create increased potential litigation risk for the chief executive officer, even when prudent measures are designed to structure an offering. That is small comfort to securitization executives and it remains to be seen whether the certification requirement will drive some offerings to Form SF-1 or into the private markets.

2. **Asset Review Provision:** The underlying transaction documents for each offering must provide for the selection and appointment, at the outset of the transaction, of an "asset representations reviewer" who is not an affiliate of the sponsor, depositor, servicer or trustee or be (or be an affiliate of) the party who performed pre-offering due diligence for the

¹⁰ See revised Item 1100(f) of Regulation AB.

sponsor or the underwriter¹¹. The asset representations reviewer is required to review, at a minimum, all 60+ day delinquent assets for compliance with representations and warranties, upon the occurrence of a trigger event specified in the transaction documents. Although the Final Rules do not mandate the range of possible trigger events, they require that at a minimum, the triggers must include a two prong test consisting of (i) exceeding a delinquency threshold specified in the transaction documents¹², followed by (ii) an investor vote to direct the review, based on processes specified in the transaction documents, but which may not involve more than a 5% investor interest in the pool¹³ to initiate the vote or more than a simple majority of those investors casting a vote to direct the review. The asset representations reviewer must have authority to access copies of any asset documents necessary to perform its review and may not be the party to determine whether noncompliance with a representation and warranty constitutes a breach of the transaction documents¹⁴. The asset representations reviewer is required to provide a report of its findings and conclusions to the trustee. Although not part of the shelf eligibility requirement *per se*, the Final Rules also make corresponding revisions to Form 10-D to require disclosure of a review triggering event that occurs during the applicable reporting period and a summary of the asset representations reviewer's findings and conclusions.

- 3. Dispute Resolution Provision:** The underlying transaction documents for each offering must provide that if a request to repurchase an asset under the transaction documents is not resolved¹⁵ within 180 days from receipt of the request, the requesting party shall have the right to refer the dispute, at its discretion, to either mediation or arbitration and the party obligated to repurchase must accept the selected dispute resolution method. Rather than

¹¹ Affiliation between the asset representations reviewer and an investor is not precluded by the Final Rules, but may be prohibited by the transaction documents.

¹² While the determination of the appropriate delinquency level is left up to the transaction documents, the Final Rules require that the percentage be calculated on the basis of the total dollar amount of delinquent assets in the pool over the total amount of assets in the pool at the end of the reporting period. The Final Rules also require, if the asset pool consists of multiple sub-pools, that the calculation be made at the sub-pool level.

¹³ In the Final Release, the SEC states that the percentages used to determine the thresholds for investor action are to be calculated excluding any interests held by the sponsor or the servicer and that, as with delinquency percentages, the requisite percentages should be calculated at a sub-pool level if there are multiple pools. The Final Rules are unclear as to whether the percentages for requesting a vote and/or directing a review are to be based on the dollar amount of the investors' interests, on the number of investors or otherwise. Also, because a simple majority of those voting may direct a review, it should be noted that a review may actually be directed by far less than a majority of *all* investors, which may result in the incurrence of substantial review costs to investors upon the direction of only a small fraction of all investors.

¹⁴ In the Final Release, the SEC states that the trustee should make the determination of whether a repurchase is required based on the conclusion by the asset representations reviewer of whether noncompliance with a representation has occurred.

¹⁵ In the Final Release, the SEC indicates that the term "resolved" leaves open the possibility that the repurchase request may be resolved through means other than repurchase.

specifying who pays for dispute resolution, the Final Rules specify that the allocation of expenses shall be determined by the arbitrator, if arbitration is chosen, or by the parties, if mediation is chosen.

- 4. Investor Communication Provision:** The underlying transaction documents for each offering must require that the party responsible for filing periodic reports on Form 10-D include in the report any requests received during the applicable reporting period by investors to communicate with other investors regarding the exercise of their rights under the transaction agreements¹⁶. The required disclosure must contain the name of the requesting investor, the date the request was received, a statement that the investor desires to communicate with other investors and a description of the method investors may use to contact the requesting investor. The substance of the matter which the requesting investor wishes to discuss is not required to be disclosed. The transaction documents may not require verification of ownership by a record holder of the ABS as a condition to exercise of the communication right, but may provide that the party obligated to file the Form 10-D may require a person who is not the record holder to provide a written certification of beneficial ownership together with one other form of documentation of ownership, such as a trade confirmation, account statement or broker's letter.

Note: Replacement of the investment grade criterion with the new transaction requirements will allow lower-rated and unrated ABS classes, which were previously unable to be registered on a shelf basis and were typically offered in a contemporaneous private offering, to be registered on Form SF-3, eliminating some complexity from the offering process for ABS and according those classes the added value of increased liquidity presumed to be enjoyed by registered securities. However, some issuers may prefer to continue to offer junior classes on a private basis to preserve certain flexible document review procedures that would be limited by the prospectus delivery requirements applicable to registered offerings. For example, in CMBS transactions it is not uncommon for issuers to establish a "war room" containing documents that are material to first loss investors (who are contractually restricted from investing in the registered classes), such as full appraisals, but that are not easily susceptible of being filed as a free writing prospectus.

C. Shelf Eligibility Criteria—New Registrant Requirements; Annual Compliance Evaluation

Form SF-3 carries over the registrant requirement from Form S-3 that is designed to ensure Exchange Act filing compliance by shelf registrants. Specifically, to the extent the depositor

¹⁶ The investor communication mechanism may not be used for communications unrelated to the exercise of rights under the transaction documents such as, for example, marketing communications.

or any issuing entity previously established by the depositor or an affiliate was subject to the periodic reporting requirements of the Exchange Act with respect to a class of AB involving the same asset class during the twelve months (and any portion of a month) preceding the filing of the registration statement, such depositor and each issuing entity must have filed all materials required with respect to the ABS under the Exchange Act and that, subject to certain specified exceptions, all such materials shall have been timely filed.

In addition, Form SF-3 adds a new registrant requirement to support compliance with the four new transaction requirements described in Part I.B above. Specifically, to the extent the depositor or any issuing entity previously established by the depositor or an affiliate was required to comply with the transaction requirements for shelf eligibility with respect to a previously issued class of ABS involving the same asset class during the twelve months (and any portion of a month) preceding the filing of the registration statement, such depositor and each issuing entity must have timely filed all CEO certifications and transaction documents containing the required independent asset review, dispute resolution and investor communication provisions (the “**New Shelf Eligibility Filings**”). The registrant is also required to disclose in each prospectus that it has met this registrant requirement. Unlike with respect to Exchange Act filings, a cure provision is included in Form SF-3 with respect to failure to timely make the New Shelf Eligibility Filings. Specifically, the depositor or issuing entity that failed to make a New Shelf Eligibility Filing will be deemed to satisfy the new registrant requirement 90 days after it makes the required filing.

Traditionally, ABS issuers who could not satisfy the registrant requirements of Form S-3 because of a missing or untimely Exchange Act filing were precluded from filing a new shelf registration statement for twelve months after the violation, but were not precluded from continuing to offer securities on a shelf basis under a registration statement that was previously declared effective. In one of the most potentially significant new developments for ABS issuers, the Final Rules add a new Securities Act rule¹⁷ that specifies that any registration statement previously declared effective will no longer meet the requirements for use of Form SF-3 for an offering if the registrant requirements described above are not met as of ninety days after the end of the depositor’s fiscal year end prior to the offering. Essentially, this will require the depositor to annually assess whether all Exchange Act filings and all New Shelf Eligibility Filings have been timely made during the twelve months preceding the 90th day after the end of its fiscal year (*i.e.*, as of March 30th for depositors whose fiscal years end December 31). Should any required filing not have been timely made during the twelve-month look-back period, the depositor will immediately lose the ability to offer securities on a shelf basis for twelve months, unless the failure was with respect to a New Shelf Eligibility Filing that was subsequently cured at least 90 days prior to the annual evaluation date.

¹⁷ Rule 401(g)(4).

Note: In the SEC's view, the annual compliance evaluation merely aligns ABS practice with corporate practice, which measures compliance at the time a registration statement is amended to update the registrant's financial statements under Section 10(a)(3) of the Securities Act. However, given the large number of issuances by programmatic issuers under ABS registration statements, the requirement for monthly filings and the reliance on third parties, such as certain servicing function participants, to provide information required to be filed, the opportunities for inadvertent "foot faults" in timely Exchange Act reporting is greatly magnified in the ABS space. To avoid loss of shelf eligibility under these circumstances, ABS sponsors will need to ensure that their Exchange Act compliance programs are even robust than they are currently.

D. Preliminary Prospectuses Required

The Final Rules implement new Rule 430D, applicable exclusively to ABS, which specifies that information omitted from the prospectus included in a registration statement, other than information with respect to offering price, offering syndicate, underwriting and dealer discounts or commissions, amount of proceeds and other matters dependent on the offering price, must be disclosed in a preliminary prospectus filed under new Rule 424(h). That rule, in turn, requires the preliminary prospectus to be filed not later than the earlier of three business days prior to the first sale in the offering or the second business day after first use, if used earlier. This rule, which is designed to ensure that investors have sufficient time to review the offering materials, reduces the delivery period from the five business days that would have been required under the Proposed Rules. In the event of a material change to the information in the preliminary prospectus, the Proposed Rules would have required the filing of a new preliminary prospectus plus the recommencement of a five business day waiting period before the first sale. The Final Rules, however, provide that a material change to the information in a preliminary prospectus may be contained in a prospectus supplement¹⁸ delineating the change and must be filed at least 48 hours before the first sale in the offering.

E. Miscellaneous ABS Registration Provisions

The Final Rules also implement the following additional changes to the registration and offering process:

- Exchange Act Rule 15c2-8(b), which requires brokers and dealers to deliver a copy of a preliminary prospectus to investors at least 48 hours prior to a confirmation of sale, has been amended to eliminate the exception for ABS, making this rule now applicable to ABS offerings;

¹⁸ As noted in Part II.E, this is now one of the few instances in which a prospectus supplement is permitted.

- In order to prevent circumvention of the new asset-level disclosure rules, the Final Rules amend Rule 415 to limit the registration of continuous offerings to “all or none” offerings, thereby excluding “best efforts” or “minimum-maximum” offerings except where the total offering size is known but a portion of the securities of a class may both be sold through an underwriter to investors and retained by the depositor or an affiliate;
- The Final Rules, through the instructions to Form SF-3, require that a separate registration statement and form of prospectus be filed for each asset class and each country of origin from which the pool assets originate, unless such additional asset classes or jurisdictions represent in total less than 10% of the asset pool. In addition, the Final Rules require that a single prospectus be filed in connection with each offering (except, as noted above, for a supplement to reflect material changes to a previously filed preliminary prospectus), thereby ending the longstanding ABS market practice of presenting disclosure through a base prospectus and prospectus supplement;
- To allow ABS issuers to more effectively manage multiple registration statements, the Final Rules permit, but do not require, ABS issuers to avail themselves of the ability, previously available only to “well-known seasoned issuers” to pay registration fees on a “pay as you go” basis at the time of each offering. Fees paid on a pay as you go basis are required to be reflected in the preliminary prospectus, will be payable at the time of the filing of the initial preliminary prospectus and will be calculated on the basis of the registration fee rate in effect at the date of payment;
- The Final Rules codify the SEC’s position that a post-effective amendment must be filed to add any information about structural features or credit enhancements that were not reflected in the prospectus filed as part of an ABS registration statement, in order to allow the SEC staff to review and comment on the new features;
- The Final Rules codify the SEC staff’s interpretive position that final transaction documents and other documents required to be filed as exhibits to an ABS registration statement are required to be filed no later than the date that the final prospectus is required to be filed;¹⁹
- The Final Rules codify the SEC staff’s interpretive position that an ABS issuer may choose to comply with the Form SF-3 requirement to incorporate by reference subsequently filed Exchange Act reports by either incorporating all subsequently filed Exchange Act reports or incorporating only subsequently filed current reports on Form 8-K; and
- The Final Rules amend Securities Act Rule 190 to require the separate registration of pool assets consisting of collateral certificates or special units of beneficial interest, while codifying

¹⁹ The SEC did not adopt the proposal from the Proposed Rules that would have required final transaction documents to be filed no later than the date the preliminary prospectus is required to be filed.

the SEC staff's interpretive position that no additional registration fee is payable with respect thereto.

III. ENHANCED DISCLOSURE AND REPORTING REQUIREMENTS FOR ABS

A. Disclosure of Asset-Level Information

The Final Rules adopt asset-level disclosures only for ABS backed by residential mortgage loans, commercial mortgage loans, auto loans, auto leases, debt securities²⁰ and resecuritizations of ABS. Accordingly, no asset-level disclosure is currently being required under the Final Rules with respect to ABS backed by equipment loans or leases, student loans, credit cards, floorplan loans or other assets, although the SEC expressly notes in the Final Release that it is obligated under Section 7(c) of the Securities Act, as added by Section 942 of the Dodd-Frank Act, to prescribe asset-level disclosures for ABS if necessary for investors to independently perform due diligence, and indicates that it is continuing to consider whether asset-level disclosures would be useful to investors in other ABS asset classes which may be less standardized or involve a large number of assets.²¹

Although the Final Rules require asset-level disclosures with respect to residential and commercial mortgage loans, auto loans or auto leases that underlie ABS backing a resecuritization, the Final Rules exempt such disclosure with respect to assets underlying ABS issued prior to the asset-level disclosure compliance date.

²⁰ In the Final Release, the SEC indicates that "debt securities" includes both corporate debt and resecuritizations of ABS, which are required to provide the same security-level information with respect to the underlying ABS as is required with respect to corporate debt securities, as well as asset-level information with respect to the assets underlying those ABS if those assets are of the classes for which asset-level disclosure is required under the Final Rules.

²¹ The Proposed Rules had proposed 28 general fields of asset level information that would have been required to be disclosed for all asset types at the commencement of an offering, together with additional asset-specific fields of information tailored to ABS backed by residential mortgage loans, commercial mortgage loans, automobile loans, automobile leases, equipment loans, equipment leases, student loans, floorplan financings or corporate debt and to resecuritizations. In addition, the Proposed Rules provided for the provision of grouped account information with respect to ABS backed by credit card receivables. The required data fields were described in a proposed new Schedule L, which would have been required to be filed as an exhibit to a current report on Form 8-K (1) at the time of effectiveness of an SF-1 registration statement or at the date of the filing of a preliminary prospectus, in the case of takedowns from an SF-3 registration statement, (2) at the time of filing of a final prospectus and (3) at the time of the filing of a report under Item 6.05 of Form 8-K, which is required to report differences of five percent or more in any material characteristic of the asset pool at the closing date from the description in the final prospectus.²¹ In addition, the Proposed Rules had proposed that similar information be filed for each asset class on an ongoing basis, as an exhibit to Form 10-D. The specific fields required to be filed on an ongoing basis were enumerated in a proposed new Schedule L-D.

Note: The exemption for asset-level data in resecuritizations of legacy ABS responds favorably to the concerns expressed by commenters that much of such asset-level data would be virtually impossible to produce because of the lack of mechanisms in place to capture it at the time the legacy ABS was issued.

The Final Rules adopt a single new Schedule AL, which will be contained in new Item 1125 of Regulation AB. Schedule AL specifies the content of a required asset data file for each asset class to which asset-level disclosure applies. To minimize issuers' implementation cost, the required data fields (referred to by the SEC in the Final Rules as "asset data points") comprising the asset data file for each asset class now consist both of the relevant general fields applicable to such asset class as well as the specific fields tailored to that asset class. The applicable asset data file specified in Schedule AL is required to be provided in the XML data format²² and must be included in the preliminary prospectus, the final prospectus and each Form 10-D for each offering of ABS to which asset-level disclosure applies. The information is required to be provided as of the close of business on the last day of the reporting period identified in the asset data file²³ unless required by Schedule AL to be provided as of another date, such as the origination date, and must be provided for each asset that was a part of the asset pool at any time during the reporting period. The Final Rules include a new Form ABS-EE, which is required to be used for filing the required asset data file through the EDGAR system²⁴ and which may also be used by the issuer to provide additional explanatory disclosure related to an asset data file or other asset-level information (including definitions and formulas for each additional asset data point) in addition to the information required by Schedule AL.

In the 2010 Proposal, the SEC had attempted to preclude the possibility that disclosure of certain asset-level data might compromise borrower privacy by proposing that borrower income, debt and credit scores be disclosed in ranges and that more broadly defined geographic identifiers, such as Metropolitan Statistical Areas, be disclosed rather than zip codes. In response to concerns raised by commenters that the proposed asset-level disclosures, combined with publicly available information, such as records maintained in county recorders' offices, could be used to re-identify a borrower, the Final Rules omit various proposed data points for residential mortgage and auto ABS,

²² The SEC has published a draft EDGAR ABS XML technical specification at http://www.sec.gov/info/edgar/edgarabsxml1_d.htm. The draft specification contains, among other things, the values or coded responses required for the various data points required to be included in the asset data file.

²³ Although the reporting period for an asset data file included in a Form 10-D would be the distribution period covered by the report, it is a bit less clear under the Final Rules what an appropriate reporting period would be for an asset data file included in a preliminary or final prospectus.

²⁴ Based on the comments it received, in particular with regard to the difficulty of identifying whether users are investors or potential investors, the SEC abandoned the approach suggested in its 2014 staff memorandum of having a portion of the asset-level data provided through password-protected issuer websites.

most notably with respect to borrower income and debt²⁵, property sales price, original property valuation, loan origination date, first payment date, whether the borrower is self-employed and the borrower's bankruptcy and foreclosure history²⁶. In addition geographic information is required to be provided through 2-digit zip codes, which are broader than the originally-proposed Metropolitan Statistical Areas. In spite of the various deletions and modifications to the data points, the SEC acknowledges in the Final Release that the final data points, while striking a balance between offering transparency and protection of borrower privacy, do not completely eliminate re-identification risk, and notes that issuers may have costs associated with consulting privacy experts on the impact of providing the required disclosures.²⁷

Note: While the SEC has attempted in good faith to mitigate privacy concerns, there is still something fundamentally troubling about a regulator mandating public disclosure of information that it acknowledges may give rise to liability solely as a result of the disclosure.

A description of the precise data points required in the asset data file for each covered asset class and the modifications to those data points from the data points proposed in the Proposed Rules is beyond the scope of this memorandum. However, a few noteworthy points applicable to all asset classes that are required to disclose asset-level data, and, in addition, to RMBS and CMBS include:

All Asset Classes

- Disclosure of a unique asset number for the asset, and the source of the number is required;
- Consistent with Item 1111(a)(8) of Regulation AB, which requires the disclosure of loans not meeting disclosed underwriting criteria, and the SEC's view that where incrementally higher levels of loan approval may be granted based on judgmental underwriting, the criteria for the first level of underwriting should be disclosed, Schedule AL requires an indicator of whether

²⁵ Data points with respect to the borrower's front and back-end debt-to-income ratio at origination and at the time of any modification are still required.

²⁶ In the Final Release the SEC notes that the borrower's bankruptcy and foreclosure history will have been taken into account in arriving at the disclosed credit score.

²⁷ In the Final Release the SEC states that it has consulted with and received guidance from the Consumer Financial Protection Bureau that collecting and disclosing asset-level information determined by the SEC to be required as necessary for investors to perform due diligence would not cause an issuer to become a "credit reporting agency" subject to the provisions of the Fair Credit Reporting Act or to result in a violation of that Act to the extent that the disclosed information is a consumer credit report.

the asset met the criteria for the first level of underwriting criteria used to originate the pool asset; and

- Data points have been added regarding the status of assets subject to a repurchase demand, which are designed to mirror, at the asset level, the information required to be reported under Rule 15Ga-1.²⁸

RMBS

- Data points have been added for 12-month pay history, number of payments past due and paid through date
- Data points have been added for the most recent aggregate balance of senior or junior liens, to the extent known or available.
- Disclosure is required of any recent property valuations obtained by or for “any transaction party,”²⁹ although this data point does not require updated valuations to be obtained;
- Precise obligor credit scores, rather than credit score ranges, as originally proposed, are required to be disclosed;
- Servicer advances, including cumulative outstanding advances and advance reimbursement information are required to be disclosed for each of four categories: interest advances, principal advances, tax and insurance advances and corporate advances; and
- Information about the effective date and the nature of the most recent loan modification is required to be disclosed.

CMBS

- Asset data points are brought into greater alignment with the industry-standard CREFC® Investor Reporting Package;

²⁸ We note that, because most ABS have monthly distribution dates, this requirement will require asset-level repurchase information to be reported more frequently than aggregated repurchase information is required to be reported under Rule 15Ga-1.

²⁹ In the Final Release the SEC notes that this should be construed broadly to include, without limitation, valuations obtained as part of due diligence conducted by credit rating agencies, underwriters or other parties to the transaction. In order to comply with this requirement, a sponsor may need to negotiate revisions to current forms of underwriting agreements, rating agency engagement letters and other transaction documents to ensure the availability to it and the reliability of the information required to be disclosed.

- As described above for RMBS, disclosure is required of any recent property valuations obtained by or for “any transaction party,” although this data point does not require updated valuations to be obtained; and
- Data points about the three largest tenants, based on square feet, are adopted but rent roll information is not required in spite of commenter request for the data.

B. Static Pool Disclosure

The Final Rules make various changes to Item 1105 of Regulation AB that are designed to increase the clarity, transparency and comparability of static pool information. The changes require (1) an introductory narrative explanation to introduce characteristics of the static pool, the methodology used in determining and calculating the characteristics and any abbreviations used, (2) a description of how the characteristics of the static pool differ from the pool of assets underlying the offered ABS³⁰, (3) graphical presentation of the static pool information if it would aid understanding, (4) explanatory information about why alternative static pool information, if any, is presented or static pool information is omitted³¹, (5) presentation of historical delinquency and loss information in increments of 30 or 31 days through at least 120 days and (6) for amortizing asset pools, graphical illustration of delinquencies, prepayments and losses for each prior securitized pool or by vintage origination year. The Final Rules also add a new item 6.06 to Form 8-K and require that, if the issuer wishes to incorporate static pool information by reference into the prospectus rather than including it in the prospectus, the static pool information should be filed under Item 6.06 no later than the effective date of a registration statement on Form SF-1 or the date on which the preliminary prospectus is required to be filed in the case of an offering under a shelf registration statement.

C. Other Changes to Disclosure Requirements

In addition to the adoption of asset-level disclosures for specified asset classes and the additional requirements made applicable to static pool information, the Final Rules also implement the following changes to the existing disclosure scheme for registered ABS:

- Item 1110 of Regulation AB is amended to require identification of each originator of pool assets if the total amount of assets originated by parties other than the sponsor or its

³⁰ The instructions to amended Item 1105 cite as illustrative differences between the static pool and the offered pool differences in underwriting criteria, loan terms and risk tolerances.

³¹ In the Final Release the SEC states that this requirement would not be satisfied by a conclusory statement that the required static pool information is unavailable or not material.

affiliates exceeds 10% of the pool³²;

- Items 1104 and 1110 of Regulation AB are amended to require information about the sponsor or any other identified originator if the sponsor or such originator is obligated to repurchase or replace assets for breach of a representation and warranty and there is a material risk that the effect of such party's financial condition on its ability to comply with its repurchase or replacement obligations could have a material impact on the performance of the pool or the ABS;
- Items 1104, 1108 and 1110 of Regulation AB are amended to require disclosure of any interest retained in the transaction by the sponsor, any servicer or any originator of 20% or more of the pool assets, or by their respective affiliates, as well as any security-specific or portfolio hedges entered into by such party to offset the risk position held;
- An instruction has been added to Item 1103 of Regulation AB to clarify that the summary section of the prospectus should summarize material characteristics of the particular asset pool backing the ABS. Illustrative possible statistical summary information cited by the instruction includes types of underwriting or origination programs, underwriting exceptions and post-origination modifications;
- Item 1102 of Regulation AB has been amended to require disclosure, on the cover page of the prospectus, of the Central Index Key (CIK) number of the depositor, the issuing entity and if applicable, the sponsor;
- Item 1111 of Regulation AB has been amended to require a description of the provisions in the transaction agreements governing modification of any terms of the pool assets, including how any such modification may affect cash flows from the pool assets on the ABS;
- Item 1109 of Regulation AB has been amended to require disclosures about the asset representations reviewer comparable to those disclosures now required about the experience, duties, compensation, indemnification and removal of the trustee; and
- Items 1112 and 1114 of Regulation AB, which require disclosure of financial information with respect to significant obligors and significant credit enhancement providers, have been modified to eliminate certain exceptions for obligations of highly rated foreign governments.

³² Under existing Item 1110, only originators of 10% or more of the pool assets need to be identified.

D. Other Changes to Periodic Reporting Requirements

In addition to requiring asset-level data with respect to certain asset classes to be provided in each report on Form 10-D, the Final Rules also implement the following changes to the Exchange Act reporting requirements for ABS:

- Delinquency and loss information required to be presented in distribution reports on Form 10-D are required, by virtue of an amendment to Item 1121 of Regulation AB, to be presented in 30 or 31 day increments through at least 120 days;
- Form 10-D is amended to require reference to the CIK number, the file number and the date of any previously reported information that is not reported in a current report because it is substantially the same as the same as the information previously reported;
- Form 10-D is amended to require inclusion of information prescribed in new item 1124 of Regulation AB about material changes in the sponsor's or an affiliate's interest in the ABS resulting from an acquisition or disposition (but not a pledge) of the ABS during the reporting period covered by the Form 10-D. In addition, the resulting amount and nature of any interest or asset retained in compliance with law (*i.e.*, under risk retention requirements, when finally enacted), including amounts retained by third parties to satisfy such legal requirements³³, is required to be separately stated;
- Information is required to be included in Form 10-D concerning any resignation or removal during the reporting period of an asset representations reviewer and, if a new asset representations reviewer has been appointed, the information about the reviewer required by the amendment to Item 1109 of Regulation S-K is required to be provided;
- Item 1122 of Regulation S-K is amended to require that if an ABS servicing function participant's assessment of compliance with servicing criteria identifies a material instance of noncompliance, then (1) the material instance of noncompliance must be described in the annual report on Form 10-K for the ABS and (2) the report on Form 10-K must disclose whether the identified instance of noncompliance was determined to involve the servicing of the assets backing the ABS covered by the report. In addition, the report on Form 10-K is also required to contain a discussion of any steps taken to remedy a material instance of

³³ This would include, for example, unaffiliated B-piece holders who hold a horizontal first loss position in CMBS transactions under the proposed risk retention rules.

noncompliance previously identified by the servicing function participant for its activities on a platform level for assets of the same asset type as those backing the ABS³⁴;

- Several SEC staff interpretive positions relating to assessments of compliance have been codified in Item 1122 of Regulation AB. First, an instruction to Item 1122 expressly requires that a description of the scope of the asserting party's servicing platform be included in the assessment. In addition, a new servicing criterion has been added to Item 1122(d)(1) to require an assessment that aggregated information is mathematically accurate and that information, whether aggregated or unaggregated, conveyed to another asserting party accurately reflects the information; and
- Forms 10-D, 10-K and 8-K have been amended to include the CIK number of the depositor, the issuing entity and, if applicable, the sponsor.

CONCLUSION

The Final Rules, while sweeping in scope and containing many detailed changes from the Proposed Rules, particularly with regard to asset-level disclosures, feature no real surprises for anyone who has been following the evolution of Reg. AB II since the 2010 Proposal. While there will be much work to be done, principally by issuers, in implementing the new rules, the potentially severe disruption to certain ABS markets that may have occurred if those traditionally private markets were subject to the same disclosure requirements as registered ABS, has been avoided for now by the SEC's decision to defer consideration of requiring Regulation AB disclosures in private offerings of ABS. The Final Rules also represent a sensible balancing of added investor protections and added transaction costs to ABS markets, such as RMBS, that are still struggling to recover from the financial crisis.

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³⁴ In the Final release, the SEC, noting inconsistent market practice, states its view that Item 1108(b)(2) of Regulation AB, which requires prospectus disclosure of a servicer's servicing experience, requires disclosure of material instances of noncompliance and steps taken to remedy them.

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