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Clients&FriendsMemo

SEC Proposes New Disclosure Requirements Regarding Representations and Warranties in Asset-Backed Securities Offerings

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Act**") was signed into law by President Obama on July 21, 2010.* Section 943 of the Act requires the Securities and Exchange Commission (the "**SEC**") to prescribe regulations in the use of representations and warranties in the market for asset-backed securities.[1] Such regulations must set forth new disclosure requirements for issuers, originators and depositors and nationally recognized statistical rating organizations ("**NRSROs**") in securitization transactions where the transaction documents require the repurchase or replacement of underlying assets in connection with a breach of asset-level representations and warranties.

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* Cadwalader has prepared a short summary of the Act and a series of memoranda focused on the Act's application to specific industries, entities and transactions. To see these other memoranda, please see *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Appendix A links to the various topic-focused memoranda) or visit our website at http://www.cadwalader.com/list_client_friend.php.

1 Section 943 of the Act reads as follows:

REPRESENTATIONS AND WARRANTIES IN ASSET-BACKED OFFERINGS.

Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe regulations on the use of representations and warranties in the market for asset-backed securities (as that term is defined in section 3(a)(77) of the Securities Exchange Act of 1934, as added by this subtitle) that—

(1) require each national (*sic.*) recognized statistical rating organization to include in any report accompanying a credit rating a description of—

(A) the representations, warranties, and enforcement mechanisms available to investors; and

(B) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities; and

(2) require any securitizer (as that term is defined in section 15G(a) of the Securities Exchange Act of 1934, as added by this subtitle) to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer, so that investors may identify asset originators with clear underwriting deficiencies.

On October 4, 2010, the SEC released its proposed rule[2] (the "**Proposed Rule**") pursuant to Section 943 of the Act. The Proposed Rule would require (a) new disclosures applicable to any "securitizer" with respect to "asset-backed securities" (each as defined in the Act and described below), (b) modifications to disclosure requirements under Regulation AB and (c) new disclosure requirements for NRSROs rating new issues of asset-backed securities. The SEC has requested comments on the Proposed Rule, which must be provided by November 15, 2010.[3]

New Disclosure Requirements Applicable to Securitizers of Exchange Act-ABS

Overview

The SEC explains that Section 943(2) of the Act was a response to a perceived lack of effectiveness of the buy-back covenants in asset-backed securities transaction documents where breaches of underlying asset-level representations and warranties were alleged. The SEC believes that by mandating detailed reporting requirements of all repurchase requests and the ultimate results thereof to investors in both registered and unregistered asset-backed securities offerings, investors would have sufficient information to identify asset originators "with clear underwriting deficiencies."

To that end, the SEC proposes new Rule 15Ga-1 to the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") to satisfy the requirements of Section 943(2).

Applicability of disclosure requirements of proposed Rule 15Ga-1

The new disclosure requirements of proposed Rule 15Ga-1 would apply to asset-backed securities, as defined in the Act ("**Exchange Act-ABS**"), which is substantially broader than the definition set forth in Regulation AB. Exchange Act-ABS includes securities that are typically sold in transactions that are exempt from the registration requirements of the Securities Act of 1933, as amended (the "**Securities Act**").[4]

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2 *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, SEC Release Nos. 33-9148; 34-63029 (October 4, 2010).

3 Proposed Rule, pages 1, 40.

4 "Asset backed security (A) means a 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— (i) a collateralized mortgage obligation; (ii) a collateralized debt obligation; (iii) a collateralized bond obligation; (iv) a collateralized debt obligation of asset-backed securities; (v) a collateralized debt obligation of collateralized debt obligations; and (vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and (B) does not include a security issued by a

The new disclosure requirements apply to any "securitizer", which is broadly defined in the Act to include issuers, sponsors, originators and depositors.[5] The SEC states that this definition is intended to apply to any entity or person that issues or organizes an Exchange Act-ABS transaction, including asset-backed securities issued or guaranteed by government-sponsored enterprises, such as Fannie Mae and Freddie Mac, or municipal issuers.[6]

The scope of proposed Rule 15Ga-1 is limited to Exchange Act-ABS transactions where the underlying documents contain a covenant to repurchase or replace assets in the event of a breach of a representation or warranty. Within the context of such transactions, both the applicability of the rule and the scope of the new reporting requirements are quite broad. However, it is important to note that proposed Rule 15Ga-1 would have no application to any transaction that does not require repurchase or replacement of assets as a remedy for breaches of representations and warranties. As such, traditional CDO and CLO transactions and other second and third-level securitizations that do not have repurchase requirements would not be impacted by proposed Rule 15Ga-1. Issuers and originators should note, however, that if such a feature were added to any new CDO or CLO products as part of a revitalization of the CDO/CLO market, issuers and originators would be required to comply with the proposed disclosure requirements, even if such offerings are conducted under Rule 144A or Regulation S of the Securities Act or are otherwise structured to be exempt from the registration requirements of the Securities Act.[7]

Disclosures required under proposed Rule 15Ga-1; proposed Form ABS-15G

Proposed Rule 15Ga-1 would require any securitizer of Exchange Act-ABS to disclose all fulfilled and unfulfilled requests for asset repurchases or replacements based on breach of representation or warranty across all trusts aggregated by the securitizer. This disclosure is required regardless of whether or not there is any merit to the request, whether or not the request is fulfilled or unfulfilled and regardless of whether the request is made by the transaction trustee at its own initiative or pursuant to a request received by the trustee from investors. The disclosure would be required for all assets originated or sold by the securitizer that are included in outstanding Exchange Act-ABS

finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company." *See* Section 3(a)(77) of the Exchange Act, as amended by the Act.

5 "Securitizer means (A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer." *See* Section 15G(a)(3) of the Exchange Act, as amended by the Act.

6 *See* Proposed Rule, page 10. The Commission specifies that the Proposed Rule would apply to Fannie Mae, Freddie Mac and municipal entities, as well as entities engaged in private offerings under Rule 144A and other exemptions from the registration requirements of the Securities Act.

7 Concerns with the applicability of the Proposed Rule to offshore transactions are discussed below.

transactions, regardless of asset class, where any such securities are held by non-affiliates of the securitizer and where a repurchase covenant for breaches of representations and warranties exists.[8]

The disclosures would be made on proposed Form ABS-15G, which would be filed with the SEC on EDGAR. The form must be signed by the senior officer of the securitizer in charge of the securitization.[9] Because disclosure is required of all repurchase requests, whether or not the repurchase is consummated, the SEC proposes allowing securitizers to footnote information included in Form ABS-15G to provide explanatory information (*e.g.*, to explain why repurchase requests were not satisfied).[10]

As discussed above, disclosure is required of all repurchase demands, whether initiated by the trustee on its own or by investor demands upon a trustee, irrespective of the trustee's determination to make a repurchase demand on a securitizer based on such investor demand. In this regard, the SEC acknowledges its concern that a securitizer may not be able to obtain complete information from trustees that did not keep track of investor requests for repurchase received by the trustee prior to the effective date of the Proposed Rule. The SEC is therefore proposing that a securitizer be permitted, in such a case, to disclose in a footnote, if true, that the securitizer requested and was able to obtain only partial information or was unable to obtain any information with respect to investor demands to a trustee that occurred prior to the effective date of the Proposed Rule.[11]

Proposed Form ABS-15G would require reporting in tabular format of the following information: (a) name of each issuing entity of Exchange Act-ABS, organized by asset class, (b) name of each originator, (c) assets subject to a demand for repurchase or replacement, by issuing entity and originator, (d) assets repurchased or replaced, by issuing entity and originator, (e) assets not repurchased or replaced, by issuing entity and originator, (f) assets pending repurchase or replacement (relevant, for example, where repurchase or replacement was demanded but a cure period that is longer than the one-month reporting period has not expired), by issuing entity and originator and (g) a "check the box" column to denote a registered transaction.[12] A copy of the tabular format to be used in proposed Form ABS-15G is attached as an annex to this memorandum.

Securitizers would be required to file Form ABS-15G at the time a securitizer first offers Exchange Act-ABS or organizes or initiates an offering of Exchange Act-ABS after the effective date of the

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[8] Proposed Rule, pages 12-13.

[9] Proposed Rule, page 27.

[10] Proposed Rule, page 14.

[11] Proposed Rule, pages 14-15.

[12] Proposed Rule, page 15, and proposed Form ABS-15G.

Proposed Rule.[13] The initial filing must include all information required by proposed Rule 15Ga-1, even if there had been no demands to repurchase or replace any assets for all of the applicable Exchange Act-ABS transactions containing a repurchase covenant for breaches of representations and warranties. The initial filing must cover all applicable Exchange Act-ABS transactions going back five years from the date of the initial filing. In addition, updated monthly reporting on Form ABS-15G is required to be filed within 15 calendar days after the end of each calendar month.[14] Proposed Rule 15Ga-1 makes no efforts to link the timing for monthly reports to the underlying payment dates under the transactions reported on Form ABS-15G.

Considerations for exempt transactions

The SEC notes that the disclosures required by the Proposed Rule do not fit neatly within the framework of the existing Securities Act and Exchange Act forms because there are currently no filing requirements for unregistered transactions. Therefore, the SEC proposes that Form ABS-15G be filed on EDGAR, even for unregistered transactions.[15] Securitizers of Exchange Act-ABS offerings that are unregistered should note that, although the SEC states that filing Form ABS-15G would not foreclose reliance of an issuer on the private offering exemption and the safe harbor for offshore transactions from the registration requirements of Section 5 of the Securities Act, the SEC also notes that inclusion in a Form ABS-15G filing of information beyond what is required by proposed Rule 15Ga-1 may jeopardize such reliance by constituting a public offering or conditioning the market for the securities being offered under an exemption.[16]

> *Note: Securitizers involved in unregistered offerings should be mindful of this issue and should limit disclosures to the strict requirements of proposed Rule 15Ga-1.*

The SEC also recognizes that requiring a five-year look-back and updated monthly filings may chill the marketing of offshore exempt transactions to U.S. investors. Nevertheless, the SEC notes that the Proposed Rule would apply to offshore transactions and requests comments on ways to mitigate the impact on offshore transactions so that foreign issuers and underwriters would not be unduly discouraged from selling to U.S. investors.

[13] Proposed Rule, page 18.

[14] Proposed Rule, page 20.

[15] Proposed Rule, page 26.

[16] Proposed Rule, page 18, fn 34.

Re-proposal of certain Regulation AB proposals

The SEC notes that there is overlap between its proposal to update the disclosure requirements of Regulation AB pursuant to the SEC's release of April 7, 2010[17] and the disclosure requirements of Section 943 of the Act. However, the requirements of Section 943(2) go beyond the SEC's prior Regulation AB proposals. The prior Regulation AB proposals would impose similar disclosure obligations for fulfilled and unfulfilled repurchase requests, but only for registered offerings and only if the amount of publicly securitized assets subject to repurchase or replacement is material.

Under the Proposed Rule, the SEC re-proposes its previous Regulation AB proposal to amend Items 1104 and 1121 of Regulation AB. These amendments would now require disclosures, within prospectuses and ongoing reports on Form 10-D, of securitized assets subject to repurchase or replacement to be reported in the format set forth in proposed Rule 15Ga-1; provided that disclosure would be limited to the same asset class as the registered securities that are the subject of the offering.[18] The SEC did not change the three-year look-back on repurchase history required by sponsors under Item 1104 of Regulation AB, but is removing the materiality threshold it proposed in its April 7, 2010 release. In addition, the Proposed Rule requires all prospectuses in registered offerings to reference the Form ABS-15G filings made by the securitizer (*i.e.* the sponsor) of the transaction and disclose the CIK number of the securitizer so that investors may easily locate Form ABS-15G filings of such securitizer on EDGAR.

Proposed disclosure requirements for NRSROs

Section 943(1) of the Act requires each NRSRO to include, in any report accompanying a "credit rating" for an Exchange Act-ABS, a description of the representations, warranties and enforcement mechanisms available to investors and of how such rights and remedies differ from the representations, warranties and enforcement mechanisms in issuances of similar securities. The Proposed Rule would add Rule 17g-7 to the Exchange Act to implement the requirements of Section 943(1). This part of the Proposed Rule simply restates the statutory requirements of Section 943(1) and contains no mandate and little guidance on how NRSROs may comply with the requirements of Section 943(1) of the Act. The SEC notes that it "anticipates" one way NRSROs could fulfill this requirement would be to review previous issuances on both an initial and ongoing basis in order to establish "benchmarks" for various types of securities and revise them as

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[17] *See Asset Backed Securities*, SEC Release No. 33-9117 (April 7, 2010) [75 FR 23328]. Cadwalader has prepared a memorandum summarizing and discussing these proposed amendments to Regulation AB. *See SEC Announces Proposal to Significantly Enhance the Regulation of Asset-Backed Securities* (April 20, 2010), which may be accessed on our website at http://www.cadwalader.com/assets/client_friend/042010SEC_Enhancements.pdf.

[18] Proposed Rule, pages 30-31 and fn 53.

appropriate.[19] The SEC also indicates it is proposing a note that would clarify that the term "credit rating" for purposes of the Proposed Rule would include any expected or preliminary credit rating issued by an NRSRO, including any indications of a rating used prior to the assignment of an initial credit rating for a new issuance.[20] Pre-sale reports typically issued by NRSROs in connection with an offering would be considered a "credit rating" for purposes of the Proposed Rule.

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Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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[19] Proposed Rule, pages 35-36, fn 63.

[20] Proposed Rule, page 36, fn 65.