

Clients & Friends Memo

SEC Announces Proposal to Significantly Enhance the Regulation of Asset-Backed Securities

April 7, 2010

In 2005, the Securities and Exchange Commission (the “SEC”) adopted Regulation AB, which for the first time established a tailored set of rules governing the issuance of asset-backed securities (“ABS”). The perceived role of ABS in the recent financial crisis has led to renewed concerns regarding the regulation of the ABS market. In response to such concerns, the SEC held an open meeting earlier today at which proposed revisions to Regulation AB and other rules relating to public and private offerings of ABS were announced. This memo provides highlights of the proposals announced in the open meeting. Cadwalader is in the process of reviewing the text of the proposed rules¹, which were published this afternoon, and will shortly circulate another memorandum describing the proposals in greater detail.

Enhanced Disclosure Requirements for ABS

- Issuers would be required to disclose at the time the asset is securitized, and on an ongoing basis thereafter, standardized asset-specific data elements (or certain grouped data for ABS backed by credit cards and charge cards). In addition, the data would be required to be filed and tagged in XML format so investors can analyze it. Specific disclosure requirements will be prescribed for 11 different asset classes, although the requirement for residential and commercial mortgage-backed securities will be largely based on models promulgated by broad-based industry groups, including those contained in the American Securitization Forum’s Project RESTART.
- Issuers would be required to file with the SEC a computer program that would permit investors to perform their own quantitative evaluation of the pool. The program would be required to incorporate, among other things, the transaction’s cashflow provisions (i.e., the waterfall).
- Issuers would be required to file static pool disclosure with the SEC in PDF format. The SEC would end its temporary accommodation that permits static pool information to be incorporated into prospectuses by referring in such prospectuses to an internet website where the required static pool information is posted.

¹ A copy of the proposed rules can be found at <http://www.sec.gov/rules/proposed/2010/33-9117.pdf>.

- Issuers would be required to file a preliminary prospectus containing all material terms of the transaction (other than pricing information) at least 5 days before investors make an investment decision.

Revisions to Shelf Registration Procedures for ABS

- The SEC would create new SEC Forms SF-1 (non-shelf issuance) and SF-3 (shelf issuance) for ABS.
- Issuers would be required to use a single prospectus for each takedown, which would eliminate the use of base prospectuses and prospectus supplements for shelf registrations.
- The proposal would eliminate the requirement that ABS offered pursuant to shelf registration be rated investment grade by a nationally recognized statistical rating organization and would establish the following criteria for the shelf eligibility of ABS:
 1. The sponsor or an affiliate would be required to retain a 5% un-hedged vertical slice of the pool (or, in the case of master trusts, an unhedged “originator’s interest” of 5% of the securitized exposure);
 2. The party obligated to repurchase the defective assets of a transaction would be required to periodically provide to the trustee a third party opinion regarding whether any assets tendered for repurchase for alleged breaches of representations and warranties that were not repurchased were in compliance with the transaction’s representations and warranties;
 3. The CEO of the depositor would be required to certify that the assets have characteristics that provide a reasonable basis to believe that they will produce cashflows sufficient to meet the payments due on the securities as described in the prospectus; and
 4. The issuer would be required to file reports under the Securities Exchange Act of 1934, as amended, for the life of the transaction.
- Shelf registration of master trust securities backed by non-revolving assets would no longer be permitted.
- The maximum revolving period permitted in connection with the shelf registration of securities backed by non-revolving assets would be reduced from three years to one year.
- The maximum amount of prefunding allowed for securities registered on a shelf basis would be reduced from 50% to 10% of the offering proceeds.

Revisions to Securities Act Safe-Harbor Provisions for Privately-Placed ABS

- Issuers would be required to covenant to provide, upon request, to certificateholders in private securitizations, any information that would otherwise have been required to be filed with the SEC for publicly offered securitizations. This information would need to be provided at the time

of the offering and on an ongoing basis. These proposed rules would apply to Rule 144A and Regulation D offerings, but would not apply to structured finance products offered and sold under (i) the private placement exemption of 4(2) of the Securities Act or the so-called “Section 4(1½)” exemption relating to private resales or (ii) Regulation S. New Rule 192 would enable the SEC to enforce this requirement, and investors would be able to sue issuers for breach of contract if the required information is not so provided.

- Issuers would be required to file a public notice with the SEC regarding the initial placement of securities to be sold under Rule 144A. In addition, Form D would be revised to collect information on structured products.
- The foregoing requirements would apply to a broader class of “structured finance products” (e.g., certain CDOs and synthetics) than currently meet the Regulation AB definition of “asset-backed security.”
- Comments on the proposed rules must be received by the SEC on or before 90 days after publication of the SEC’s Notice of Proposed Rulemaking in the Federal Register.

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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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