

# Clients & Friends Alert

## SEC Adopts Regulation AB II

**August 28, 2014**

Yesterday morning the Securities and Exchange Commission in an open meeting voted to adopt long-awaited final rules (the "Final Rules") implementing a series of changes to the registration and offering process for asset-backed securities ("ABS") and expanded disclosure and reporting under the SEC's Regulation AB. The package of rules, which is commonly referred to as "Regulation AB II", was first proposed by the SEC on April 7, 2010 and certain elements were repropounded on July 26, 2011 (the "Reproposed Rules").

The following is a summary of the highlights of the Final Rules, as described by SEC staff at the open meeting:

- Loan level disclosures are mandated, at issuance and on an ongoing basis, for ABS backed by residential mortgages, commercial mortgages, auto loans, auto leases and debt securities, as well as resecuritizations of ABS backed by those assets. Some fields have been modified to address privacy concerns about possible identification of borrowers. Loan level disclosures must be provided in a tagged XML format and be filed by issuers through the EDGAR system;
- Delivery of a preliminary prospectus is required 3 business days prior to the first sale in an offering of ABS.
- The investment grade requirement for shelf eligibility for ABS is replaced with 4 new conditions:
  - 1) The principal executive officer of the depositor must provide a certification regarding the disclosure in the prospectus and the structure of the securities<sup>1</sup>;
  - 2) Underlying transaction documents must require the review of loans for breaches of representations and warranties after specified trigger events, which must include, at a minimum, the occurrence of a delinquency threshold followed by an investor vote directing review. A summary of the findings and conclusions of the reviewer must be provided to the ABS trustee and be included in the issuer's report on Form 10-D;

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<sup>1</sup> The SEC staff indicated the certification would be implemented with certain changes from the Reproposed Rules to address concerns expressed in comment letters that the certifications could be seen as a guaranty of future performance by the certifier and result in increased liability.

- 3) Underlying transaction documents must provide a mechanism for dispute resolution for repurchase requests. Although the rules do not mandate who pays for the cost of any dispute resolution, that determination should be made by the arbitrator in an arbitration or by the parties in a mediation;
- 4) Underlying transaction documents must provide a mechanism for investor communication, and requests by investors to communicate with each other must be reported on Form 10-D.
- Issuers are required to assess their compliance with the shelf eligibility and Exchange Act requirements annually and would be permitted to correct any deficiencies by filing any missing documents and waiting 90 days before becoming eligible to again use the shelf.

Noteworthy is that the SEC has not yet adopted any portion of the proposed rules (1) requiring loan level disclosures for asset classes other than those described above, such as equipment loans and leases and student loans, (2) extending certain disclosure and reporting obligations to exempt transactions conducted under Rule 144A or Regulation D or (3) requiring the filing of a cashflow “waterfall” program, although several commissioners in their remarks suggested that some or all of these items should continue to be the subject of ongoing rulemaking. Additionally, the SEC staff indicated that while they were not implementing any rules at this time on “risk retention”, they will continue to work with the other agencies on rules addressing this component of Dodd-Frank.

The Final Rules will become effective 60 days after publication in the Federal Register. Compliance with the Final Rules will be required one year after effectiveness or, in the case of the newly-mandated loan-level disclosures, two years after effectiveness.

Cadwalader will shortly circulate a Client and Friends Memorandum describing the Final Rules in more detail and their implications for the asset-backed securities markets.

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Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this Clients & Friends Alert.

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