Proskauer

SEC Adopts Rules on ABS Transactions

February 7, 2011

Recently, the Securities and Exchange Commission voted to approve two sets of final rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) that seek to improve the market for asset-backed securities by enabling investors to better assess underwriting standards.

The first set of rules, implementing Section 943 of the Act, identifies and imposes new disclosure requirements on "securitizers" and imposes new disclosure requirements on nationally recognized statistical rating organizations (NRSRO). A securitizer is defined as either (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. The rules require securitizers to disclose their three-year demand, repurchase and replacement histories on the underlying assets in a tabular format on February 14, 2012 and, thereafter, to disclose quarterly, demand, repurchase and replacement activity in a tabular format.

In any report accompanying the issuance of a preliminary or other credit rating of an ABS offering, the rules require an NRSRO to describe the representations, warranties and enforcement mechanisms available to an investor in such ABS, and how they differ from the representations, warranties and enforcement mechanisms of "similar securities." An NRSRO is expected to identify "similar securities" based on its knowledge of industry standards, along with its own experience with previously rated deals and its knowledge of the market in general. The SEC's release suggests that NRSROs might accomplish this objective by creating and maintaining benchmarks for various types of securities based on previous issuances.

The second set of rules, implementing Section 945 of the Act, requires an issuer to review, or engage a third party to review, the assets underlying an ABS that will be registered under the Securities Act. At a minimum, such review must provide "reasonable assurance" that prospectus disclosures regarding such assets are accurate in all material respects. The SEC's release provides an example: if a prospectus discloses that loans are limited to borrowers with a specified minimum credit score, or certain income level, the review, as designed and effected, must provide reasonable assurance that the loans in the pool meet such criteria. Although a review will necessarily include credit quality and the underwriting of assets, the SEC declined to further specify standards for any kind of review. Rather, it indicated that "reasonable assurance" encompasses the full range of reviews an issuer may perform to ensure that its review is designed and effected to evaluate whether prospectus disclosures regarding the pool assets are accurate in all material respects. Factors that may be relevant to determining what kind of review is necessary or appropriate include (i) the nature of underlying assets, (ii) the degree of continuing involvement by the sponsor and (iii) the rate of turnover of underlying assets.

As to sampling (which is not mandated), the SEC noted that sampling may be appropriate for a security backed by a larger number of assets, such as typical residential mortgage-backed securities, but inadequate for a security backed by a smaller number of assets, as is more common for securities backed by commercial loans. If sampling is used, the release provides that the issuer should disclose the size of the sample and describe how individual particular assets were selected for review.

An issuer may rely on a review conducted by a third party that is named in the registration statement and consents to being named as an expert under the Securities Act.

The rules are effective March 28, 2011.