

Clients & Friends Memo

Securitization Reforms: What is the Current State of Play?

May 26, 2010

On May 20, 2010, the United States Senate passed a financial reform bill entitled The Restoring American Financial Stability Act of 2010 (the "**Senate Bill**"), which includes provisions designed to improve the offering process for asset-backed securities ("**ABS**").¹ The Senate Bill was passed in response to a bill passed by the United States House of Representatives on December 11, 2009, entitled The Wall Street Reform and Consumer Protection Act of 2009 (the "**House Bill**").² A portion of the House Bill contains similar securitization reforms.³ The United States Senate and the United States House of Representatives will now hold a conference to reconcile the provisions of the House Bill and the Senate Bill.⁴

Separately, the Federal Deposit Insurance Corporation (the "**FDIC**") released an Advanced Notice of Proposed Rulemaking (the "**FDIC ANPR**")⁵ on December 15, 2009, which contains proposed amendments to the FDIC's securitization "safe harbor" rule that would regulate the issuance of ABS.⁶ The FDIC ANPR would require banking institutions that issue ABS to satisfy various conditions to obtain "safe harbor" from the FDIC's ability to repudiate contracts of insolvent banks and recover securitized assets.⁷ On May 17, 2010, the FDIC released a Notice of Proposed

¹ See The Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. (2010), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3217pcs.txt.pdf.

² See The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173eh.txt.pdf.

³ See *Id.* at Title I, Subtitle F, The Credit Risk Retention Act of 2009.

⁴ In passing the Senate Bill, the United States Senate renamed it H.R. 4173, The Wall Street Reform and Consumer Protection Act of 2009.

⁵ See Advance Notice of Proposed Rulemaking Regarding Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After March 31, 2010, available at <http://www.fdic.gov/news/board/DEC152009no5.pdf>.

⁶ See 12 C.F.R. § 360.6.

⁷ Currently, the FDIC provides a safe harbor where assets transferred in a securitization constitute a "sale" under generally accepted accounting principles ("**GAAP**"). However, FAS 166 and 167, which are effective for reporting periods beginning after November 15, 2009, may require some securitizations to be consolidated on the balance sheet of the sponsor if the sponsor retains (i) the power to direct activities that significantly impact the securitization entity's performance or (ii) the obligation to absorb losses or right to receive benefits that could potentially be significant.

Rulemaking⁸ revising the proposed regulations in the FDIC ANPR, and extending the comment period until July 1, 2010.

Finally, on April 7, 2010, the Securities and Exchange Commission announced proposed regulations that would significantly revise Regulation AB and other laws governing offerings, sales and reporting for ABS.⁹

These legislative and regulatory initiatives address many of the same issues, such as (i) risk retention, (ii) continued periodic reporting and (iii) increased disclosure to investors. We thought it would be helpful to provide a chart that compares and contrasts some of the key overlapping points in these initiatives.

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

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⁸ See Notice of Proposed Rulemaking Regarding Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010, available at <http://www.fdic.gov/regulations/laws/federal/2010/10proposeAD53.pdf>.

⁹ See Asset-Backed Securities Proposed Rule, SEC Release Nos. 33-91117; 34-61858, File No. S7-08-10, 75 Fed. Reg. 23,328, 23,514 (May 3, 2010), available at <http://www.sec.gov/rules/proposed/2010/33-91117fr.pdf>.

CERTAIN PROPOSED LEGISLATIVE AND REGULATORY SECURITIZATION PROVISIONS

Provision	Senate Bill	House Bill	FDIC NPR	SEC Reg AB Proposal
Credit Risk Retention:				
<u>Credit Risk Retention Percentage:</u>	5%.	5%.	5%.	5%. Retention requirement doesn't apply to non-shelf offerings (i.e., public deals registered on Form SF-1 and private offerings).
<u>Type of Risk Retained:</u>	To be specified in regulations.	Retained credit risk must be no less at risk of loss than the average credit risk not retained.	An interest (i) in each tranche or (ii) in a representative sample of the securitized financial assets.	An interest in (i) each tranche sold to investors or (ii) in the case of a revolving asset master trust, an originator's interest, provided the originator's interest and the securities sold to investors are backed by the same pool of receivables and payments on the originator's interest are not less than 5% of the payments on the securities held by investors collectively.
<u>Duration of Risk Retention:</u>	To be specified in regulations.	To be specified in regulations.	The term of the securitization.	As long as non-affiliates of the depositor hold any of the securities.
<u>Risk Retention by Whom:</u>	Any securitizer who transfers an asset to a third party through the issuance of ABS.	(i) Creditors that originate and transfer loans to third parties and (ii) securitizers of ABS in any asset used to back an issuance of securities (no double-counting).	Sponsor. Note that the FDIC safe harbor is only relevant to securitizations involving transfers of assets by FDIC-insured banks (not non-bank subsidiaries).	Sponsor or an affiliate.
<u>Definition of "securitizer" or "sponsor":</u>	"(A) an issuer of an ABS; or (B) a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer."	"A person that transfers, conveys, or assigns, or causes the transfer, conveyance or assignment of, loans, including through a special purpose vehicle, to any securitization vehicle, excluding any trustee that holds such loans for the benefit of the securitization vehicle."	"A person or entity that organizes and initiates a securitization by transferring financial assets, either directly or indirectly, including through an affiliate, to an issuing entity. . ."	"The 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 issuing entity."
<u>Prohibition on Hedging:</u>	Securitizers are prohibited from directly or indirectly hedging or otherwise transferring the credit risk.	Creditors and securitizers are prohibited from directly or indirectly hedging or otherwise transferring the credit risk.	The retained interest may not be transferred or hedged for credit risk during the term of the securitization.	Hedge positions <u>directly related</u> to the securities retained or exposures taken by the sponsor or affiliate are counted against the 5%.
<u>Risk Sharing:</u>	Yes. Risk can be allocated between a securitizer and an originator as jointly deemed appropriate by the federal banking agencies and the SEC, considering whether (i) the assets have terms, conditions and characteristics that reflect reduced credit risk, (ii) the form or volume of transactions in securitization markets creates incentives for imprudent origination of that type of asset and (iii) the potential impact of the risk retention obligations on access of consumers and businesses to credit on reasonable terms.	Yes. The appropriate agencies can apply the credit risk retention requirement to securitizers of loans or particular types of loans in addition to or in substitution for any or all requirements that apply to creditors that make such loans or types of loans if doing so would (i) help ensure high quality underwriting standards for creditors and (ii) facilitate appropriate risk management practices by such creditors, improve access of consumers to credit on reasonable terms or otherwise serve the public interest.	No.	No.

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<u>Effective Date:</u>	1 year after publication of regulations for residential mortgage loans; 2 years after publication of regulations for all other forms of ABS. Regulations are due within 270 days after legislation is enacted.	Not specified. Regulations required by the legislation must be promulgated within 180 days after legislation is enacted.	October 2010. Comments on NPR due by July 1, 2010.	Not specified. Comments on proposal due by August 2, 2010.
Exceptions to Credit Risk Retention:				
<u>Regulatory Discretion:</u>	Total or partial exemption of any securitization, as appropriate for the public interest or protection of investors. Exemptions, exceptions or adjustments to the rules on risk retention and prohibition on hedging.	Exemptions or adjustments to the rules, including risk retention and the prohibition on hedging, that (i) are consistent with ensuring high quality underwriting standards for creditors and (ii) facilitate appropriate risk management practices by creditors, improve access for consumers to credit on reasonable terms or otherwise serve the public interest.	No.	No.
<u>Qualified Residential Mortgages:</u>	No risk retention requirement for any asset included in an ABS if all the ABS's assets are "qualified residential mortgages." Federal banking agencies, Secretary of HUD and the Director of the Federal Housing Finance Agency must jointly define "qualified residential mortgages", taking into consideration features that historical data indicate result in a lower risk of default. This exception would not be available for resecuritizations.	No.	No.	No.
<u>Underwriting Guidelines:</u>	Securitizers can retain less than 5% credit risk if the originator meets underwriting standards to be established for each asset class (e.g., residential mortgages, commercial mortgages, auto loans, and other classes the federal banking agencies and the SEC deem appropriate), which specify terms, conditions and characteristics of a loan within each asset class that indicate a reduced credit risk.	Yes, if an exemption or adjustment is granted by the appropriate regulator (see above).	No.	No.
<u>First Loss Purchaser:</u>	Regulations must specify, with respect to commercial mortgages, the permissible types, forms and amounts of risk retention, such as (i) retention of a specified amount or percentage of total credit risk of the assets, (ii) retention of a first loss position by a 3d party purchaser that specifically negotiates for the purchase of the first loss position and provides due diligence on all the pool	Risk retention can be reduced or exempted if (i) the credit underwriting or due diligence meets certain standards and (ii) the loan has terms, conditions and characteristics that reflect loans with reduced credit risk (such as loans that have interest rate thresholds, are fully amortizing and loans included in a securitization in which a third-party purchaser specifically negotiates for the	No.	No.

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	assets prior to issuance of the ABS, (iii) determination by a federal bank agency or the SEC that the underwriting standards for the asset are adequate, and (iv) provision of adequate representations and warranties and related enforcement mechanisms.	purchase of the first-loss position, provides due diligence on all individual loans in the pool prior to issuance and retains a first-loss position).		
<u>Governmental Guarantee Exclusion:</u>	No.	Credit risk retention provisions do not apply to any loan (i) insured, guaranteed or administered by the Secretary of Education, the Secretary of Agriculture, the Secretary of Veterans Affairs or the Small Business Administration or (ii) made, insured, guaranteed or purchased by any person subject to supervision by the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation.	No.	NA
Improved Disclosure:				
<u>Continued Periodic Reporting with the SEC:</u>	Yes. Requires continued filing of Exchange Act reports for ABS after the first fiscal year even if there are less than 300 holders of record. The SEC may suspend or terminate the duty to file for any class of ABS as necessary or appropriate in the public interest or for protection of investors.	Yes. Requires continued filing of Exchange Act reports for ABS after the first fiscal year even if there are less than 300 holders of record. The SEC may suspend or terminate the duty to file for any class of ABS as necessary or appropriate in the public interest or for protection of investors.	No. However, the Proposed Rule requires periodic reporting to investors by the sponsor, issuer and/or servicer, as frequently as monthly, regarding asset performance, including data related to the substitution and removal of financial assets, servicer advances, and loss allocations.	Yes, for shelf-registered ABS, and for Rule 144A ABS offerings, and for other structured finance product offerings under Rule 144A.
<u>Identity of Loan Brokers and Originators; Nature and Extent of Compensation; Amount of Risk Retained:</u>	Disclose (i) identity of loan broker or originator, (ii) nature and extent of compensation of broker or originator and (iii) amount of risk retained by originator and securitizer. Applies to Securities Act and Exchange Act filings.	Disclose (i) identity of loan broker or originator, (ii) nature and extent of compensation of broker or originator and (iii) amount of risk retained by originator or securitizer. Applies to Exchange Act filings only.	Disclose the nature and amount of compensation paid to the originator, sponsor, rating agency or third-party advisor, and any mortgage or other broker, compensation expenses of servicers and the risk of loss retained by any such party.	Yes, as to nature and extent of interest in transaction retained by the sponsor or originator. Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D.
<u>Assets Backing Each Class or Tranche:</u>	Disclose assets backing each tranche or class of security. Applies to Securities Act and Exchange Act filings.	Disclose assets backing each tranche or class of security. Applies to Exchange Act filings only.	Disclose asset, pool and security-level detail required prior to issuance and monthly while outstanding.	Yes. Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D.
<u>Loan-Level Detail:</u>	Disclose asset level or loan level data necessary for investors to independently perform due diligence. Applies to Securities Act and Exchange Act filings.	Disclose asset-level or loan level data necessary for investors to independently perform due diligence. Applies to Exchange Act filings only.	For residential mortgage loans, prior to issuance disclose loan-level information including, but not limited to, loan type, loan structure, maturity, interest rate and/or annual percentage rate, and location of property.	Yes as to all asset classes (or grouped account data for credit cards). Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D. Applies to offering documents and to ongoing reporting for public and Rule 144A offerings.

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<u>Underwriting Standards:</u>	No.	No.	For residential mortgage loans, sponsor must affirm application of specific underwriting criteria and provide a third-party due diligence report confirming compliance with underwriting standards.	Disclosure regarding the underwriting standards and specific data about the amount and characteristics of those assets that did not meet the standards. To the extent that disclosure is provided regarding compensating or other factors, if any, that were used to determine that the assets should be included in the pool, despite not having met the disclosed underwriting standards, the issuer would be required to specify the factors that were used and provide data on the amount of assets in the pool that are represented as meeting those factors. Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D.
<u>Standardization of Data Format Provided by Issuers:</u>	Set standards for format of data provided by ABS issuers to facilitate comparison of data across securities of similar types and asset classes.	Set standards for format of data provided by ABS issuers to facilitate comparison of data across securities of similar types and asset classes.	No.	Yes, for ABS public offerings and, it appears, for offerings of ABS and other structured finance products under Rule 144A and Regulation D.
<u>Extend Regulation AB to Private Placements:</u>	No.	No.	Disclosure shall comply with Regulation AB requirements for public issuances even if issued in a private placement.	Extends disclosure requirements for ABS public offerings to ABS offerings under Rule 144A and Regulation D, and extends ABS or other applicable public offering disclosure requirements to other structured finance products.
<u>Disclosure of Due Diligence Analysis:</u>	ABS issuers are required to perform due diligence analysis of assets backing ABS and disclose the nature of such analysis in registration statements.	No.	For residential mortgage loans, sponsors must disclose a third party due diligence report on compliance with underwriting standards and representations and warranties.	No.
Representations and Warranties:				
<u>Description of Representations, Warranties and Enforcement Mechanisms and Comparison to Similar Transactions:</u>	Rating agencies are required to include in any report accompanying a credit rating a description of (i) the representations, warranties and enforcement mechanisms available to investors and (ii) how they differ from issuances of similar securities.	Rating agencies are required to include in reports accompanying credit ratings a description of (i) the representations, warranties and enforcement mechanisms available to investors and (ii) how they differ from issuances of similar securities.	Disclose the representations and warranties made, the remedies for breach and the time period to cure. For residential mortgage loans, a reserve fund would be required in an amount equal to 5% of cash proceeds from the securitization payable to the sponsor, which reserve would be held for 12 months to cover any repurchases required for breaches of representations and warranties.	Disclose the representations and warranties made and the remedies for breach. Must disclose whether or not a fraud representation is made.

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<u>Disclosure of Repurchase Requests by Originator:</u>	Securitizers are required to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer, so investors may identify asset originators with clear underwriting deficiencies.	Securitizers are required to disclose fulfilled repurchase requests across all trusts aggregated by originator, so investors may identify asset originators with clear underwriting deficiencies.	No.	<p>Disclosure required for sponsors and 20% originators as to repurchase demands and performance during prior 3 years, including the percentage that was not then repurchased or replaced by the sponsor or originator and whether an opinion of an unaffiliated third party had been furnished to the trustee that confirms that the assets did not violate a representation or warranty. Disclosure also required of financial condition of warranting party to the extent the financial condition could have a material impact on repurchase ability.</p> <p>Shelf-registered ABS must require a warranting party to furnish an opinion or certificate, furnished to the trustee at least each quarter, from a non-affiliated third party relating to any asset for which the trustee has asserted a breach of a representation or warranty and for which the asset was not repurchased or replaced by the obligated party on the basis of an assertion that the asset did not violate a representation or warranty contained in the pooling and servicing agreement or other transaction agreement.</p> <p>Periodic reports must include disclosure of any repurchase demands made of the obligated party in the reporting period, including the percentage that was not then repurchased or replaced by the originator and whether an opinion of an unaffiliated third party had been furnished to the trustee that confirms that the assets did not violate a representation or warranty.</p>