Scott A. Sinder
202.429.6289
ssinder@steptoe.com

1330 Connecticut Avenue, NW
Washington, DC 20036-1795
Tel 202.429.3000
Fax 202.429.3902
steptoe.com

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TO: The CRE Finance Council

FROM: Scott A. Sinder
Rhonda M. Bolton

RE: Analysis of New SEC Rules Under Dodd-Frank Section 943 and 945

I. Overview

You have requested an analysis of the rules adopted by the Securities and Exchange Commission on January 20, 2011 to implement Sections 943 and 945 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 943 requires the adoption of rules requiring asset backed securities ("ABS") issuers to disclose any fulfilled or unfulfilled repurchase requests. Section 943 also requires credit rating agencies ("CRAs") to include in any ratings report a description of the representations, warranties, and enforcement mechanisms available to investors in the offering, with a comparison to the representations, warranties, and enforcement mechanisms in "similar issuances." Section 945 requires the adoption of rules mandating that issuers perform a review of the underlying assets for any registered offering of asset-backed securities.

The CRE Finance Council did not oppose the SEC's adoption of the rules, but did make a number of requests for clarification and revision of the rules described in the Proposing Releases. Chief among these requests were that: (i) repurchase request disclosure be prospective rather than retrospective; (ii) CRAs be permitted to utilize the CRE Finance Council's Model Representations and Warranties as a point of reference for comparing a deal's representations and warranties to those in "similar issuances;" and (iii) there be no mandate for a particular type or level of review for the diligence regarding underlying assets under Section 945.

The SEC largely adopted the rules as described in the Proposing Releases, with a few notable exceptions. For example, while disclosure of repurchase requests will not be prospective as CREFC sought, a 3-year lookback period will apply for the initial disclosure rather than 5 years, to help address concern about unavailability of historic information. Second, the SEC did not preclude CRAs' ability to rely on industry standards in comparing a particular offering's representations and warranties to similar issuances, which means there should be no regulatory obstacle to CRAs relying on CREFC's Model Representations and Warranties for this purpose. Finally, while the Commission did opt to

prescribe a standard for review of underlying assets, it adopted what it describes as a principles'-based flexible standard that should be workable across all asset classes, to address concerns that a one-size-fits-all approach would be unworkable: the review "must be designed and effected to provide reasonable assurance that the disclosure in the prospectus regarding the asses is accurate in all material respects."

In terms of implementation, with respect to repurchase requests, any registered offering commencing with an initial bona fide offer on or after February 14, 2012 must comply with the disclosure requirements in a new Item 1104(e) of Regulation AB (described in more detail below); for private deals, a registration statement filed after December 31, 2011 relating to such offering must be pre-effectively or post-effectively amended, as applicable, to make the prospectus compliant. And any registered offering of ABS commencing with a bona fide offer after December 31, 2011 must comply with the new rules on review of underlying assets. NRSROs will be required to provide the information concerning representations and warranties beginning six months and sixty days after the new rules are published in the Federal Register, which will likely result in a start date in September 2011.

The requirements of the new rules are discussed in additional detail below.

II. Repurchase Requests and CRA Disclosures Concerning Representations and Warranties

Where the underlying transaction agreements contain a covenant to repurchase or replace an asset, a new Rule 15Ga-1 will require the securitizer of the asset-backed securities to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by securitizer, for the purpose of helping investors to identify asset originators with underwriting deficiencies. A "securitizer" is defined by reference to Dodd-Frank, as either (1) an issuer of an asset-backed security; or (2) a person who organizes and initiates an ABS securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer. Thus, the definition includes both sponsors and depositors; but if a sponsor files all appropriate disclosures, affiliated depositors would not need to file as well.

Disclosure would be made by filing a new Form ABS 15G, and disclosure would be required for all asset-backed securities that fall within the new statutory definition of ABS, whether or not they are registered under the Exchange Act. For this purpose, note that the definition of "asset-backed security" in the Securities Exchange Act as amended by Dodd-Frank is broader than the definition used in Regulation AB (e.g., the Dodd-Frank definition includes securities that are typically sold in transactions that are exempt from registration such as collateralized debt obligations).

In terms of the period for disclosures, the Proposing Release originally sought to require retrospective disclosure of repurchase request information with a five-year look-back period. In its comments, CREFC suggested that disclosure should instead be prospective, given the liklihood that historic data would be unavailable. CREFC suggested alternatively that if retrospective disclosure is required, securitizers be permitted to indicate in their filings that the data is unavailable if such is the case. While the final rule did not adopt CREFC's recommendation of prospective disclosure, it does mandate a shorter look-back period of three years in recognition of the fact that historic data may

largely be unavailable or difficult to obtain.[1] Where data are unknown or difficult to obtain, such data may be omitted and footnoted as such; with respect to data that may be difficult or costly to obtain, the rule will allow omission where the securitizer cannot obtain the data "without unreasonable effort or expense, and the securitizer must include a statement explaining why unreasonable effort or expense would be involved to obtain the omitted information.[2]

With respect to the definition of "repurchase request" that needs to be disclosed, CREFC recommended that the SEC define this term by tying it to repurchase requests made in accordance with the requirements of the transaction documets, to distinguish demands arising from actual concerns about underwriting deficiences from demands motivated by unrelated tactical considerations. While the SEC acknowledged this request,[3] it did not adopt it, stating only that it had concerns about adopting a requirement of disclosure limited to repurchase covenants pertaining solely to representations and warranties regarding underwriting standards. The Commission observed that covenants to repurchase may pertain to other types of representations and warranties such as applicable laws or fraud.

The Form ABS 15G will contain a table for reporting repurchase requests, with information grouped by asset class. Information to be reported includes name of the issuing entity; whether the ABS is registered or unregistered; name of the originator; assets that were subject of a demand request; assets that were repurchased or replaced; assets that were not repurchased or replaced because the demand is disputed, withdrawn, or was rejected; and assets that are pending repurchase or replacement (within the cure period). As mentioned, a securitizer is allowed to footnote the table where it is unable to obtain information. In specific regard to information regarding investor demands on a trustee, a footnote can be used to indicate that the securitizer was unable to obtain information from the trustee about demands that occurred prior to July 22, 2010 (Dodd-Frank's effective date).[4] Securitizers may also, at their option, include a narrative to further explain any information in the table.

The initial submission of Form ABS 15G must be filed via EDGAR by Feburary 14, 2012, as mentioned, for the three-year period ending December 31, 2011. With respect ongoing disclosure, filing will be required on a quarterly basis (as suggested by CREFC instead of montly as the SEC had proposed), and no quarterly filing (i.e., no filing after the initial one) will be required if a securitizer has no repurchase request activity – in that case, the securitizer can check a box indicated that it had no demands for the quarter in question.[5]

To conform the new rule to related proposals regarding Regulation AB, issuers of registered securities must provide the repurchase request disclosures specified in Rule 15Ga-1(a) (i.e., the table) within a prospectus, and within ongoing reports on Form 10-D. However, prospectus disclosure is limited to the securitizer's repurchase request history for the same asset class as the securities being

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[1] *See* Release Nos. 33-9175; 34-63741 at 31-32.

[2] *Id*. at 32.

[3] *Id*. at 23-26.

[4] Id. at 30-31.

[5] Id. at 41.

registered. Note futher that there is no materiality threshold, as the SEC concludes that Dodd-Frank Section 943 includes no such standard. There is a special phase-in period for prospectus disclosure to address concerns about the availability of historic data: a prospectus filed in the first year after the compliance date will be permitted to include only a one-year look back period, and in the second year after the compliance date, a two-year look back. Those filed in the third year after the compliance date and thereafter will be required to include the full three-year look back period.

The obligation of an issuer to provide the disclosures in prospectuses and in ongoing reports under this revision to Regulation AB would be independent from, and would not alleviate, the disclosure obligations of a securitizer under Rule 15Ga-1. And the issuer would be required to reference the Form ABS-15G filings made by the securitizer (i.e., sponsor) of the transaction and disclose the CIK number of the securitizer.

III. Disclosure Requirements for CRAs Regarding Representations and Warranties

Under a new Rule 17g-7, CRAs will be required to make certain disclosures regarding representations and warranties in any report (including preliminary or expected reports) accompanying a credit rating relating to an asset-backed security. More specifically, the report must include a description of the representations, warranties and enforcement mechanisms available to investors for the offering in question and a description of how they differ from the representations, warranties and enforcement mechanisms in “issuances of similar securities.”

CREFC requested in its comments that CRAs be permitted to rely on industry standards such as CREFC’s Model Representations and Warranties as a reference point for representations and warranties in “issuances of similar securities.” The SEC acknowledged this request, and did not preclude CRA reliance on such industry standards, although the Commission also cautioned that it did not want to limit CRAs to relying solely on industry standards.[6] Accordingly, there is no reason to believe that CRAs cannot utilize industry standards such as CREFC’s Model Representations and Warranties in their comparisons of representations and warranties to fulful the requirements under Rule 17g-7.

IV. Review of Underlying Assets

Under a new Securities Act Rule 193 and amendments to Item 1111 of Regulation AB, any “issuer” of ABS in a registered offering must perform a review of the underlying assets. In response to a CREFC request that the SEC more precisely define “issuer,” the final rule explains that for purposes of the rule, “issuer” means the sponsor or depositor of the securitization. And where the originator and sponsor are different parties, the review may be conducted by the sponsor, but a review performed by an unaffiliated originator will not satisfy the rule’s requirement.[7]

The standard of review was perhaps the most significant issue with respect to diligence of underlying assets, and CREFC urged the SEC to adhere to the approach in the Proposing Release,

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[6] *See id*. at 52.

[7] *See* Release Nos. 33-9176, 34-63742 at 5-6.

which was to avoid prescribing a particular type or level of review, because the type or level will necessarily differ depending on the asset class, and perhaps depending on the offering. While the SEC did opt to prescribe a standard for review of underlying assets, it adopted what it describes as a principles'-based flexible standard that should be workable across all asset classes, to address concerns that a one-size-fits-all approach would be unworkable: the review "must be designed and effected to provide reasonable assurance that the disclosure in the prospectus regarding the asses is accurate in all material respects."[8] The SEC noted that this standard is similar to the one many companies already use in designing and maintaining disclosure controls and procedures required under Exchange Act Rule 13a-15, so it expects that many issuers will have some familiarity with this standard. Therefore, the type and level of review may vary depending on the asset class and other circumstances (for example, the SEC notes, for CMBS it may be appropriate for the review to include every asset in the pool because of the relatively small number of loans in the pool) so long as it meets the prescribed principles-based standard.[9] Note that the nature of the review must be disclosed in the prospectus, as well as the findings and conclusions of the review.

In response to requests for clarification raised by CREFC regarding whether the rule pertains to the review conducted to originate the assets or that done for purposes of the securitization, the SEC specified that the rule pertains to the review that is conducted for purposes of the securitization.[10] Further, the SEC advised, the accuracy of disclosure in the prospectus is an appropriate objective for the required review, which is broader than just a review of the underwriting of the assets.[11]

An issuer may rely on a third party review of the underlying assets to satisfy its obligations under new Rule 193, provided that the third party is named in the registration statement, and consents to being named as an "expert" in accordance with the Securities Act Section 7. CREFC sought clarification of this aspect of the rule, as proposed, because CMBS issuers do not retain third parties to conduct diligence per se, and there is concern that such third parties would refuse to consent to being named as experts in this context. The final rule clarifies that if the issuer is attributing the findings and conclusions of the review to itself, any third parties assisting the issuer need not consent to being named as experts, although they must be identified.[12] To the extent an issuer attributes findings or conclusions to a third party, that third party must consent to being named as an expert.

Issuers would also be required to disclose how any assets included in the pool deviate from the disclosed underwriting criteria, accompanied by specific data about the amount and characteristics of those assets that did not meet the disclosed standards, and the name of the entity (sponsor, originator, etc.) who determined that the assets should be included in the pool. CREFC's comments pointed out that this latter requirement seems ill-suited to the CMBS context since the decision to include exception loans is typically an iterative and collaborative process. The SEC responded to this

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[8] *See id*. at 12-14.

[9] *Id*. at 14.

[10] *See id*. at 14, n.50.

[11] *See id*. at 16.

[12] *See id*. at 19.

observation by revising its proposal to require disclosure of the names of all parties involved in making the decision to include exception loans in the pool.[13]

There were two aspects of the SEC's proposal that it decided to omit from the final version of the rule. First, the SEC sought comment on whether it should require disclosure of all the findings and conclusions of reviews provided to B-piece buyers, a proposal CREFC opposed, explaining that the industry is working on the issue of enhanced disclosure through its Annex A improvements. The SEC did not include or address this additional disclosure requirement in the final rule.

Finally, the SEC had proposed to include a new requirement of public disclosure of any third party diligence reports obtained, pursuant to Dodd-Frank Section 932, which applies to registered as well as unregistered offerings. The SEC has postponed its adoption of such a rule until it complete work on other aspects of implementation of Section 932, and it advises that it will implement all of Sectio 932 simultaneously.[14]

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[13] *Id*. at 27.

[14] *See id*. at 3.