



October 20, 2010

## Summary

### **SEC Proposed Rules Related to Issuer Review of Assets in Asset-Backed Securities (ABS) Offerings Under Dodd-Frank § 932 and § 945**

**Comments Due:** November 15, 2010.

**Rule Adoption:** January 17, 2011 (180 days of enactment of Dodd-Frank)

## High-Level Summary

1. Requires any issuer registering the offer and sale of an asset-backed security (ABS) to perform a review of the assets underlying the ABS; and
2. Requires an ABS issuer to disclose the nature of its review of the assets and the findings and conclusions of the of the review; and
3. Requires any issuer, if it engages a third party to conduct the review of the assets, to disclose the third party's findings and conclusions.

## Section-By-Section Summary

### II. Proposed Rules

**A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets** – The SEC proposes new “Rule 193” to require any issuer of ABS in a registered offering to perform a review of the underlying assets.

1. **Application of the Proposed Rule** – The SEC proposes using the definition of “asset-backed security” in the Securities Exchange Act as amended by Dodd-Frank, which 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).

2. **New Securities Act 193** – Requires an issuer to perform a review of the assets underlying an ABS transaction registered under the Securities Act.
  - a. Rule Application - Would only apply to registered offerings of ABS transactions.
  - b. Issuer Definition – Issuer would be defined as the depositor or sponsor of the securitization.
    - i. In cases where the originator and sponsor are different, the review may be performed by the sponsor. Review by an unaffiliated originator would not be acceptable.
  - c. Review Type - The new rule does not specify the level or type of review an issuer is required to perform, but is expected to vary based on circumstances including asset class. The asset-level data points proposed for Regulation AB may be relevant, for example.
  - d. CMBS Note - Notes that for CMBS, as an example, 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.
  - e. Prospectus Disclosure - Would require a prospectus disclosure describing the type and level of review completed.
  - f. Third-Party Review - 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:
    - i. Named in the registration statement; and
    - ii. Consents to being named as an “expert” in accordance with the Securities Act Section 7.

### 3. **Questions for Comment** - (1-13)

#### **B. Proposed Disclosure Requirements -**

1. **Registered Offerings** – The SEC is proposing amendments to Item 1111 of Regulation AB, which outlines aspects of the ABS pool that the prospectus disclosure should cover. Specifically, the SEC is proposing that Item 1111 include the nature of the issuer’s review of the underlying assets, and the findings and conclusions of that review. The SEC is also re-proposing amendments from its pending proposal to revise Regulation AB, to require disclosure regarding the composition of the pool as it relates to assets that do not meet disclosed underwriting standards.
  - a. Nature of the Review - Issuers would be required to disclose, on new “Item 1111(a)(7)” of Regulation AB:

- i. A description of the scope of the review, such as what type of sampling and sampling techniques were used; and
      - ii. Whether a third party conducted the review.
    - b. Findings and Conclusions – Issuers would be required to disclose, on new “Item 1111(a)(7)” of Regulation AB, the findings and conclusions of any issuer or third party review of the underlying assets. The disclosure would be made in the registration statement.
    - c. Disclosures Regarding Exception Loans – Issuers would be required to disclose, on new “Item 1111(a)(8)” of Regulation AB, how any assets included in the ABS 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.
      - i. Required to disclose the entity (sponsor, originator, etc.) who determined that the assets should be included in the pool, and what factors were used to make the determination.
      - ii. Factors used to make the determination include compensating factors such as materiality of the exception. If compensating or other factors were used, issuers would be required to provide data on the amount of assets in the pool that are represented as meeting each factor and the amount of assets that do not meet those factors.
2. **Exchange Act Section 15E(s)(4)(A) and New Form ABS-15G** – New Section 15E(s)(4)(A) of the Exchange act requires that any issuer or underwriter of any ABS make publicly available the findings and conclusions of any third party due diligence report they obtain.
- a. Application – applies to both registered and unregistered ABS offerings.
  - b. Registered Transaction Disclosure – Disclosure of the findings and conclusions of the third party would be required in the prospectus.
  - c. Unregistered Transaction Disclosure – The SEC proposes, under new “Rule 15Ga-2,” that the issuer or underwriter disclose the findings and conclusions of third party on new “Form ABS-15G.” Parties in unregistered transaction that perform similar functions to an underwriter in a registered transaction (e.g., placement agents or initial purchasers) are included in the term “underwriter” and are covered under the proposed rule.
    - i. Filing of the new form would be required five business days prior to the first sale of the offering.
    - ii. Form ABS-15G would be signed by the senior officer in charge of securitization if the review was conducted by a third party hired by the issuer.
      - 1. If an underwriter engaged the third party, then the form would be signed by a duly authorized officer of the underwriter.

- iii. An issuer who already filed the information on EDGAR in connection with a registered offering would also satisfy the Form ABS-15G disclosure requirement.
  - iv. The SEC recognizes that public disclosure of information relating to an unregistered offering could raise concerns regarding an issuer's or underwriter's reliance on the private offering exemptions and safe harbors under the Securities Act, and advises that it is of the view that "issuers and underwriters can disclose information required by Rule 15Ga-2 without jeopardizing reliance on those exemptions and safe harbors, provided that the only information made publicly available is that which is required by the proposed rule, and the issuer does not otherwise use Form ABS-15G to offer or sell securities or in a manner that conditions the market for offers or sales of its securities."
- d. Offshore Transactions – Securitizers in the U.S. who sell ABS to offshore purchasers as part of a registered or unregistered transaction would be subject to the new disclosure requirements under new "Rule 15Ga-2" for third party reviews.

**3. Questions for Comment – (14-29)**

Question #	Section	Proposed Rule Page Number	Question
1	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	10	Does our proposed rule to require the issuer of ABS in a registered transaction to perform a review of the assets adequately address Section 7(d)(1) of the Securities Act, as added by Section 945 of the Act? Is this proposal, coupled with the proposed disclosure requirements described below, sufficient to carry out the purposes of Section 7(d)(1) of the Act? Can investors evaluate for themselves the sufficiency of the review undertaken by the issuer? Will issuers undertake a meaningful review absent a minimum review standard?
2 (a)	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	11	Should we instead mandate a minimum level of review that must be performed on the pool of assets? Would requiring a minimum level of review better carry out the mandate of Securities Act Section 7(d)(1), which imposes a new review requirement, separate from the disclosure requirement in Section 7(d)(2)? If so, what level of review would be appropriate? For instance, should we require that the review, at a minimum, provide reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects? We note that the federal securities laws currently require that disclosure in the prospectus not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements not misleading. Therefore, we would expect that issuers are currently performing some level of review in order to provide them sufficient comfort to believe that the prospectus disclosure is accurate. A reasonable assurance level would be similar to the standard that companies use in designing and maintaining disclosure controls and procedures required under Exchange Act Rule 13a-15.34 Our rules generally “require an issuer to maintain disclosure controls and procedures to provide reasonable
2 (b)	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	12	<ul style="list-style-type: none"> <li>•If we required that the review, at a minimum, provide reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects, would issuers and their advisers be familiar with this reasonable assurance level and understand how that level would apply in the context of a review of assets underlying ABS?</li> <li>•Would a different level of assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects be appropriate? If so, what level and why?</li> <li>•Should a minimum standard require that the review be not just designed but also effected to provide reasonable assurance that the disclosure was accurate?</li> <li>•Is there a minimum level of review that would be more appropriate or useful to investors without imposing impracticable burdens and costs on issuers?</li> <li>•How, if at all, should any such standard of review affect current law regarding antifraud liability? How, if at all, should any such standard of review affect the due diligence defense against liability under Securities Act Section 1137 and the reasonable care defense against liability under Securities Act Section 12(a)(2)?</li> <li>•Should the rule further specify the types of matters – e.g., credit – that should be covered by the review?</li> <li>•In addition, should the rule further specify the level of review? For example, should it set out parameters to determine whether sampling is appropriate?</li> </ul>
3	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	13	We note that in the 2010 ABS Proposing Release, we proposed requiring that the underlying transaction agreement in a transaction relying on certain Commission safe harbors for an exemption from the Securities Act contain a provision requiring the issuer to provide to any initial purchaser, security holder, and designated prospective purchaser the same information as would be required in a registered transaction. Similar to the approach in the 2010 ABS Proposing Release, should we condition the safe harbors for an exemption from registration provided in Regulation D and Securities Act Rule 144A on a requirement that the underlying transaction agreement for the ABS contain a representation that the issuer performed a review that complies with proposed Rule 193? Alternatively, if we adopt Rule 193 with some minimum standard of review, should we condition the safe harbors for an exemption from registration provided in Regulation D and Securities Act Rule 144A simply on a requirement that the issuer perform a review of the underlying assets? If so, should we also require that the issuer represent in the transaction agreement that it will certify such review or provide disclosure regarding the nature of the issuer’s review and findings and conclusions?
4	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	14	Should we specify the types of review that should be performed? For example, should we require that the review verify the accuracy of the data entry of loan information into the loan tape, containing data about the loans in the pool (e.g., loan-to-value ratio, debt-to-income ratio)? Should the rule establish a standard requiring a review sufficient to determine whether the underlying assets meet the underwriting criteria? Should any required review entail reviewing borrowers’ income levels to determine borrowers’ ability to repay the underlying loans? Should the rule establish a standard for reviewing whether the loans have been originated in compliance with applicable laws, including predatory lending and Truth in Lending statutes? Should we establish standards for a review of the accuracy of the property values reported by the originators for the underlying collateral? Could each such type of review be conducted across all asset classes (e.g., residential mortgages, commercial mortgages, credit card receivables, resecuritizations)? What standards would be appropriate for each asset class or across all asset classes of asset-backed securities?
5	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	15	Should we explore devising review standards for each particular asset class and consider proposing more detailed standards for the nature of review at a later date? If so, how?
6	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	15	Should our rules, as proposed, permit issuers to rely on a third party that was hired by the issuer to perform the required review of the assets under Rule 193? Should we, as proposed, condition the ability to rely on a third party for this purpose on the third-party’s review satisfying the requirements of Rule 193? When we adopt rules in the future to establish the appropriate format and content for the certifications required pursuant to Exchange Act Section 15E(s)(4)(B), we will be required to do so in a manner “to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for a nationally recognized statistical rating organization to provide an accurate rating.” Should we condition reliance on third parties for purposes of Rule 193 upon satisfaction of that standard? How else could the proposal better effectuate Exchange Act Section 15E(s)(4)?
7	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	15	If an originator performs a review of the assets and provides the findings and conclusions of its review to the issuer and the originator is not affiliated with the sponsor of the securitization, should we allow an issuer to rely on the originator’s review of the assets in order to satisfy the issuer’s review requirements? If so, should the information relating to the originator’s review be treated similarly to third-party reviews? As described above, under our proposal, an issuer would be permitted to rely on a third party to conduct the Rule 193 review provided the review satisfied the requirements of Rule 193 and the third party is named in the registration statement and consents to being named as an expert in accordance with Section 7 of the Securities Act and Rule 436 under the Securities Act. If we allow such reviews to satisfy Rule 193, should the findings and conclusions of third-party originators who conduct Rule 193 reviews likewise be subject to expert liability?

8	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	16	Is there any other party that an issuer should be allowed to rely upon in order to satisfy the review required by proposed Rule 193? For example, should an issuer be permitted to rely upon the underwriter of the offering? If so, how should we treat the findings and conclusions of that party? Should that party's findings and conclusions be subject to expert liability? If not, how can we ensure that such parties would take appropriate responsibility for any findings included in the issuer's registration statement?
9	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	16	We propose to permit an issuer to rely upon a third party that is engaged for purposes of performing a review of the assets to satisfy Rule 193. Is "third party engaged for purposes of performing a review of the pool assets" an appropriate description? If not, what is a more appropriate description? What entities should be considered a "third party engaged for purposes of performing a review"? Should such third-party reviewers include accountants who, for example, perform reviews and prepare reports pursuant to agreed-upon procedures? Should such third-party reviewers include attorneys who, for example, provide opinions as to the perfection of the security interest in the collateral? Are there policy reasons why a particular type of third-party reviewer should be excluded from this requirement? We note that the issuer would remain responsible for its disclosure under the federal securities laws, including disclosure regarding pool assets, even if it engages a third party to perform the review required by Rule 193. Should the proposed rule be revised to clarify this point?
10	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	17	It appears that the scope of third-party due diligence providers is broad enough to include appraisers and engineers for purposes of Section 15E(s)(4). Is there a basis for a different approach? Should this vary among different asset classes? For example, should the requirements differ depending on whether the asset class for the securities is commercial mortgages or residential mortgages? We are aware that for certain types of ABS offerings (e.g., CMBS offerings) an issuer may receive numerous reports from appraisers and engineers regarding the property underlying the loan.
11	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	17	As discussed below, Exchange Act Section 15E(s)(4)(A) requires an issuer or underwriter of ABS to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. How does new Exchange Act Section 15E(s)(4)(A) impact the analysis here? Should the third parties whose findings and conclusions must be made publicly available under Exchange Act Section 15E(s)(4)(A) be the same group of third parties that are engaged for the review of the assets for purposes of proposed Rule 193? If not, how can we appropriately differentiate between the groups of third-party due diligence providers? In other words, how should the rule describe the nature of the work performed by third parties subject to Section 15E(s)(4)(A) versus the nature of the work performed by third parties employed by an issuer whose findings and conclusions should be required to be disclosed in a registration statement if such parties should be different?
12	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	18	We have previously noted the potential conflict of interest arising from the "issuer pays" model for NRSROs in which an NRSRO is paid by the arranger of a structured finance product to rate the product. Are third-party due diligence firms subject to the same type of potential conflicts of interest as credit rating agencies operating under the "issuer pays" model? If so, is there a way to mitigate this potential conflict?
13	II. A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets	18	Are there other potential conflicts relating to a third-party due diligence provider that we should address? How should we encourage the quality of third-party reviews? Should a third party be required to be independent if the review will be used to satisfy Rule 193? If so, do we need to define "independent"? How should we define it? Should we require disclosure relating to the affiliations of the third party? Item 1119 of Regulation AB requires disclosure of affiliations among participants in the securitization. Should we revise Item 1119 to require disclosure regarding affiliations between a third-party due diligence provider and the parties listed in Item 1119?
14	II. B. Proposed Disclosure Requirements	27	Are our disclosure proposals appropriate? Should we provide more specific requirements regarding the information that must be provided about the nature and scope of the review? If so, what should we require?
15	II. B. Proposed Disclosure Requirements	27	Should we consider Securities Act Section 7(d) and Exchange Act Section 15E(s)(4)(A) together and require disclosure of the findings and conclusions of the issuer's or third party's review of the assets, as proposed? Should we, instead, implement Section 15E(s)(4)(A) as part of the later rulemaking under Section 15E?
16	II. B. Proposed Disclosure Requirements	28	Should we require, as proposed, disclosure relating to assets that deviate from the disclosed origination underwriting criteria?
17	II. B. Proposed Disclosure Requirements	28	Should we require, as proposed, disclosure of the entity who determined that assets that did not meet the disclosed criteria should be included in the pool, despite not having met the disclosed underwriting criteria? Should issuers be required to disclose, as proposed, what factors were used to make the determination? Would this provide useful information for investors?
18	II. B. Proposed Disclosure Requirements	28	Is requiring the filing of information regarding the findings and conclusions of the third-party due diligence provider's report on proposed Form ABS-15G on EDGAR an appropriate way for issuers in unregistered offerings and for underwriters in registered and unregistered offerings to make this information publicly available? Should we allow website posting of the information instead? If so, how can we ensure the materials remain public? What advantages does website posting have over requiring that the information be filed on EDGAR? How do we ensure that investors and market participants have access to such information? What would be the liability implications of allowing the information to be posted on a website as an alternative to filing on EDGAR? Are there other appropriate means of making the findings and conclusions "publicly available"?
19	II. B. Proposed Disclosure Requirements	28	As discussed in request for comment number 10 above, we are aware that for certain types of ABS offerings an issuer may receive numerous reports from appraisers and engineers regarding the property underlying the loan. To what extent do the findings and conclusions of these reports help the issuer in performing its review? We are aware that CMBS issuers often provide the results of such reports to the "B-piece purchaser" to the extent that the findings of those reports differ from the representations and warranties regarding the assets in the underlying transaction agreements. Should we require that the issuer disclose all of the findings and conclusions provided to a B-piece buyer for purposes of the required disclosure in the registration statement? To what extent do the findings and conclusions of these reports assist rating agencies rating ABS? Should we require, for purposes of Section 15E(s)(4)(A), the findings and conclusions of such reports to be disclosed only to the extent that those findings and conclusions differ from the representations and warranties or the complete list of findings and conclusions provided to a B-piece buyer?
20	II. B. Proposed Disclosure Requirements	29	Should we provide a temporary hardship exemption from electronic submission of Form ABS-15G with the Commission for filers who experience unanticipated technical difficulties that prevent timely preparation and submission of an electronic filing? Are there any reasons that ABS issuers and underwriters would not be able to submit Form ABS-15G on EDGAR in a timely fashion? If so, what would be an appropriate format for the filing? Would a paper filing be useful to investors and other market participants? Is timely availability of an electronic filing of this information important? If so, should we instead require that the information be posted on a website on the same day it was due to be filed on EDGAR, but require that the filer submit a confirming electronic copy of the information within a prescribed number of business days (e.g., six) of filing the information in paper?
21	II. B. Proposed Disclosure Requirements	30	Is there any reason Exchange Act Section 15E(s)(4)(A) should not apply to both registered and unregistered ABS transactions? If the requirement applies to both registered and unregistered transactions, should the universe of ABS offerings that are subject to the requirement be defined, as proposed, as an offering of asset-backed securities, as that term is defined in Section 3(a)(77) of the Exchange Act? Should the requirement be instead applicable to some other subcategory of asset-backed securities? For example, existing Exchange Act Section 15E(i) refers to a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. Should our rule refer to this description of an asset-backed security instead of the proposed reference to Exchange Act Section 3(a)(77)?

22	II. B. Proposed Disclosure Requirements	30	Should we exempt any issuers, underwriters or other parties from this requirement? Should we exempt issuers and underwriters of ABS that are not rated by an NRSRO from having to make publicly available the findings and conclusions of third-party due diligence reports?64 As proposed, Rule 15Ga-2 would apply to issuers and underwriters of ABS that are exempted securities as defined in Section 3(a)(12) of the Exchange Act, including government securities and municipal securities. Should such exempted securities be exempt from this provision?
23	II. B. Proposed Disclosure Requirements	31	Would the proposed requirement that Form ABS-15G be filed five business days prior to first sale provide investors with sufficient time to review the findings and conclusions contained therein? Would it provide NRSROs with sufficient time to take the included information into account in determining a rating? If not, what would be a more appropriate filing deadline and why? Are five business days also appropriate in unregistered offerings? Is there reason to require a different number of days in unregistered offerings?
24	II. B. Proposed Disclosure Requirements	31	Is our proposed signature requirement for Form ABS-15G appropriate? Is it necessary? Conversely, are there other appropriate individuals that are better suited to sign the form?
25	II. B. Proposed Disclosure Requirements	31	Should issuers of registered ABS offerings be required to provide notice on Form ABS15G that they have provided information relating to the third-party due diligence report obtained by the issuer in a prospectus that is filed with the Commission?
26	II. B. Proposed Disclosure Requirements	31	Where an issuer, underwriter or NRSRO employs a third-party due diligence provider, Section 15E(s)(4)(B) of the Exchange Act also requires that the person providing the due diligence services provide to the NRSRO a written certification in the format and containing content to be determined by the Commission. The Commission is required to prescribe this form and content not later than one year after enactment of the Act. Although we are not proposing to implement this requirement in this release, we request comment on the appropriate format and content for this certification and how we can appropriately coordinate the rules and requirements proposed in this release with that statutory requirement.
27	II. B. Proposed Disclosure Requirements	32	Are there any extra or special considerations relating to offshore sales of ABS that we should take into account in our rules? Should our rules permit issuers or underwriters to exclude information from Form ABS-15G with respect to assets underlying "foreign offered ABS," and if so, should foreign-offered ABS be defined to include Exchange Act-ABS that were initially offered and sold solely in accordance with Regulation S, the payments to holders of which are in non-U.S. currency, that are governed by non-U.S. law, and have foreign assets (i.e., assets that are not originated in the United States) that comprise at least a majority of the value of the asset pool? For this purpose, should the foreign asset composition threshold be higher or lower (e.g., 40%, 60%, or 80%)? Would another definition be more appropriate?
28	II. B. Proposed Disclosure Requirements	32	Should our rules require issuers that are foreign private issuers to provide information on Form ABS-15G for those Exchange Act-ABS that are to be offered and sold in the United States pursuant to an exemption in an unregistered offering, as proposed? Instead, should our rules only require disclosure about Exchange Act-ABS as to which more than a certain percentage (e.g., 5%, 10% or 20%) of any class of such ABS is sold to U.S. persons?
29	II. B. Proposed Disclosure Requirements	32	Should we include requirements tailored to revolving asset master trusts? For example, should we include a disclosure requirement in Exchange Act Form 8-K requiring that the issuer provide updated disclosure on its review or due diligence with respect to accounts or assets that are added to the pool after the offering transaction has been completed? Should this be a requirement for each Form 10-D or should it be provided on a quarterly basis instead?