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SEC Adopts ABS Disclosure and Shelf Eligibility Rules

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 17-14
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 24-14
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 20-14
SEC RULES MEMBERS No. 37-14
SMALL FUNDS MEMBERS No. 23-14 RE: SEC ADOPTS ABS DISCLOSURE AND SHELF ELIGIBILITY RULES

On August 27, the Securities and Exchange Commission (the "SEC" or "Commission") voted unanimously to adopt rule amendments affecting asset-backed securities ("ABS"). [1] Losses suffered by ABS holders were considered to be a contributing factor to the 2008 financial crisis, and the SEC noted in its April 2010 release proposing changes related to the disclosure, reporting, and offering process for ABS that investors in the securitization market did not have the necessary information and time to fully assess the risks underlying ABS. [2] The Commission then revised and re-proposed the rules in light of provisions affecting ABS in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and comments the Commission received on the 2010 Proposal. [3]

Among other things, the newly adopted rule amendments require, for certain asset types, specified asset-level disclosure for each asset in the pool; provide more time for investors to review and consider an ABS offering; revise the eligibility criteria for using "shelf offerings;" and make revisions to reporting requirements. ICI generally supported these reforms, which we believed would improve ABS disclosure and reporting and provide protections to ABS investors. [4]

I. Disclosure Requirements

A. Asset-Level Information

In the 2010 Proposal, the Commission proposed to require standardized asset-level information in ABS prospectuses and on an ongoing basis in periodic reports. Subsequently, the Dodd-Frank Act added Section 7(c) to the Securities Act of 1933 (the

"Securities Act"), which requires the Commission to adopt regulations requiring an ABS issuer to disclose certain loan level information regarding the assets backing that security. Currently, an ABS issuer need only provide information about the composition and characteristics of the asset pool, rather than each asset within the pool. [5]

The final rules require issuers to provide standardized asset-level information for ABS backed by residential mortgages, commercial mortgages, auto loans, auto leases, debt securities, and resecuritizations of ABS that include these asset types. [6] Generally speaking, issuers will have to provide, for each asset, information about the obligor's credit quality, the collateral related to the asset, the cash flows related to the asset, and contractual terms. Each specified ABS asset class has its own separate set of required data points. [7] In finalizing these data points, the SEC considered the comments it received, and was particularly concerned with attempting to balanced investors' desire for granular information with privacy concerns. [8] Asset-level information is required in the prospectus (both the preliminary and final prospectus) and in ongoing reports required under the Exchange Act. [9] Issuers are also free to provide additional asset-level information in an Asset Related Document. This information must be filed through EDGAR and provided in a standardized, tagged data format (eXtensible Mark-up Language ("XML")), in order to facilitate investors' data analysis.

The SEC believes that the addition of standardized, comprehensive asset-level information (at both inception and over the life of the ABS) offers a more complete picture of the composition and characteristics of the pool assets and their performance and will allow investors to better understand, analyze, and track the performance of ABS.

B. Additional Prospectus Disclosure

In addition to adding the asset-level disclosure discussed above, the amendments provide for the following:

- Disclosure about smaller originators. [10]
- Enhanced disclosure of the financial capacity of parties (i.e., sponsors or originators of 20% or more of pool assets ("20% originators")) to repurchase assets as required by the transaction agreements.
- Disclosure about a sponsor's, servicer's, or 20% originator's retained interest in a transaction, including the amount and nature of the interest and any related hedge.
- Clarification that the prospectus summary should include disclosure tailored to the particular asset pool backing the ABS.
- More detailed and specific information regarding the provisions in the transaction agreements governing modification of the assets, and disclosure regarding how modifications may affect cash flows from the assets or to the securities.
- Improved clarity, transparency, and comparability of certain static pool information. [11]
- Financial information disclosure for certain significant obligors and credit enhancement providers that had been exempted. [12]

II. Securities Act Registration and Related Matters

A. Changes to Shelf Registration Requirements and Procedure

An ABS issuer with an effective registration statement is currently permitted to conduct delayed offerings "off the shelf" under Securities Act Rule 415 without further SEC staff action, provided it satisfies a number of conditions. The amendments make a number of

notable changes to shelf registration requirements and procedures for ABS issuers.

First, because pool assets are not identified until the time of the offering, information about the actual assets and material terms of the transaction are currently included in a prospectus or prospectus supplement that is required to be filed with the SEC by the second business day after first use. In the 2010 Proposal, the Commission had proposed that ABS issuers be required to file a preliminary prospectus with the Commission for each shelf takedown at least five business days prior to the first sale in the offering, which would provide investors with additional time to analyze transition-specific information. In the final amendments to Securities Act Rule 424 ("Filing of Prospectuses, Number of Copies"), this period has been shortened to three business days. [13] In addition, the amended rule requires that the issuer disclose any material changes in a supplement to the preliminary prospectus that must be filed with the SEC at least 48 hours before the date and time of the first sale.

Second, the SEC has adopted new Securities Act Rule 430D, which provides the specific framework for ABS shelf offerings. This new rule is similar to Rule 430B, which previously governed ABS shelf offerings, but is designed to be more tailored to such offerings.

Third, the SEC has adopted Forms SF-1 (non-shelf registrations) and SF-3 (shelf registrations) as the new registration forms for ABS, in lieu of Form S-1 and S-3, respectively. The new forms are largely based on Forms S-1 and S-3, but again are tailored to the requirements of ABS.

Fourth, one of the existing conditions for ABS shelf registration is that the securities be rated investment grade by an NRSRO. In accordance with Section 939A of the Dodd-Frank Act, the SEC has removed this condition and instituted the following new transaction-related requirements for shelf offerings:

- A certification filed at the time of each takedown by the chief executive officer of the depositor concerning the disclosure contained in the prospectus and the structure of the securitization;
- A provision in the underlying transaction agreements requiring review of the assets for compliance with the representations and warranties following a specific level of defaults and security holder action; [14]
- A provision in the underlying transaction agreements requiring repurchase request dispute resolution; [15] and
- A provision in the underlying transaction agreements to include in ongoing distribution reports on Form 10-D a request by an investor to communicate with other investors. [16]

Fifth, in addition to these transaction-related requirements, the SEC has adopted registrant requirements providing that to the extent the depositor or any issuing entity that was previously established by the depositor, or any affiliate of the depositor is or was at any time during the twelve month look-back period required to comply with the transaction requirements of Form SF-3 with respect to a previous offering of ABS involving the same asset class, then such depositor, each such issuing entity, and any affiliate of the depositor, must have timely filed all required certifications and all transaction agreements that contain the required provisions relating to the asset review provision, dispute resolution, and investor communication. In addition, the registrant must disclose in the prospectus that it has met the registrant requirements.

Sixth, an ABS issuer with an effective shelf registration statement must evaluate whether the depositor, any issuing entity previously established by the depositor, or any affiliate of the depositor was required to report under the Exchange Act during the previous twelve months for ABS involving the same asset class, and have filed such reports on a timely basis. In addition, in order to conduct a takedown off an effective shelf registration statement, an ABS issuer must evaluate, as of 90 days after the end of the depositor's fiscal year end, whether it meets the registrant requirements.

Finally, the SEC has amended Securities Act Rule 415 to limit the registration of continuous ABS offerings to "all or none" offerings. [17] It has also amended this rule to require that offerings of mortgage related securities be eligible for shelf registration only if, like other ABS, they meet the registrant and transaction requirements for shelf registration on new Form SF-3.

B. Other Related Changes

In addition to the changes related to shelf registration described above, the SEC has:

- removed from Exchange Act Rule 15c2-8(b) the exception for ABS, so that a broker or dealer must deliver a preliminary prospectus at least 48 hours before sending a confirmation of sale for all offerings of ABS;
- eliminated the current practice in shelf ABS offerings of providing a base prospectus and prospectus supplement; going forward, ABS issuers must file a form of prospectus at the time of effectiveness of the Form SF-3 and a single prospectus for each takedown;
- adopted amendments to permit ABS issuers to pay registration fees as securities are offered off a registration statement as opposed to paying all registration fees upfront at the time of filing a registration statement on Form SF-3; and
- codified in these rules some of its longstanding positions related to ABS. [18]

III. Additional Matters

A. Transaction Documents

Currently, some ABS issuers file transaction agreements days or weeks after the shelf offering of securities. Under the final rules, the exhibits filed with respect to an ABS offering must be on file and made part of the registration statement at the latest by the date the final prospectus is filed. This approach follows the 2010 Proposal. The 2011 Proposal went further in this regard, and would have required ABS issuers to file copies of the underlying transaction documents, in substantially final form, by the date the preliminary prospectus would be required to be filed. As noted below, the SEC has left open the possibility of acting on the 2011 Proposal in the future.

B. Definition of Asset-Backed Security

A security must meet the Regulation AB definition of "asset-backed security" to use the Regulation AB disclosure regime and be eligible for shelf registration as an asset-backed security. [19] The SEC has amended this definition to limit the scope of the prefunding exception, which will result in applicable asset pools being more developed at the time of the offerings. Specifically, the maximum percentage of offering proceeds (or, for master trusts, the principal balance of the total assets) that may be used for prefunding has been reduced from 50% to 25%.

C. Exchange Act Reporting

In connection with ABS issuers' Exchange Act reporting requirements, the SEC has amended:

- Regulation AB to require Form 10-D delinquency disclosures to be presented in accordance with Item 1100(b) of Regulation AB with respect to presenting delinquencies in 30- or 31-day increments (currently, delinquency reporting on Form 10-D is subject to a different standard);
- the instructions to Form 10-D to specify that previously reported information need not be reported again, provided that the issuer properly identifies the form or report containing the previously filed information;
- Form 10-D to require disclosure if there has been a material change in the sponsor's interest in the securities (e.g., due to purchases or sales of the securities by the sponsor or an affiliate) during the period covered;
- Regulation AB to require disclosure in the body of the annual report as to whether an identified material instance of noncompliance with servicing criteria was determined to have involved the servicing of the assets backing the ABS covered in the particular Form 10-K report, along with disclosure concerning any steps taken to remedy a material instance of noncompliance previously identified; and
- Forms 10-D, 10-K, and 8-K [20] for ABS issuers to require the CIK number of the depositor, the issuing entity, and, if applicable, the sponsor, to make it easier to locate registration statements and periodic reports associated with a particular offering.

IV. Effective Dates and Implementation

The amendments become effective 60 days after publication in the Federal Register. Other than the new asset-level disclosure requirements, ABS issuers must comply with new rules, forms, and disclosures no later than one year after the effective date. ABS offerings backed by residential and commercial mortgages, auto loans, auto leases, and debt securities (including resecuritizations) must comply with the asset-level disclosure requirements no later than two years after the effective date.

V. Outstanding Items from the 2010 and 2011 Proposals

The SEC did not act on several items from the 2010 and 2011 Proposals. The most noteworthy are the following:

- Requiring issuers to provide the same disclosure for Rule 144A offerings as required for registered offerings; [21]
- Making the general asset-level requirements applicable to all asset classes and asset-class specific requirements for equipment loans and leases, student loans, and floorplan financings;
- Requiring grouped-account disclosure for credit and charge card ABS;
- Filing of a waterfall computer program of the contractual cash flow provisions of the securities; and
- Requiring the transaction documents, in substantially final form, be filed by the date the preliminary prospectus is required to be filed. [22]

The SEC states in the Release that these proposals remain open.

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endnotes

[1] See Asset-Backed Securities Disclosure and Registration, SEC Release Nos. 33-9638, 34-72982 (Sept. 4, 2014) (the "Release"), available at www.sec.gov/rules/final/2014/33-9638.pdf.

[2] See Asset-Backed Securities, SEC Release Nos. 33-9117, 34-61858 (Apr. 7, 2010)(the "2010 Proposal"). For a summary of the 2010 Proposal, see ICI memorandum, dated April 28, 2010. ICI's comment letter on the 2010 Proposal is available at www.ici.org/pdf/24465.pdf.

[3] See Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment, SEC Release Nos. 33-9244, 34-64968 (July 26, 2011) (the "2011 Proposal"). For a summary of the 2011 Proposal, see ICI Memorandum, dated August 11, 2011.

[4] ICI's comment letter on the 2011 Proposal is available at www.sec.gov/comments/s7-08-10/s70810-212.pdf.

[5] However, ABS transaction agreements will sometimes require that issuers provide investors with (non-standardized) asset-level information as well.

[6] The SEC states in the Release that it is continuing to consider the best approach for requiring information about underlying assets for the remaining asset classes covered by the 2010 Proposal.

[7] New Schedule AL in new Item 1125 of Regulation AB (the source of disclosure items and requirements applicable to ABS filings under the Securities Act and Securities Exchange Act of 1934 (the "Exchange Act")) enumerates all of these asset-level disclosure requirements by asset class. For example, for residential mortgage-backed securities, an issuer must provide 270 data points for each asset of the pool, which includes information about the property (e.g., type, geographic location, valuation), the mortgage, the obligor's creditworthiness (e.g., credit score information, length of employment, debt-to-income ratio), original and current mortgage terms (e.g., loan modification information), and loan performance information.

[8] Some commenters expressed concern that if the asset-level information were overly specific, it, together with other publicly available information (e.g., information available through real property databases), could be used to "re-identify" the obligors in ABS pools, and thus reveal their personal financial information.

[9] Issuers must provide this ongoing asset-level information at the time of each Form 10-D filing. Issuers of ABS use Form 10-D for Exchange Act distribution reports. Issuers must provide the same set of data points in the ongoing filings as they do in prospectus filings, although any changes to the assets in the pool (e.g., substitutions of assets) would have to be reflected.

[10] Currently, an originator (apart from the sponsor or its affiliates) is identified only if it

has originated, or expects to originate, 10% or more of the pool assets. Under the final rules, Regulation AB also requires that if the cumulative amount of originated assets by parties, other than the sponsor or its affiliates, comprises more than 10% of the total pool assets, then any originator(s) originating less than 10% of the pool assets must also be identified in the prospectus.

[11] Static pool information indicates how groups, or static pools, of assets, such as those originated at different intervals, are performing over time.

[12] Currently, Regulation AB requires disclosure of certain financial information regarding significant obligors of an asset pool and significant credit enhancement providers relating to a class of ABS, but creates exceptions if pool assets and the enhancement provider, respectively, were rated investment grade by a nationally recognized statistical rating organization ("NRSRO"). These exceptions have been removed. The SEC states in the Release that these changes are consistent with Section 939A of the Dodd-Frank Act, which requires it to remove references to credit ratings in its rules.

[13] ICI, in its comment letters, supported the proposed five business day period, but indicated that a three day period would suffice.

[14] The SEC's concern behind this provision is that transaction agreements have not typically had specific mechanisms for identifying breaches of representations and warranties made by sponsors or originators regarding pool assets, or for resolving a question as to whether a breach has occurred. The agreements must require a review, at a minimum, upon the occurrence of a specified percentage of delinquencies in the pool, and if the delinquency trigger is met, then upon direction of investors by vote. Once both prongs have been met, a review must be conducted of all assets that are 60 or more days delinquent as reported in the most recent periodic report, at a minimum, for compliance with the related representations and warranties. A summary of the reviewer's report must be included in the Form 10-D filing. The agreements must provide for the selection and appointment of the reviewer, and information about the reviewer must be disclosed in the prospectus.

[15] The transaction agreements must provide that if an asset subject to a repurchase request pursuant to the terms of the agreements is not resolved by the end of the 180-day period beginning when notice is received, then the party submitting such repurchase request will have the right to refer the matter, at its discretion, to either mediation or third-party arbitration.

[16] Investors had raised concerns to the SEC about their inability to locate other investors and enforce their rights. The disclosure in Form 10-D is required to include no more than the name of the investor making the request, the date the request was received, a statement that the party responsible for filing the Form 10-D has received a request from such investor, stating that such investor is interested in communicating with other investors about the possible exercise of rights under the transaction agreements, and a description of the method by which other investors may contact the requesting investor.

[17] In an "all or none" offering, the transaction is completed only if all of the securities are sold. ABS offerings are typically not conducted as continuous offerings.

[18] For example, new Securities Act Rule 430D requires that an ABS issuer file a post-effective amendment to the registration statement to add information about new structural

features or credit enhancements that were not described in the effective registration statement.

[19] Item 1101(c)(1) of Regulation AB defines an asset-backed security in relevant part as "a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets…that by their terms convert into cash within a finite time period…" The definition has exceptions to this "discrete pool" requirement for prefunding periods, among others. The prefunding exception allows issuers to use a portion of the offering proceeds for future acquisitions of pool assets, subject to certain conditions.

[20] An issuer must file a report on Form 8-K upon the occurrence of a reportable event described in Form 8-K, typically within four business days of the event.

[21] ICI generally supported this proposal, although we (i) recognized the differences among the various types of structured finance products and recommended that the SEC evaluate them on a product-by-product basis, and (ii) were concerned about the implications of the proposal for asset-backed commercial paper and tender option bonds and recommended that they be excluded from any new disclosure requirements.

[22] ICI supported this proposal because of the critical information it would provide investors prior to making an investment decision. As noted above, the SEC adopted amendments requiring that these transaction documents be filed by the date the final prospectus is filed, but opted not to go further.
