

JANUARY 21, 2011

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SEC Adopts Rules Requiring Asset-Backed Issuers to Review Securitized Assets and Disclose Asset Repurchase History; Rating Agencies Required to Report on Representations and Remedies in Securitizations

The SEC on January 20 adopted several final rules applicable to securitization transactions, some of which apply to both SEC-registered transactions and private placements of asset-backed securities. The new rules, which were mandated under the Dodd-Frank Act and were proposed for comment by the SEC in October 2010, are:

Issuer Review of Securitized Assets and Disclosure of Findings

A new rule under the Securities Act that requires issuers of SEC-registered asset-backed securities (ABS) to *review the underlying assets*, and a revision to Item 1111 of Regulation AB that requires the issuer to *disclose the nature of that review and its findings and conclusions*.

- “Issuer” for this purpose means the depositor or sponsor of the ABS transaction.
- As originally proposed, the rule did not prescribe any minimum standard for the asset review—an issue that divided the Commission. The adopted rule requires that the review be *designed and effected to provide reasonable assurance that the asset disclosure is accurate in all material respects*, a requirement that several Commissioners continue to question as neither required by Dodd-Frank nor necessary in light of the existing Securities Act liability standards.
- The required disclosure must describe how any assets included in the pool deviate from the disclosed underwriting criteria and which transaction party decided to include them nonetheless.
- The new requirements apply to registered offerings of ABS commencing after December 31, 2011.
- Like the proposed version, the final rule permits an issuer to engage a third party to perform the review. While the SEC had originally proposed that any such third party would need to consent to be named as an “expert” in the registration statement, the

final rule requires this only if the issuer attributes the findings and conclusions to the third party; if the issuer adopts them as its own, no expert's consent is necessary.

- Because of the inherent conflict of interest, issuers may not rely on a third-party review by the originator of the assets unless the originator is affiliated with the issuer.
- The SEC postponed further consideration of their previously proposed rule to implement a separate Dodd-Frank mandate requiring issuers and underwriters of ABS to make publicly available the findings of any third-party diligence report they obtain.
- The adopting release includes a discussion that may signal a retreat from the SEC's April 2010 proposal that the private placement safe harbors from Securities Act registration be unavailable to ABS offerings unless the issuer agrees to provide investors the same information it would be required to provide in a registered transaction.

Issuer Disclosure of Fulfilled and Un-Fulfilled Repurchase Requests

A new rule under the Securities Exchange Act that requires "securitizers" (which includes issuers, sponsors, underwriters and depositors) of ABS (whether or not the ABS is registered with the SEC) to *disclose historical information on asset put-backs on an ongoing basis*.

- "ABS" for this purpose is defined very broadly and includes, for example, CDOs, GSE-issued or guaranteed securities, and asset-backed municipal securities.
- However, the requirement applies only if the underlying transaction agreements require the securitizer to repurchase or replace assets for breaches of representations and warranties. For that reason, the new requirement will likely be irrelevant to most CDOs and many municipal transactions even if they qualify as ABS.
- The rule requires securitizers to disclose in an SEC-mandated tabular format, by asset class and asset originator, total securitized assets; how many were subject to repurchase demands; how many of those were repurchased or replaced; how many repurchase requests are pending; and how many demands are disputed, were withdrawn or rejected.
- The SEC has created a new form for this reporting, which is required to be filed on the SEC's EDGAR system (including by securitizers who are not otherwise SEC filers). Issuers of SEC-registered ABS will also need to make related disclosures in prospectuses and in their Form 10-D filings.

- The initial filing is required to include aggregate data for the three-year period ending December 31, 2011. Any securitizer involved in a securitization with a repurchase covenant at any time during those three years, and who has any such ABS outstanding at the end of 2011, will be required to make its initial filing by February 14, 2012.
- Thereafter, the activity for each quarter must be reported on the form within 45 days of quarter end.

Rating Agency Reports for ABS Required to Describe and Compare Representations and Enforcement Mechanisms

A new Securities Exchange Act rule under which any rating report by a nationally recognized statistical rating organization (NRSRO) relating to an ABS must *describe the representations, warranties and enforcement mechanisms available to investors and describe how they differ from those in similar ABS issuances.*

- This new rule applies to all ABS transactions rated by an NRSRO, whether or not registered with the SEC and whether or not offered in the United States.
- The disclosure must be provided in reports for both final ratings and preliminary or expected ratings, including pre-sale reports.
- This requirement will become effective in late September 2011.

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The final rule relating to issuer review of assets is available at <http://www.sec.gov/rules/final/2011/33-9176.pdf>.

The final rules relating to issuer disclosure of repurchase requests and rating agency reports on representations and enforcement mechanisms is available at <http://www.sec.gov/rules/final/2011/33-9175.pdf>.

If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Structured Finance under the “Practices” section of our website at <http://www.clearygottlieb.com>.

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