

Structured Finance Alert

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SEC Adopts Final Regulation AB II Rules

On August 27, 2014, the Securities and Exchange Commission ("SEC") adopted final rules ("ABS Final Rules") that significantly revise the existing regulations that govern disclosure requirements, offering processes and periodic reporting for asset-backed securities (commonly referred to as "Regulation AB"). The ABS Final Rules were adopted in part in response to the requirements of Sections 939A and 942(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The implementing release for the ABS Final Rules states that the rules are intended to provide investors with timely and sufficient information, to reduce the likelihood of undue reliance on credit ratings and to provide mechanisms to help enforce representations and warranties made about the underlying assets.

The draft of the ABS Final Rules, which are pending a "major rule" analysis by the Office of Management and Budget, can be found here: <http://www.sec.gov/nb/reg-ab-adopting-release-draft.pdf>.

BACKGROUND

In April 2010, the SEC proposed sweeping revisions to Regulation AB, including provisions requiring disclosure of loan-level data for most asset classes, expanding the scope of the rules to apply to asset-backed securities and other structured finance products sold in most private offerings and imposing new conditions for shelf eligibility. In July 2011 a re-proposal of certain portions of these rules was released to respond to both the Dodd-Frank Act and comments received with respect to the original proposal and included revised conditions for shelf eligibility. Early this year, the SEC announced that there would be a vote on final rules at an open meeting. Instead, in February the SEC reopened the comment period on the earlier proposals and released a staff memorandum regarding the posting of asset-level data on issuer-maintained websites in response to concerns that making loan-level data available through the SEC's EDGAR system could result in the disclosure of personally identifiable consumer information. The proposals to revise Regulation AB have been commonly referred to as Regulation AB II.

CERTAIN ASPECTS OF THE PRIOR PROPOSALS HAVE NOT BEEN ADDRESSED AND REMAIN OUTSTANDING

The ABS Final Rules do not address a number of changes to Regulation AB that were proposed in 2010 and 2011. The SEC notes that these proposed changes remain outstanding and may be implemented in the future. Private offerings are notably not encompassed by the ABS Final Rules. Further, as noted below, the adopted asset-level data requirements apply only to specified asset classes, but not to student loans, equipment loans and leases or to credit cards and charge card securitizations for which grouped account data requirements had been proposed in 2010. The ABS Final Rules also do not require the filing of a waterfall computer program of the contractual cash flow provisions, as proposed in 2010.

The rules proposed in 2010 would have been applicable to all “asset-backed securities” as defined in Regulation AB and all “structured finance products,” a much broader term intended to encompass securitizations of managed pools of assets as well as the discrete pools encompassed by the “asset-backed securities” definition. The ABS Final Rules do not extend to the broader range of structured finance products but are limited to the narrower instruments that constitute asset-backed securities, a term that has been further narrowed in the ABS Final Rules to limit the amount of permissible pre-funding.

SUMMARY OF PRINCIPAL NEW REQUIREMENTS AND REVISIONS

Asset-Level Data Requirements Now Apply to Commercial and Residential Mortgage Loans, Auto Loans and Leases and Bonds

In response to the requirements of Section 942(b) of the Dodd-Frank Act, the ABS Final Rules require issuers of asset-backed securities (“ABS”) backed by residential mortgages, commercial mortgages, auto loans, auto leases and debt securities (including resecuritizations involving these asset classes) to provide standardized asset-level information. The asset-level data must be filed with the SEC on EDGAR and presented in a standardized, tagged data format called eXtensible Mark-up Language (XML) in both offering documents and periodic reports, and it must contain enumerated data points, each complying with specified disclosure requirements relating to the characteristics of the underlying assets, including (i) the credit quality of the obligors on the underlying assets, (ii) the collateral related to each asset and (iii) the cash flows related to a particular asset, such as the timing and amount of payments and any expected changes to payment terms over time. The implementing release explains that certain asset-level disclosures included in the 2010 proposal have been modified or omitted for residential mortgage-backed securities and auto loan/lease ABS to reduce the amount of potentially sensitive data about underlying obligors and the potential privacy risk that obligors could be identified.

New Shelf Registration Eligibility Requirements

The requirement that ABS be rated investment grade in order to be eligible for shelf registration has been eliminated by the ABS Final Rules and replaced with the following criteria:

- The depositor’s CEO must provide a certification at the time of each offering from a shelf registration statement that he or she has reviewed the prospectus and is familiar in all material respects with the characteristics of the securitized assets, the structure of the securitization and all material transaction agreements, and that the prospectus fairly presents such asset characteristics, such structure and the risks of ownership of the offered ABS. The CEO must further certify that, based on his or her knowledge, taking into account the key aspects of the securitization described in the preceding sentence, there is a reasonable basis to conclude that the securitization is structured to produce, but is not guaranteed to produce, expected cash flows at times and in amounts to service scheduled payments of interest and the ultimate repayment of principal on the securities in accordance with their terms as described in the prospectus. Finally, the certification is permitted to be qualified by a statement that it is given subject all defenses available under the federal securities laws.
- The governing transaction agreements must (i) contain a dispute resolution mechanism and (ii) require the appointment of an “assets representation reviewer” responsible for conducting a review of the underlying assets for compliance with the representations and warranties made with respect to the assets following the occurrence of certain trigger events.
- Requests by investors to communicate with other investors must be disclosed.

In addition, the ABS Rules require ABS issuers using a shelf registration to file a preliminary prospectus containing transaction-specific information at least three business days in advance of the first sale of securities in the offering (in contrast to the five business days that had been proposed in 2010), in order to give investors time to analyze the structure, underlying assets and contractual rights of the transaction.

Other Changes to the Registration Process

Additional changes to the procedures, forms and disclosure related to registration of ABS include: (i) a new pay-as-you-go registration fee alternative; (ii) new Forms SF-1 and SF-3, with disclosure requirements specific to ABS issuers in place of Forms S-1 and S-3 used by corporate filers; (iii) a prohibition on the use of a base prospectus and supplements, and a requirement to use a single prospectus that must be filed for each shelf takedown (though it is permissible to highlight material changes from the preliminary prospectus in a separate supplement to the preliminary prospectus 48 hours prior to the first sale); (iv) expanded disclosure about transaction parties, including the sponsor's retention of any economic interest in the transaction and financial information about parties who may be required to repurchase assets that fail to comply with representations and warranties; (v) a description of how the underlying assets may be modified; and (vi) a requirement to file final transaction documents not later than the date of the final prospectus (in contrast to filing of substantially final documents by the date of the preliminary prospectus, as proposed in 2010).

Exchange Act Reports

The ABS Final Rules contain revisions to the required disclosures for ABS under Form 10-D and Form 10-K. Form 10-D will require modified standardized presentation of delinquencies, disclosure of changes in the sponsor's interest in the offered ABS and revised rules regarding cross-referencing information from other filings. The SEC has also adopted modifications to Form 10-K disclosure with respect to material instances of noncompliance and is codifying certain staff interpretations relating to the servicer's assessment of compliance with servicing criteria.

IMPLEMENTATION TIMELINE

The general effective date for the ABS Final Rules will be 60 days after their publication in the Federal Register.

Issuers of publicly registered ABS will be required to use new Forms SF-1 and SF-3 and comply with new rules, disclosure requirements and shelf eligibility criteria applicable to registered ABS offerings starting one year after the effective date of the ABS Final Rules.

Offerings of ABS backed by residential and commercial mortgages, auto loans and leases and debt securities must comply with asset-level disclosure requirements no later than two years after the effective date of the ABS Final Rules.

Issuers filing periodic reports on Forms 10-D and 10-K must comply with revised disclosure requirements (other than asset-level disclosures) starting one year after the effective date of the ABS Final Rules.

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We have provided above only a brief summary of certain of the significant provisions of the lengthy ABS Final Rules release. We will provide a detailed analysis of the contents and expected impact of the ABS Final Rules in the coming weeks.