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SEC Adopts Long Awaited Rules for Asset-Backed Securities

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Earlier this week, the SEC adopted significant changes to Regulation AB, which governs the offering process and disclosure and periodic reporting requirements for public offerings of asset-backed securities, including residential mortgage backed securities (RMBS). The revisions to Regulation AB were a long time coming—they were first proposed in 2010 and have drawn several rounds of comments from industry participants. Issuers must comply with the new rules no later than one year after publication in the Federal Registrar (or two years in the case of the asset-level disclosure requirements described below). The new rules do not address "risk retention" by sponsors which is the subject of a separate rule-making process.

The new Regulation AB provides for enhanced disclosure, including a new requirement to provide asset-level information for certain types of asset-backed securities (including RMBS) in both the prospectus and periodic reports. The disclosure is required to be made in a special machine readable format to facilitate investor analysis.

Another key set of changes are new eligibility criteria for shelf offerings of asset-backed securities, including an "independent" third party reviewer of representations and warranties, a dispute resolution procedure for repurchase requests and a new certification requirement. The reviewer will be named in the prospectus and cannot be affiliated with the sponsor, depositor, servicer, trustee or any of their affiliates or be the party that performs pre-closing diligence. The reviewer will assess the accuracy of representations and warranties made in the securitization documents upon the occurrence of the following triggers: (1) a specified threshold of delinquencies in the pool and (2) a specified threshold vote of the interest-holders to initiate a review. The thresholds will be specified in the transaction documents for each individual securitization; there are no specified requirements other than maximum thresholds of 5% of the total interests in the pool to initiate a vote and a simple majority of interests casting a vote for approval. If a review is triggered, it will include, at a minimum, all assets that are 60 days or more delinquent and a report to the trustee who will then determine whether to make a repurchase request. If a repurchase request is not resolved in 180 days, the party submitting the repurchase request may elect to pursue resolution through arbitration or mediation.

The new certification is required to be provided by the chief executive officer of the depositor at the time of the offering. The certification covers the absence of material misstatements or omissions, the prospectus fairly presenting the structure of the securitization and related risks, and there being a reasonable basis to conclude that the securitization is structured to produce the expected cash flows in accordance with the terms described in the prospectus. The SEC has clarified that the certification is not a guarantee and that the certifying officer would have the same defenses available to a person signing a registration statement.

The SEC hailed the rules as reforms designed to enhance transparency and investor protection, and to facilitate capital formation in the securitization market. Whether they succeed in bringing issuers and investors back into what has been a tepid market remains to be seen as many of the new rules will likely impose additional costs on issuers and investors. It also remains to be seen how the new Regulation AB fits with the sometimes stated national housing policy of encouraging mortgage originations in the private sector, consistent with the recognition that a functioning RMBS market is an essential element of revitalizing private lending.