



STRUCTURED FINANCE AND SECURITIZATION UPDATE

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Summary of SEC Proposals Regarding Asset-Backed Securities and Other Structured Finance Securities

On April 7, 2010, the SEC unanimously approved for public comment proposed rules (the "proposed rules") that would significantly modify and expand the regulations governing structured finance securities.¹ Comments on the proposed rules are due 90 days after their publication in the *Federal Register*.

Among other things, the proposed rules would:

- revise the registration process for asset-backed securities under the Securities Act of 1933 (the "Securities Act"), including by replacing the current investment grade rating requirement for shelf registration with an alternative set of requirements, including a 5% risk retention requirement and the obligation to file reports under the Securities Exchange Act of 1934 (the "Exchange Act") on an ongoing basis (even when the obligation to file is suspended under the Exchange Act);
- significantly expand the disclosure requirements applicable to registered offerings of asset-backed securities, including extensive asset-level or grouped account data and a waterfall computer program, and provide for a 5-business day waiting period for the sale of shelf-registered securities during which investors would have the opportunity to review such disclosures; and
- condition the availability of the Rule 144A and Regulation D safe harbors for private placements of asset-backed securities and a broad array of other "structured finance products" (such as CDOs, asset-backed commercial paper and synthetic asset-backed securities) on the transaction documents requiring the issuer to provide investors, upon request, with the same information that would be required to be provided in a public offering.

Introducing the proposed rules, SEC Chairman Mary L. Schapiro said "[t]he proposed rules are intended to better protect investors in the securitization market by giving

¹ The 667-page proposing release (the "proposing release"), including the text of the proposed rules, is available at: <http://www.sec.gov/rules/proposed/2010/33-9117.pdf>. The archived webcast of the SEC's April 7, 2010, public meeting is available at: <http://www.sec.gov/news/openmeetings/2010/040710openmeeting.shtml>.

them more detailed information about pooled assets, more time to make their investment decisions, and the benefits of better alignment of the interests of issuers and investors through a retention or ‘skin in the game’ requirement. Finally, the rules would bring greater transparency to the private market as well.” Although the proposed rules were unanimously approved for public comment, certain of the SEC commissioners, including Commissioner Kathleen L. Casey and Commissioner Troy A. Paredes, expressed reservations regarding some of the proposals. In particular, both Commissioner Casey and Commissioner Paredes questioned whether risk retention should be more thoroughly analyzed before imposing it as a requirement for shelf eligibility. With respect to the private placement reform proposals, both commissioners questioned the SEC’s apparent abandonment in the context of structured finance securities of its traditional position that sophisticated investors do not require the same protection as investors in registered securities offerings. The two commissioners also expressed concern that Fannie Mae, Freddie Mac and Ginnie Mae (each of whose asset-backed securities are exempt from registration under the Securities Act and therefore would not generally be subject to the proposed rules) would be accorded an unfair competitive advantage as a result of the proposed rules.

The proposed rules follow months of debate in Congress regarding financial regulatory reform, including reforms aimed at securitization. The most recent of such reform proposals, the Wall Street Reform and Consumer Protection Act of 2009 passed by the House of Representatives in December 2009, and the Restoring American Financial Stability Act of 2010, re-proposed by Senator Christopher Dodd in March 2010, both include a 5% risk retention requirement and would require asset-level disclosure in offerings of asset-backed securities. In addition, the Federal Deposit Insurance Corporation (“FDIC”) has issued an Advance Notice of Proposed Rulemaking (“ANPR”) which proposes a number of securitization reforms (including risk retention and asset-level disclosure) as part of proposed changes to its securitization conservatorship and receivership safe harbor rule for FDIC-insured depository

institutions. Whether and how these various proposals will be harmonized remains to be seen.²

In this Sidley update, we summarize certain significant provisions of the proposed rules.

A. The Registration Process for Asset-Backed Securities under the Securities Act

Under the current asset-backed securities rules, asset-backed securities may be offered on an individual basis on Form S-1 or, if they meet certain requirements, on a shelf basis on Form S-3. Form S-3 permits an issuer to register securities using a base prospectus and forms of prospectus supplements included at the time of effectiveness. Unlike Form S-1, which requires review by the SEC of the prospectus describing the specific securities to be issued in the transaction, Form S-3 and Rule 430B enable an asset-backed securities issuer to offer securities in a takedown without SEC review of the prospectus supplement describing such securities. This permits issuers to quickly offer and issue asset-backed securities in multiple offerings once the SEC has declared the Form S-3 registration statement effective. Shelf registration of asset-backed securities on Form S-3 requires, among other things, that such securities be rated investment grade by a nationally recognized statistical rating organization.

² Note that the proposed rules, the legislative proposals and the FDIC’s ANPR vary as to which entity must retain the credit risk, the method of retaining the credit risk (*e.g.*, a vertical or horizontal slice), whether the risk retention is allocated between different parties, when the risk retention applies (*e.g.*, in all secondary market transactions, as is the case in the House bill, only to structured finance securities transactions, as is the case in the Dodd proposal, to depository institution “securitizations” as a condition to conservatorship/receivership safe harbor treatment, as is the case in the FDIC’s ANPR, or only to “asset-backed securities” as a condition to Form SF-3 eligibility, as is the case in the proposed rules) and as to whether the risk retention requirement may be lowered, increased or eliminated entirely for certain transactions based on asset type, underwriting criteria or other considerations.

(1) New Registration Forms

The proposed rules would introduce new SF (for “structured finance”) registration statement forms for asset-backed securities. Form SF-1 would replace Form S-1 for the transaction-specific registration of asset-backed securities, while Form SF-3 would replace Form S-3 for the shelf registration of asset-backed securities. Form SF-1 differs from Form S-1 only in the removal of permission to use a summary prospectus and in the limitation on incorporation by reference to Form 8-Ks disclosing asset-level data, waterfall computer programs and static pool information required by Regulation AB. The use of the SF forms would be compulsory in registered offerings of asset-backed securities.

(2) New Shelf Eligibility Requirements

Form SF-3 would introduce significant changes compared to existing Form S-3, principally in novel eligibility requirements for use of Form SF-3. The proposed rules would limit shelf registration of “mortgage related securities” (as defined in Section 3(a)(41) of the Exchange Act) to Form SF-3, a change from the current rules, which permit shelf registration of mortgage related securities on Form S-1 as well.

(a) Transaction Requirements

In the belief that investors may have unduly relied on the ratings of asset-backed securities in purchasing such securities, the SEC proposes new transaction requirements (“transaction requirements”) in place of the investment grade condition of Form S-3. These requirements would apply only to shelf offerings; they would not apply to offerings on Form SF-1 or as conditions to the use of the Rule 144A and Regulation D safe harbors. The new transaction requirements are set forth below.

Risk Retention

The sponsor or an affiliate of the sponsor must retain (i) a minimum of 5% of the nominal amount of each of the tranches sold or transferred to investors, net of any directly related hedge

positions or (ii) for a revolving asset master trust, the originator’s interest of a minimum of 5% of the nominal amount of the securitized exposures, net of any directly related hedge positions; provided that payments on the originator’s interest are not less than 5% of the payments on the securities held by investors. The net economic interest required to be retained would be measured at the time of issuance (or at origination in the case of a revolving asset master trust) and then be required to be retained as long as non-affiliates of the depositor hold any of the issuer’s securities that were sold in the related offering. Significantly, hedge positions not directly related to the securities or exposures taken by the sponsor or affiliate would not be required to be netted. The SEC states that such positions would include hedges related to overall market movements, such as movements of market interest rates, or to the overall value of a particular broad category of asset-backed securities. The risk retention would be measured quarterly, and if not maintained, would result in a suspension of the shelf.

Under Regulation AB, a “sponsor” is defined as “the person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity” and is not necessarily the same entity as the originator of the assets in the securitization. In contrast to the risk retention requirement in the Dodd proposal, the proposed rules would not impose risk retention requirements on originators who are not also sponsors.

Third Party Review of Repurchase Obligations

The transaction documents must require each party with a repurchase obligation to provide to the trustee on a quarterly basis an opinion or certificate from an unaffiliated party assessing whether any breach of a representation or warranty asserted by the trustee with respect to any pool assets that have not been repurchased or replaced by the party, did in fact occur. The transaction documents containing the repurchase obligations must be filed on EDGAR.

Undertaking to File Exchange Act Reports on an Ongoing Basis

The registrant must undertake that (even when its obligation to file is suspended under Section 15(d) of the Exchange Act) it will continue to file all reports required under the Exchange Act (including Form 8-Ks, Form 10-Ds and Form 10-Ks) for so long as non-affiliates of the depositor hold any of the issuer's securities that were sold in a registered transaction. Section 15(d) of the Exchange Act suspends an issuer's Exchange Act reporting obligations if the issuer's securities are held by fewer than 300 persons at the beginning of a fiscal year (other than the year of issuance).

Note that this undertaking to continue filing Exchange Act reports (the "SF-3 ongoing reporting obligation") is a condition to shelf eligibility and does not amend Section 15(d) of the Exchange Act. This distinction is relevant for assessing an issuer's ability to use Form SF-3 in that an issuer's compliance with its **Exchange Act** reporting obligations is measured annually and, subject to certain limited exceptions, takes into account whether filings are made timely. In contrast, an issuer's SF-3 ongoing reporting obligation is measured quarterly and does not take into account timely filing.

Certification of Depositor's Chief Executive Officer

For each takedown, the depositor must file a certificate (in a prescribed form that cannot be varied) of its chief executive officer certifying that the pool assets backing the issuance of asset-backed securities have characteristics that provide a reasonable basis to believe that those pool assets will produce cash flows at times and in amounts necessary to service any payments on the securities. This certification is based on the chief executive officer's knowledge and takes into account any internal credit enhancements. Each certification applies to all securities described in the related prospectus regardless of whether the securities are registered.

Carryover of Certain Form S-3 Conditions

The Form S-3 conditions limiting delinquent assets and the portion of the asset pool balance attributable to residual values for leases other than motor vehicle leases would be retained in Form SF-3.

(b) Registrant Requirements

To use Form SF-3, a registrant must meet the following eligibility requirements ("registrant requirements"):

Risk Retention

If the sponsor is required to retain risk with respect to the depositor or an issuing entity previously established by the depositor or any affiliate of the depositor in connection with a previous offering of asset-backed securities on Form SF-3 involving the same asset class, at the time of filing the registration statement on Form SF-3, the sponsor must hold the required risk.

Compliance with Transaction Requirements

If the depositor or any issuing entity previously established by the depositor or any affiliate of the depositor was required to comply with the Form SF-3 transaction requirements with respect to a previous offering of securities involving the same asset class during the 12 months preceding the filing of the registration statement, the depositor and each such issuing entity must have filed all transaction documents and certificates timely and must have filed all Exchange Act reports in accordance with its SF-3 ongoing reporting obligation.

Disclosure of Compliance

The issuer must disclose in the related prospectus that it has complied with the registrant requirements.

Timely Filing of Exchange Act Reports

Consistent with current Form S-3, the depositor or any issuing entity previously established by the depositor or any affiliate of the depositor must have filed all Exchange Act reports required

pursuant to Section 13, 14 or 15(d) of the Exchange Act (the “Exchange Act reporting requirement”) and, with certain exceptions, those reports must have been filed in a *timely* manner with respect to all asset-backed securities involving the same asset class. Unlike Form S-3, current reports on Form 8-K used to update offering information under Item 6.05 must have been timely filed. As discussed above, this obligation to file Exchange Act reports under Section 13, 14 or 15(d) of the Exchange Act (in contrast to the SF-3 ongoing reporting obligation) takes into account whether the filing is made timely.

(c) Evaluation of Eligibility for Takedowns under Form SF-3

Pursuant to proposed Rule 401(g)(4), an offering of securities under an effective Form SF-3 registration statement would not be permitted if (i) any of the registrant requirements described above, other than the Exchange Act reporting requirement and the disclosure of compliance requirement, was not satisfied as of the last day of the most recent fiscal quarter prior to the offering or (ii) the Exchange Act reporting requirement was not satisfied as of 90 days after the end of the depositor’s fiscal year end prior to such offering. Ordinarily, Securities Act form eligibility is tested only at the date of filing and the time of any update to satisfy Section 10(a)(3). For asset-backed issuers, which do not file financial statements, effectively, the registrant requirements for use of Form S-3 are only tested at the time of filing of the registration statement on Form S-3.

(3) Rule 430D; Preliminary Prospectus Supplement Filing Requirement

Proposed Rule 430D would replace Rule 430B for offerings of asset-backed securities. Proposed Rule 430D would authorize the omission of certain transactional information from a Form SF-3 registration statement, subject to the requirement that the prospectus later filed under proposed Rule 424(h) includes all of the omitted information for the specific takedown, other than the offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds or other matters dependent upon the offering price.

To permit investors time to review the information regarding the transaction structure, the documents and the assets underlying the securities, proposed Rule 424(h) would require issuers of asset-backed securities registered on Form SF-3 to file a preliminary prospectus meeting proposed Rule 424(h) with the SEC at least five business days prior to the first sale of securities in the offering – resulting in a five-business day waiting period for sales of shelf-registered asset-backed securities. If the preliminary prospectus is used earlier than five business days prior to the first sale of securities, it must be filed within two business days of first use.

Any material change from the information filed in the Rule 424(h) prospectus would require a new Rule 424(h) prospectus to be filed and would re-start the five-business day waiting period before the first sale of securities could occur. For certain asset classes, the requirement to file a preliminary prospectus supplement would constitute a change from the current practice of using one or more free writing prospectuses to provide information to investors.

For purposes of determining liability under the Securities Act, (i) a Rule 424(h) prospectus would be deemed part of and included in the registration statement as of the date such prospectus is filed with the SEC or, if used earlier than the date of filing, the date it is first used after effectiveness and (ii) the final prospectus filed under proposed Rule 430D would be deemed to be part of and included in the registration statement as of the earlier of the date such final prospectus is first used after effectiveness or the date and time of the first contract of sale of securities in the offering described in the prospectus. For Section 11 liability purposes of the issuer and any person that is at that time an underwriter, the date the final prospectus is deemed to be part of and included in the registration statement will be deemed to be a new effective date of the registration statement relating to the securities offered in the takedown.

(4) Exchange Act Rule 15c2-8(b)

Rule 15c2-8(b) requires delivery of a preliminary prospectus 48 hours prior to delivery of a sales confirmation if the issuer of the securities is not subject to the reporting requirements of the Exchange Act unless the securities are asset-backed securities meeting the Form S-3 asset-backed securities transaction requirements. The proposed rules make all asset-backed securities subject to the 48-hour prospectus delivery requirement. Given that proposed Rule 424(h) would require the filing of a preliminary prospectus at least five business days prior to the time of sale in a shelf offering, this change, in and of itself, would not appear to cause an issuer to produce a preliminary prospectus supplement earlier than otherwise required by the proposed rules.

(5) Registration Statement Form of Prospectus; Adding New Structural Features, Credit Enhancement or Assets

At effectiveness, a Form S-3 registration statement covering asset-backed securities generally contains a base prospectus that describes the asset class backing the securities and the possible types of offerings, including the structural features of, or credit enhancement with respect to, the securities to be issued. One or more forms of prospectus supplement will set forth the transaction specific information with respect to a takedown. A separate base prospectus is required for each asset class or country of origin (unless the concentration of assets backed by the asset class or country of origin is less than 10% of any particular transaction). Form S-3 may be used by multiple depositors and may include multiple base prospectuses covering different asset types.

The proposed rules would require a single form of integrated prospectus for Form SF-3 registration statements limited to a single asset class and would permit use only by a single depositor. As a result, the current practice of using a base prospectus and a separate prospectus supplement would be prohibited. A Form SF-3 registration statement could not be used by multiple depositors or to issue securities backed by different asset classes. For example, the depositor in a

resecuritization of mortgage-backed securities could not use its Form SF-3 registration statement related to mortgage loans; a separate Form SF-3 for resecritizations would be required. The proposed rules also would require an issuer to file a post-effective amendment to add new structural features or credit enhancements.

(6) Pay-as-You-Go Registration

The proposed rules would enable an issuer of asset-backed securities using Form SF-3 to pay the registration fees for securities at the time the Rule 424(h) prospectus is filed with the SEC rather than prior to the time the registration statement goes effective. At present, pay-as-you-go rules are only available for automatic shelf registration statements for well-known seasoned issuers.

(7) Registration Statement Signature Pages

The proposed registration forms would require the signature of the senior officer of the depositor in charge of securitization and remove the signature requirement for the principal accounting officer or controller of the depositor.

B. Disclosure Requirements Applicable to Publicly Registered Offerings of Asset-Backed Securities

The proposed rules would substantially expand the disclosure required in a registered issuance of asset-backed securities under the Securities Act and in subsequent Exchange Act reports. Current rules generally require disclosure only at the pool level. The proposed rules generally would require asset-level disclosure (or, in the case of credit card and charge card asset-backed securities, disclosure of grouped account data), as well as the filing of a waterfall computer program, which investors could use to model cash flow waterfalls, all of which are likely to increase the time and expense of an offering. The proposed rules would also impose significant new disclosure requirements related to sponsors, originators and servicers.

(1) Asset-Level Disclosure

The proposed rules indentify 10 asset classes, each of which has specific reporting requirements with respect to asset-level data. Over 100 pages of the proposed rules are devoted to tables identifying specific data points with respect to pool assets related to various asset classes that would be required to be disclosed. Many of these data fields call for information that has not previously been disclosed by issuers in particular asset classes. In addition to the specific reporting requirements, the proposed rules would require disclosure of general data points with respect to pool assets across all asset classes.

For all asset classes other than credit cards, charge cards and stranded costs, asset-level data would be required to be provided to investors at the time of the initial offering of the securities pursuant to a preliminary prospectus, at the time of the filing of the final prospectus and on a monthly basis as part of the issuer's Form 10-D filing. For securities backed by credit cards and charge cards, grouped account data is required in lieu of asset-level data. For securities backed by stranded costs, no asset-level disclosure is proposed to be required. The asset-level data would need to be filed on EDGAR in XML format allowing it to be processed by the waterfall computer program discussed below and to be manipulated in other computer programs.

Due to concerns regarding obligor privacy, the proposed rules would only require disclosure of the range in which certain data points fall. For example, credit scores would be coded to identify the pre-defined range in which an obligor's credit score falls as opposed to disclosing the exact credit score of the obligor. Similarly, the exact location of the obligor would not be identified, rather the Metropolitan or Micropolitan Statistical Area for the obligor would be used.

(2) Waterfall Disclosure

The proposed rules would require the issuer to prepare and file on EDGAR as an exhibit to Form 8-K, at the time the 424(h) prospectus is filed, a computer program in the Python open-source programming language that gives effect to the payment

provisions contained in the transaction agreements.³ This waterfall computer program would be required to cover each class of securities in the transaction (regardless of whether the class is registered) and to take into account all of the payment provisions and other cash flows, including payments from credit enhancement or other support. The program would need to provide users the ability to input their own assumptions regarding the cash flows from the pool assets, including interest rates, default rates and prepayment speeds and to vary the amounts payable by various credit enhancement or derivative providers.

The waterfall computer program must permit a user to directly upload each asset-level data file that the issuer files on EDGAR into the program and produce a machine-readable output detailing the cash flows associated with each asset-backed security issued in the related securitization. To enable an investor to verify that the waterfall computer program is operating properly, the issuer would be required to file a sample output data file with the inputs used in creating such data file, so the investor can replicate those outputs using the waterfall computer program and the related inputs.

(3) Static Pool Information

The proposed rules would require a description of the characteristics of the static pools, any terms or abbreviations used in the static pool information, the method used in calculating and determining the characteristics of the static pools and a description of the differences in the characteristics of the asset pool for the securitization transaction and the characteristics of the asset pools included in the static pool information. Graphical illustrations depicting delinquencies,

³ The proposed rules would exclude the filing of the waterfall computer program from the continuing hardship exemption but would permit a temporary hardship exemption under Rule 201 of Regulation S-T (but subject to a website posting of the required information as opposed to a paper filing, and subject to certain other conditions). The proposed rules would apply the same exemptions to the filing of asset-level data.

prepayments and losses for each prior securitized pool or vintage origination year for amortizing asset pools would be required.

For amortizing asset pools, delinquency information (and presumably loss information) could no longer be reported in quarterly increments. Pursuant to the proposed instruction to Item 1105(a)(3)(ii), delinquency and loss information must be reported in accordance with Item 1100(b) of Regulation AB which would require, among other things, delinquencies to be reported in 30 or 31 day increments, as applicable, through the date that assets are written off or charged off.⁴ This may be problematic for some asset classes such as first-lien residential mortgage loans where a “charge off” concept does not exist, and delinquency information for these assets would need to be shown in 30 or 31 day increments through foreclosure or other liquidation. Additional explanatory information regarding how delinquencies, charge-offs and losses are determined would be required.

Under Item 1105(c) of Regulation AB, an issuer may provide disclosure other than the static pool information specified for amortizing and master trust structures if the information specified in those sections is not material but alternative information would be material. If the issuer chooses to provide alternative disclosure pursuant to Item 1105(c) of Regulation AB or does not disclose any static pool information, proposed Item 1105(c) would require the issuer to provide explanatory disclosure as to why alternative (or no) disclosure of static pool information has been provided.

The proposed rules would eliminate the exemption allowing static pool information to be maintained on an internet web site and not filed on EDGAR. Consequently, all static pool information would need to be included in the prospectus or filed on EDGAR as part of a Form 8-K that is specifically

incorporated by reference into the prospectus. For frequent issuers with a significant amount of static pool information, this requirement would be onerous as updated static pool data (in some cases, hundreds of pages of information) would need to be filed in advance of each securitization. The proposed rules would, however, permit static pool information to be filed in portable document format (PDF), which would remove the need to convert data into ASCII or HTML.

(4) Pool Asset Disclosure

The proposed rules would bolster the description of the underwriting criteria that was used to originate or purchase the pool assets including any changes in criteria. If the underwriting of any pool assets deviated from the disclosed underwriting criteria, the amount and characteristics of those pool assets must be disclosed. If the disclosed underwriting criteria refer to compensating or other factors used to determine that certain pool assets qualified for inclusion in the pool, those factors must be disclosed, and the amount of pool assets that meet and do not meet those factors must be included in the prospectus. Disclosure regarding the originator’s procedures for verifying the information that was used in originating the pool assets would be required. The proposed rules would also require express disclosure as to whether or not a representation relating to fraud in the origination of the pool assets is given, and if so, would require a description of such representation. Proposed Item 1111(e) would also require a description of any transaction document provisions governing modification of the terms of pool assets and the effect that a modification of a pool asset would have on the cash flow from the pool asset or the related securities.

(5) Disclosure Regarding Transaction Parties

The proposed rules would expand the disclosure required for sponsors, originators and servicers. For sponsors, servicers and originators that originated 20% or more of the pool assets, disclosure regarding the amount and nature of any interest retained in a securitization transaction would be required. For servicers of first-lien mortgage loans this would include any

⁴ This proposed rule would effectively retract the guidance provided in Item 5.03 of the SEC staff’s Manual of Publicly Available Telephone Interpretations related to Regulation AB.

interest in subordinate-lien mortgage loans secured by the same mortgaged properties. Additionally, if the sponsor or a 20% originator is required to repurchase or replace any pool asset as a result of a breach of a representation or warranty in the transaction documents, the proposed rules would require the sponsor or the 20% originator, as applicable, to disclose, on a pool by pool basis, (i) the amount, if material, of the publicly securitized assets originated or sold by the sponsor or the 20% originator, as applicable, that were the subject of a **demand** to repurchase or replace during the prior three years for a breach of the representations and warranties it made in the applicable transaction agreements, (ii) the percentage of that amount that were not repurchased or replaced following such demand and (iii) whether a third-party opinion was provided to the trustee confirming that the sponsor or the 20% originator, as applicable, was not required to repurchase or replace any assets that were not repurchased or replaced after a demand to repurchase or replace was made.

Disclosure of the financial condition of the sponsor or any 20% originator would also be required to the extent there is a material risk that such entity's financial condition **could** have a material impact on its ability to perform its repurchase obligations or, in the case of the sponsor, otherwise materially impact the pool and, in the case of a 20% originator, have a material impact on the origination of the originator's assets in the pool. The proposed rules do not, however, specifically require that audited financial statements of the sponsor or a 20% originator be included as part of the disclosure.

Under current Regulation AB, originators that originate 10% or more of the pool assets must be identified. Under the proposed rules, the 10% threshold would be eliminated so that every originator of pool assets would be required to be identified unless the cumulative amount of assets originated by parties other than the sponsor comprises less than 10% of the total pool assets.

Although the proposed rules would amend the servicer disclosure requirements only to include a description of any

retained interest in the transaction, the SEC notes in the proposing release its belief that Item 1108(b)(2) of Regulation AB requires disclosure of any material instance of noncompliance identified in any assessment or attestation report prepared pursuant to Item 1122 of Regulation AB or in any servicer compliance statement prepared pursuant to Item 1123 of Regulation AB, as well as disclosure of any remedial measures taken in respect of any such noncompliance and the current status of those remedial measures.

(6) Filing of Transaction Agreements

The date by which final transaction agreements must be filed on EDGAR has been an open issue for many years, and the proposed rules would finally provide a single, consistent deadline. The proposed revisions to Item 1100(f) specify that all final transaction documents that are required to be filed as exhibits to a registration statement must be filed and made a part of the registration statement (through Form 8-K or otherwise) by the date the final prospectus is required to be filed under Rule 424 of the Securities Act.

C. Definition of an "Asset-Backed Security" under Regulation AB

Under Regulation AB, the definition of "asset-backed security" determines whether an issuer can rely on the specialized disclosure regime for registration and reporting for issuers of structured finance securities. If a structured finance security qualifies as an "asset-backed security," the registration statement for its public offering under the Securities Act and the ongoing reports under the Exchange Act will be made in accordance with these rules. If a structured finance security does not meet the definition of "asset-backed security" (and the issuer does not otherwise fit within the SEC's standard corporate issuer disclosure and reporting framework) to offer securities publicly, the issuer is required to file a Form S-1, the residual form of registration. Only a subset of structured finance securities qualify as asset-backed securities. To be an asset-backed security, subject to certain exceptions, a security must be primarily serviced by the cash flows of a discrete pool

of assets that by their terms convert into cash (with a general absence of active pool management) and must also meet certain transaction requirements, such as limits on pre-funding and revolving periods, and asset restrictions, such as a prohibition on non-performing assets and limits on delinquent assets.

In light of the developments in the structured finance securities markets since the promulgation of Regulation AB in 2004, the proposed rules would further limit the types of securities that qualify as asset-backed securities. To address the SEC's concerns regarding transparency and quality of information provided to investors, the proposed rules would modify the definition of "asset-backed security" to:

- reduce the amount of proceeds that can be applied to purchase additional pool assets after closing (referred to as pre-funding) from 50% to 10% of the offering proceeds (or, in the case of a master trust, the aggregate principal balance of the total asset pool whose cash flows support the asset-backed securities);
- limit master trust structures to transactions in which the underlying assets themselves revolve, such as credit card receivables; and
- reduce the revolving period of any transaction where the assets are not revolving assets from three years to one year.

D. Exchange Act Reporting

Regulation AB generally codified existing industry practice with respect to Exchange Act reporting for registered asset-backed securities and introduced a number of new requirements, including annual certifications by parties performing a servicing function. In addition to the revisions discussed above, the proposed rules would amend certain of these Exchange Act reporting requirements on Form 10-K and Form 8-K.

(1) Form 10-K

Item 1122 of Regulation AB generally requires that any party performing a servicing function with respect to an asset-backed

securities transaction provide an annual assessment reporting its compliance with applicable servicing criteria together with an attestation of a public accounting firm reporting on the servicing party's assessment. Because parties performing servicing functions on a particular transaction frequently perform these functions on many other transactions, any failure by a servicing party to comply with the servicing criteria could have occurred with respect to one or more of the transactions. Under the proposed rules, Item 1122 would be amended to require an issuer to disclose:

- if a material instance of noncompliance occurred with respect to the particular transaction for which the Form 10-K is being filed; and
- any steps taken by the servicing party to remedy the noncompliance for all transactions for which it is the servicing party backed by the same asset class as the type of security for which the Form 10-K is being filed.

The proposed rules also would require that a servicing party's assessment cover all asset-backed securities transactions of the same asset type serviced by the servicing party or, if less than all of the transactions are covered by the assessment, provide a description of the scope of the platform included in the assessment. Item 1122 would also be amended to add a new servicing criterion with respect to the aggregation and conveyance of transaction information by a servicing party under the transaction documents.

(2) Form 8-K

Under the proposed rules, an issuer would be required to provide new Item 1111 (pool assets) and Item 1112 (significant obligor) information, if any material pool characteristic at issuance varied 1% or more (rather than 5% or more as is currently required) from the information disclosed in the final prospectus (other than through standard amortization) and to describe the changes that were made to the asset pool, including the number of assets substituted or added to the asset pool. While filing this information on Form 8-K will satisfy the

issuer's Exchange Act reporting requirement with respect to the change in pool assets, the SEC cautions that the requirements under Securities Act with respect to information provided to an investor are distinct from the Exchange Act reporting requirements. The SEC notes in the proposing release that "[w]e believe that ... the assets of the pool underlying the securities should be set and described in the prospectus. ... We remind issuers that information about significant changes in pool asset composition provided to an investor after the sale may not have been adequately conveyed at the time of sale for the purpose of Securities Act Rule 159," which provides that, for purposes of determining liability under Section 12(a)(2), the information provided to an investor after the time of sale (generally considered to be the time at which a contract of sale is formed) will not be taken into account. New pool information only disclosed on Form 8-K would not necessarily be adequately conveyed to an investor at the time of sale. The proposed rules would also require disclosure on Form 8-K of the amount of any material change in the sponsor's ownership of any securities issued in the related transaction.

E. Information Requirements for Transactions in the Private Market Relying on One of the Securities Act Offering or Resale Safe Harbors

(1) Current Rules

Because many structured finance securities, such as collateralized debt and loan obligations ("CDOs") and synthetic asset-backed securities, do not meet the definition of an "asset-backed security," they cannot easily be registered for public offering under the Securities Act. To qualify for an exemption under the Investment Company Act, many of these transactions must limit their investors either by number or by type and cannot be sold in registered offerings.⁵ While a securities offering may qualify for the private offering exemption under Section 4(2) of the Securities Act, many issuers prefer to qualify the offering (or resales) for reliance on one of the securities offering or resale safe harbors. Rule 144A

under the Securities Act ("Rule 144A") provides a resale safe harbor for a seller of a security (other than the issuer) from being deemed an underwriter under Section 2(a)(11) of the Securities Act. Rule 506 of Regulation D ("Rule 506") under the Securities Act is an issuer safe harbor under the Section 4(2) private offering exemption for transactions including sales to "accredited investors" as defined under Rule 501. Although resales of structured finance securities in the private market most commonly rely on Rule 144A, certain classes of securities might be sold to "accredited investors" at issuance in reliance on Rule 506. In both cases, the safe harbor is predicated primarily on the investor's character as a "qualified institutional buyer" under Rule 144A or an accredited investor. These rules assume that investors meeting the definitions have the requisite financial sophistication to evaluate the transaction without the need for the protection afforded through the registration process under the Securities Act.

Rule 144A may require an issuer, upon investor request, to provide the investor with certain specified information. The information specified, however, is designed for corporate issuers, and there is no specific requirement regarding the type of information to be provided by issuers of structured finance securities. Under Rule 506, no information requirement applies for sales exclusively to accredited investors.

⁵ Generally, issuers of structured finance securities sold in registered offers are exempt from Investment Company Act registration because of the nature of their underlying assets (Section 3(c)(5) of the Investment Company Act) or their transaction structure as well as their underlying assets (Rule 3a-7 under the Investment Company Act). Transactions such as CDOs that permit active reinvestment of principal proceeds may not qualify for these exemptions and instead rely on Section 3(c)(1) of the Investment Company Act or, more typically, Section 3(c)(7) of the Investment Company Act which provide an exemption from registration by limiting the number of investors or restricting the types of investors (*e.g.*, only "Qualified Purchasers" under Section 2(a)(51) of the Investment Company Act), respectively.

(2) Proposed Rules

To address the SEC's concerns regarding the limited information available to investors (and also because the SEC was explicitly concerned that the proposed rules' new disclosure requirements for registered asset-backed securities could drive transactions to the private markets), the proposed rules would condition reliance by issuers of structured finance products on the Rule 144A and Rule 506 safe harbors on the inclusion of provisions in the underlying transaction documents requiring an issuer⁶ to provide, and represent that it will provide, specified information to investors. "Structured finance products" are broadly defined to include not only "asset-backed securities" within the meaning of Regulation AB but also a broad array of other structured finance products, including (i) synthetic asset-backed securities and (ii) any fixed-income or other security collateralized by any pool of self liquidating financial assets, such as loans, leases, mortgages, and secured or unsecured receivables, which entitles the security holders to receive payments that depend on the cash flow from the assets, including:

- collateralized mortgage obligations;
- collateralized debt obligations;
- collateralized bond obligations;
- collateralized debt obligations of asset-backed securities;
- collateralized debt obligations of collateralized debt obligations; or
- any security that at the time of the offering is commonly known as an asset-backed security or a structured finance product.

⁶ Note while the SEC states that it intends these rules to apply to the issuer as defined in Rule 191 of the Securities Act under which the depositor is considered a separate issuer with respect to the securities of each issuing entity, this framework may not be appropriate without further guidance for many private transactions, such as CDOs, which may not have a clearly identified depositor (or even a sponsor in the absence of a depositor).

In the proposing release, the SEC notes that the definition of "structured finance product" would also include asset-backed commercial paper. The breadth of the definition could, in certain cases, make determining what is and what is not a "structured finance product" difficult. For example, given such breadth, trust preferred and certain other hybrid capital securities, certain structured notes and certain hedge-fund- or other pooled investment vehicle- issued securities, could arguably be considered "structured finance products."

To allow reliance on Rule 144A, the proposed rules would require the transaction documents to grant any investor or prospective investor designated by an investor the right to obtain from the issuer promptly, upon request of the investor or prospective investor, information that would be required if the offering were registered on Form SF-1 in the case of Regulation AB "asset-backed securities," and otherwise, Form S-1, and any ongoing information that would be required by Section 15(d) of the Exchange Act if the issuer were required to report under that section and include a representation by the issuer that it will provide such information. Additionally, within 15 days of the first sale of securities that would rely on Rule 144A for resales, the issuer would be required to file on EDGAR a signed notice of the initial placement of such securities on Form 144A-SF. Form 144A-SF would require information regarding the identity of the principal parties, the type and amount of securities being sold, the underlying assets, the capital structure and the transaction structure. If the issuer fails to file the Form 144A-SF, Rule 144A would not be available for subsequent resales of newly issued structured finance products of the issuer or any affiliate of the issuer until the required notice has been filed with the SEC.

The SEC notes in the proposing release that an issuer would be required to provide the information required by Regulation AB as well as all other relevant information required under Regulation S-K of the Securities Act. For many transactions, particularly CDOs and synthetic transactions, the requirement to provide the information required under Regulation AB

would constitute a significant change both with respect to disclosure and reporting, as well as the servicing assessments and attestations that must be provided under the asset-backed securities reporting regime. The requirement to provide information on an ongoing basis in connection with the use of the Rule 144A safe harbor would apply even if the issuer were entitled to cease reporting under Section 15(d), which would result in a private issuer being obligated to provide more information than a public issuer using Form SF-1.

The proposed rules would also amend Rule 144 under the Securities Act (“Rule 144”) (a resale safe harbor under Section 4(1) of the Securities Act) to provide that, to meet the current public information requirement of Rule 144 for structured finance products, the transaction documents must contain the provisions described above with respect to resales under Rule 144A. The information requirement of Rule 144 applies to sales of restricted securities made by unaffiliated persons in the period beginning six months after purchase and ending on the anniversary of purchase and to any sales of restricted or control securities made at any time by affiliates of the issuer.

In the case of an offering relying on Rule 506, the same information that would be required if the offering were registered on Form SF-1 in the case of “asset-backed securities” under Regulation AB, and otherwise, Form S-1, would be required to be provided upon the request of an investor at a reasonable time prior to the sale. Form D would be revised to require information similar to that required by proposed Form 144A-SF described above. Because Rule 506 is an offering (and not, like Rule 144A, a resale) exemption, information would be required to be provided only to initial investors in the offering and not to subsequent transferees. Unlike the proposed Rule 144A requirement, there would be no requirement in a Rule 506 offering to provide the ongoing information that would be required by Section 15(d) of the Exchange Act.

In each case, delivery of the information itself is not a condition to the safe harbor; the safe harbor is conditioned on the

inclusion in the transaction documents of the specified provisions. As a result, while failure to provide the information would constitute a breach under the relevant transaction documents, it would not, by itself, constitute a violation of Section 5 of the Securities Act. However, the SEC asserts in the proposing release that the failure to provide the information could constitute fraud and form the basis for an SEC enforcement action. Proposed Rule 192 would require each issuer that has made the representations specified above with respect to any of Rule 144A, Rule 506 or Rule 144, to provide the information upon request of the purchaser or investor. Under proposed Rule 192, failure to provide the information would constitute an engagement in a transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser of the securities. The SEC has not previously claimed the authority to define fraudulent practices under the Securities Act.

The information delivery requirements which would apply to Rule 144A, Rule 144 and Rule 506 offerings would not apply to private placements that rely on the statutory exemption contained in Section 4(2) of the Securities Act or the so-called “Section 4(1½)” exemption for the private resale of securities (rather than the Rule 144A, Rule 144 and Rule 506 safe harbors), nor would they apply to offshore offerings that rely on the Regulation S safe harbor. Accordingly, the proposed rules may spark a renewed interest in the use of the Section 4(2) and Section 4(1½) exemptions and a possible increased focus on overseas offerings under Regulation S.

F. Codification of Staff Interpretations Related to Securities Act Registration

The proposed rules would codify certain SEC staff positions relating to the registration of asset-backed securities. Generally, Rule 190 of the Securities Act requires that, unless exempt from Securities Act registration requirements, the securities underlying registered asset-backed securities themselves be registered as a primary offering of the securities unless certain conditions are met. Rule 190(c) provides that securities that

represent an interest in pool assets, such as a collateral certificate or a special unit of beneficial interest in titling trust transactions, are not considered underlying securities for purposes of Rule 190. The proposed rules would require these securities to be registered concurrently with the registration of the asset-backed securities which they back but would specify that no additional registration fee is required to be paid.

Form S-3 requires an issuer to incorporate by reference in its prospectus all subsequently filed periodic and other reports filed under Sections 13(a) and 15(d) of the Exchange Act prior to the termination of the offering. For corporate issuers whose Exchange Act filings keep their Securities Act offering materials current, this requirement makes sense. However, for asset-backed securities issuers the Exchange Act filings may not be

relevant for the Securities Act offering materials. As the result, the SEC is proposing to codify its position that an asset-backed securities issuer may incorporate by reference either all of its Exchange Act filings or limit the incorporation by reference to Form 8-K filings.

G. Transition Period

The SEC is still considering the compliance date for the proposed rules although the SEC notes that the compliance date should be one year or less after their adoption. In the proposing release, the SEC states its current intent is to apply the proposed asset-level information requirements and private issuance reforms only to securities issued after the implementation date.

If you have questions about any of these items, please contact your regular Sidley Austin LLP contact.

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