



SEC Adopts Regulation AB II

The SEC unanimously voted to adopt the much anticipated asset-backed securities (ABS) final rules and the amendment for Regulation AB (Reg AB II).¹ The final rules responded to the financial crisis and addressed regulatory concerns about the structured finance product marketplace, and are intended to restore investor confidence by enhancing the disclosure, reporting, and offering process for ABS.

Key Facts

- Reg AB II continues to only apply to transactions sold in publicly registered offerings.
- Nonpublic transactions issued under Rule 144A are currently exempt from complying with the Reg AB II requirements.
- Reg AB II addresses several areas including asset-level disclosures during the offering process and throughout the life of a transaction, enhanced transaction disclosures in offering documents, new eligibility requirements for ABS shelf offerings, and access to more timely and detailed information in required SEC filings.

Key Impact

- The new rules enhance standardized asset-level reporting and additional disclosures about ABS transaction structures, and also establish new protocols about how and when this information is provided, which will allow investors to perform a more thorough analysis of ABS transactions instead of relying on third-party credit ratings.

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¹ SEC Release Nos. 33-9638; 34-72982, Asset-Backed Securities Disclosure and Registration, August 27, 2014; available at www.sec.gov.



Reg AB II rules have been in development since 2010. The lag in adopting the final rules was due to extensive commentary from industry participants, which resulted in modifications to the proposed rules and action being deferred with respect to certain elements of the proposed rules.

Reg AB II was originally proposed in April 2010 and then re-proposed in July 2011 in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), specifically sections 939A and 942(b).

SEC action on Reg AB II was deferred until the summer of 2014 primarily due to the vast amount of industry commentary received. An additional factor in the length of time required to adopt Reg AB II was the privacy and data concerns expressed by industry participants and SEC commissioners.

The proposed Reg AB II asset-level detail requirements raised concern among industry participants that an individual consumer's identity could be revealed in public databases if the proposed level of detail in the disclosures was provided (i.e., re-identification risk). The SEC performed significant analysis to mitigate this risk, and the final rules reflect what was determined to be an acceptable amount of disclosure detail.

Asset-Level Disclosures

Mandated asset-level data requirements are specified for offerings of residential mortgage-backed securities, commercial mortgage-backed securities, and ABS related to auto loans, auto leases, debt securitizations, and resecuritizations of securities backed by these asset classes.

For each of these identified asset classes, the SEC has provided sample technical specifications and schedules for the data points that will be required to be filed on EDGAR in eXtensible Markup Language (XML). The standardized asset-level disclosures for each asset class are described within the new Schedule AL. The asset-related disclosures (i.e., the Asset Data File) and an accompanying Asset Related Document will be filed using the new Form ABS-EE, which is required to be on file and incorporated by reference in the prospectus and Form 10-D at filing.

The final rules pertaining to asset-level disclosures will only apply to the asset classes listed above. However, the SEC continues to evaluate asset-level disclosure requirements that may eventually be established for other ABS asset classes.

Asset-level data will generally include information about the credit quality of obligors in the underlying collateral pool and loan terms related to pool assets. However, in response to comments received, the SEC eliminated asset-level disclosures that did not justify the effort required to report them or that posed re-identification risk.

Other Prospectus Disclosures

- To allow investors to evaluate pools comprised of assets originated by different originators, the final rules revised Item 1110(a) of Reg AB. If the cumulative amount of assets originated by parties other than the sponsor or its affiliates comprises more than 10 percent of the total pool assets, then those originators originating less than 10 percent of the pool assets must be identified in the prospectus.



The final rules replace the prior investment grade requirements for shelf registration eligibility.

- Information about the financial condition of sponsors and originators of more than 20 percent of pool assets who are required to repurchase pool assets following a breach of representations or warranties must be disclosed if there is a material risk that their financial condition will have a material impact on pool performance.
- Disclosures will be required about the retained interest in transactions by sponsors, servicers, and originators of more than 20 percent of the pool assets, including any interests held by affiliates and any hedge positions intended to offset the risk retention positions.
- The final rules also standardize disclosure requirements to better allow investors to compare offerings and provide more detail about the underwriting and pool asset modification processes.

New Shelf Registration Rules

- The final rules include several requirements designed to ensure that investors not only have access to adequate information to evaluate ABS transactions, but also sufficient time to analyze this information during the offering process. The final rules replace the prior investment grade requirements for shelf registration eligibility.
- Under the final rules, a preliminary prospectus, including the enhanced asset-level disclosures required under the final rules, must be filed two business days after first use, but no later than three business days prior to the first sale under the offering. Additionally, any material changes to the preliminary prospectus must be disclosed in a supplement filed no later than 48 hours before the first sale.
- Forms SF-1 and SF-3 will be used for registration of ABS non-shelf and shelf registrations, respectively. The forms are similar to Forms S-1 and S-3 but incorporate ABS-specific disclosures.
- To be considered eligible for shelf offerings, ABS transactions must meet several requirements that must be detailed in the transaction agreements. This includes designating the third-party credit risk manager at the time of offering, which is responsible for performing loan file reviews for breaches of representations and warranties based on a two-pronged trigger approach. The first prong is the occurrence of a pool asset delinquency trigger event, and the second prong is a vote of investors to initiate a loan file review.
- The transaction agreements for shelf-eligible ABS offerings must also include provisions for dispute resolution when repurchase requests are not resolved within 180 days of receipt, and provide a mechanism for investors to request communication with other investors via disclosure on Form 10-D.
- Under the prior rules, officers of the depositor were not required to re-certify takedowns of shelf offerings. However, under the final rules the chief executive officer of the depositor is required to include a certification in the prospectus about the disclosure and the structure of the transaction, particularly with respect to oversight of the transaction, accuracy of the disclosures, transaction risks, and the reasonableness that the structure is designed to service scheduled investor cash flows. However, the certification is not a guarantee of future transaction performance.



The final rules do not apply to private placements and resales of structured finance products.

- Aside from the transaction agreement requirements for shelf eligibility, the final rules also establish requirements for the registrant. These primarily relate to historical compliance with the shelf filing requirements.

Exchange Act Reporting and Transaction Document Filing

- Transaction agreements must be filed as exhibits on Form 8-K no later than the date the final prospectus is filed.
- Form 10-D will now require pool asset delinquency disclosures to be reported in 30- or 31-day increments through 120 days of delinquency. Additionally, Form 10-D must disclose material changes in a sponsor's retained interest in the pool assets during the reporting period. Sponsors will be required to furnish this information to issuers for inclusion on Form 10-D.
- In an effort to provide more transparency at the transaction-level about material instances of noncompliance (MINCs) identified through the platform-level management assessment and reporting process under Item 1122 of Reg AB, the final rules require disclosure in the body of Form 10-K about the efforts to remediate MINCs and confirmation of whether or not the MINCs pertained to the ABS transaction that is the subject of the filing on Form 10-K.
- Exchange Act reports, including Forms SF-1, SF-3, 10-D, 10-K, and 8-K, will be required to include Central Index Key (CIK) information for the depositor, sponsor, and issuer, as applicable.
- Additionally, with respect to management's assessment under Item 1122 of Regulation AB, the final rules have created an additional servicing criterion, 1122(d)(1)(v), which requires management to assert whether or not the "aggregation of information, as applicable, is mathematically accurate and the information conveyed accurately reflects the information." This codifies the Division of Corporation Finance's Manual of Publicly Available Interpretations on Regulation AB and Related Rules, Interpretation 11.03, about situations where servicers provide information to another transaction party that such transaction party uses to perform servicing criteria covered by its assessment of compliance under Item 1122.

What Reg AB II Does Not Address

The SEC deferred action on a number of significant aspects of proposed Reg AB II rules, most importantly imposing SEC registered public-style disclosure requirements on private placements and resales of structured finance products.

Certain ABS asset classes were not included in the new rules for asset-level disclosures including, but not limited to:

- Managed pools such as collateralized loan obligations and synthetic structure transactions;
- Student loan securitizations;
- Inventory loan and floorplan securitizations; and

- Equipment lease and credit card transactions.

The SEC is continuing to evaluate the best approach for requiring disclosure of information on these exempted asset classes.

The *computer waterfall program* requirement was also not included in the final rules, but remains under consideration. The SEC received considerable commentary about the complications that could arise from its use, however more than one commissioner voiced support for the future adoption of a standardized waterfall modeling program requirement.

More than one commissioner also expressed concern that government-sponsored enterprises such as Fannie Mae and Freddie Mac were not affected by either Reg AB II or Dodd-Frank risk retention rules.

Potential Industry Implications

- Originators, issuers, servicers, and trustees potentially face significant investments in reprogramming and system upgrades to meet the new reporting standards.
- ABS sponsors may see heavier burdens on collateral reporting systems, increased auditing costs, and may need to design new management oversight functions.
- Issuers may consider more 144A transactions to avoid the potential costs to comply with the final rules. However, parties to privately issued transactions may require contractual reporting obligations that adopt Reg AB II reporting standards, which would potentially negate the benefits of this approach.

Effective Date

The SEC is expected to publish the final rules in the Federal Register in the next several weeks. Compliance with the final rules related to asset-level disclosures will be required 60 days plus two years after publication in the Federal Register, while compliance with the other final rules will be required 60 days plus one year after publication in the Federal Register.

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