



ISSUE PAPER

Subject: SEC Rule on Asset-Backed Securities

Issue: On January 7, 2005, the Securities and Exchange Commission (SEC) issued a final rule to codify requirements for the registration, disclosure and reporting for asset-backed securities (ABS), a mortgage sector that has swelled to a 2004 issuance level of approximately \$685 billion in CMBS and RMBS (exclusive of agency securities) from an estimated \$40 billion amount in 1990. The final rule reflects several important modifications recommended by MBA upon review of a proposal released last May and is considered, on balance, a considerable improvement over pre-existing SEC guidelines for ABS. Nonetheless, the rule has important implications for the registration, disclosure and reporting responsibilities of companies involved in issuing private-label MBS.

Background: The final rule represents an effort by the SEC to codify twenty years of fragmented guidance and to clarify which transaction parties should handle various aspects of ABS securitizations, including clarifying and formalizing transaction participants' responsibilities for disclosing and reporting information regarding security collateral to investors. The rule is significant to MBA members who are involved in the rapidly expanding ABS sector. The rule is also significant to MBA members because Fannie Mae and Freddie Mac could decide to use the SEC requirements as "best practices" and require significant additional disclosure and/or reporting from seller/servicers.

After consulting with a large number and variety of members representing single family, multifamily and commercial lenders, MBA on July 12, 2004, submitted comments on a proposed SEC ABS rule released May 3, 2004. On September 23, MBA members and staff met with SEC staff to discuss the recommendation in MBA's comment letter. The final rule was published in the Federal Register on January 7, 2005, and reflects many of the recommendations made by MBA as shown below.

MBA Recommendation #1: Adopt a more practicable framework for servicers to report on compliance with the SEC's proposed servicing criteria.

SEC Rule on Asset-Backed Securities

Page 2

The proposed rule would have required the depositor or servicer to report on compliance with specified servicing criteria. The party reporting on servicing compliance could have "reasonably relied" on information received from third party servicers for the purpose of "assessing" their compliance with the criteria (e.g. that a servicer has procedures in place to safeguard unissued checks). MBA argued that the reporting party in most instances would not be able to "assess" third parties' compliance with the criteria. We recommended instead that the reporting party act as a conduit by obtaining third parties' reports on compliance and passing them through to investors.

The final rule adopts MBA's recommendation by eliminating the requirement that the depositor or servicer (whichever party signs the 10-K) report on compliance with specified servicing criteria by third party servicers. Instead, the rule requires all parties involved in servicing 5% or more of the ABS collateral (the rule does not specify how the 5% is to be calculated) furnish the party signing the 10-K (i.e. the depositor or servicer) with a report on their compliance with the SEC mandated servicing criteria. In turn, the party signing the 10-K will be responsible for signing a Certification of Compliance which, among other things, vouches for the receipt of required reports on compliance with the servicing criteria from all servicers that meet the 5% threshold for reporting.

Consequently, the final rule does not require (as originally proposed) that the master servicer or the depositor (whichever party signs the 10-K) make an assertion regarding compliance with specified servicing criteria by all parties participating in the servicing function.

MBA Recommendation #2: Reduce the excessive amount of proposed disclosures.

The proposed rule would have required disclosure of an extensive amount of information, including much information that is not currently disclosed. For example, the rule would have required disclosure of "static pool data," a term that is used to describe pools of mortgages of a particular vintage and type, such as residential mortgage loans with specified credit scores that were originated in the first quarter of a particular year by a particular sponsor. The depositor or sponsor of the securitization would have been required to disclose information relative to the historical and ongoing performance of the loans in the subject transaction and loans like them in its portfolio of loans. MBA argued that disclosure of static pool data could result in voluminous amounts of additional disclosures that could confuse and overwhelm investors and therefore that the SEC should eliminate the requirement from a final rule. We also asked that the SEC reduce the amount of disclosure associated with servicing practices. The proposed rule would also have required the disclosure of all points and fees as well as the APR on the loans – information that is generally not relevant to holders of the securities as most points and fees do not pass through to security holders.

Regulation AB, set forth in the final rule, represents the principles-based structure the SEC has codified for disclosure. The final rule reflects current practices with which our

SEC Rule on Asset-Backed Securities

Page 3

industry is already familiar and, regarding new requirements, it shows the sensitivity of the SEC to industry concerns conveyed by MBA and others.

Significantly for mortgage-backed securities, MBA believes the SEC made the correct judgment in deciding not to include points and fees as one of the disclosure items assumed to be material in the final rule. Consistent with the materiality standard, information such as points and fees should be included where material to an investor; however, they are not presumed to be material.

The final rule provides guidance on the extent of static pool data that should be disclosed and does so in terms of general starting points, such as a five-year historical period for performance data for a sponsor's previously securitized pools. An alternative method of disclosure is suggested for sponsors with less than five years of experience and includes utilization of data the sponsor does have for its own pools, supplemented with "vintage" pool data related to particular time periods.

As a practical accommodation to industry comments, the SEC will allow the static pool information to be provided on the sponsor's website, as is already often done. While a cross-reference to the website must be included in the prospectus, the use of websites will save the industry considerable expense otherwise entailed in providing extensive data in a hard copy form.

MBA Recommendation #3: Clarify definitions included in the proposal.

Some definitions used in the proposed rule were unclear, and others were needed. For example, we recommended that the definition of "servicer" be revised to clarify that the loan servicer is usually not involved in calculation of distributions to security holders and related functions, which are normally performed by the trustee, rather than the servicer. Also, the definition of "delinquency" did not conform to that used in the mortgage industry. We also recommended that the Commission provide definitions for originator, unaffiliated and affiliated servicer, master servicer, and special servicer and that the use of the word "subservicer" be deleted from the final rule because it has different meanings within the CMBS and RMBS markets.

In the final rule, the SEC recognized that there are multiple parties contributing each month to the servicing in an ABS transaction. However, because the names and defined roles of each party vary across asset types and transactions, the SEC decided to carry forward its "unified definition" of servicers based on functions and responsibility. The rule defines "servicer" as "any person responsible for the management or collection of the pool assets or making allocations or distributions to holders of the asset-backed securities." Based on this SEC definition, a typical trustee in a CMBS transaction that performs the waterfall calculation of payments to the investors *will* be deemed a "servicer." A trustee who does not perform any calculations, but simply sends allocations or distributions to the investors based on servicer calculations, is specifically excluded from the SEC servicer definition.

SEC Rule on Asset-Backed Securities

Page 4

MBA commented on the 10% threshold in the proposed rule for the definition of unaffiliated servicers, which would have called for the inclusion of such entities within the disclosure requirements. Our concern was that the threshold was too low. In response, Regulation AB splits the requirements, and full disclosure is required only for those servicers with a 20% participation level in the transaction pool. Disclosure for servicers with a lower participation level is limited to the name of the entity and the nature of its role.

The final rule also accommodates MBA's request that the definition of "delinquency" conform to its general use within the mortgage industry by permitting a pool asset to be considered delinquent if the asset is "more than 30 or 31 days or a single payment cycle, as applicable, past due from the contractual due date," as determined in accordance with any of the following: "(1) the transaction agreement; (2) the policies of the sponsor, any affiliate of the sponsor that originated the assets, or the servicer; or (3) the policies established by their regulators." This flexibility, however, comes with some additional disclosure requirements, including disclosures on delinquency policies, re-aging, restructures and partial payments in prospectuses. Also disclosures are required regarding modifications, extensions or waivers of terms, fees and penalties or payments and changes to delinquency recognition policies. As a result of the new disclosures, the SEC is not adopting the proposed requirement to permit only contractually based re-aging.

In considering whether to develop definitions for the various parties involved in servicing, such as "unaffiliated servicers," the SEC was not persuaded that such definitions are needed or appropriate. The SEC noted that there "is not a uniform differentiation of servicing functions consistent across all asset classes or even within the same asset class. Nor do we think it is appropriate to establish rigid definitions that may not encompass future changes to market practice involving servicing." The final rule also does not specifically define "originator."

MBA Recommendation #4: Re-propose the rule for further industry comment and also requested a one year transition period to the new SEC rule in the event that the SEC finalizes its proposal.

It appears the SEC took into account MBA's recommendation by phasing in the rule's requirements. The effective date of the rule is March 8, 2005, after which certain disclosures are required. However, full compliance with all disclosure and reporting requirements becomes effective for "...any registered offering of asset-backed securities commencing with an initial bona fide offer after December 31, 2005..."

Status: A number of questions remain regarding implementation of the final rule. MBA is coordinating an educational call with the SEC and for MBA members to cover in some detail questions members and our staff have with regard to Regulation AB. Information regarding that call will be posted on the MBA website, www.mbaa.org.

**SEC Rule on Asset-Backed Securities
Page 5**

**Staff Contacts: Alison Utermohlen
 (202) 557-2864**

**Kathy Gibbons
(202) 557-2870**

**Vicki Vidal
(202) 557-2861**

**Katie Schwarting
(202) 557-2742**

Date: January 2005