

# Regulation AB Update:

## Recap of Lessons from Year 1

# Panelists

**Tom Knox - Director**



**Stephen S. Kudenholdt**  
**Chair, Structured Finance**  
**Practice Group**



**Christopher S. Edwards**  
**Assistant General Counsel**



**Lisa A. Brewster**  
**Vice President – MBS SEC Reporting**



# Agenda

- **Review of 2006 Registration and Disclosure Issues**
- **Form 10-K and related assertions and attestations**
- **Recommendations for 2007**
- **Panelist Questions**

# Review of Registration and Disclosure Issues

- Disclosures and Static Pool Data
- Items 1114 and 1115
- Securities Offering Reform (SOR) and the impact of Free Writing Prospectuses (FWP's)

# Registration and Disclosure Issues - SPD

## Static Pool Disclosures

- One of the most important changes from the current disclosure practice is Item 1105 of Regulation AB, which requires the disclosure of static pool data of the sponsor.
- Required Disclosure. Static pool information tracks the performance of a specific pool of loans or assets over time. While the Commission declined to prescribe specific disclosure by asset class or to offer guidance as to when static pool disclosure is material, Item 1105 provides general guidance on the “starting point” for disclosure based on the sponsor’s seasoning and whether the asset pool is amortizing or a revolving asset master trusts.

# Registration and Disclosure Issues - SPD

What did we see in practice?

- Agreements to provide information to sellers.
- Indemnification issues
- Numerous Websites incorporated by reference
- No rush to the 144A Market.

# Registration and Disclosure Issues – Swaps and Caps

Providers of derivatives or external credit enhancement may need to include financial information disclosures if:

- If the “Significance Percentage” is between 10% and 20%
  - No Quarterly requirement
  - Annual summary information, unaudited
- If the “Significance Percentage” is between more than 20%
  - Quarterly financial, unaudited
  - Annual financials, audited

# Securities Offering Reform

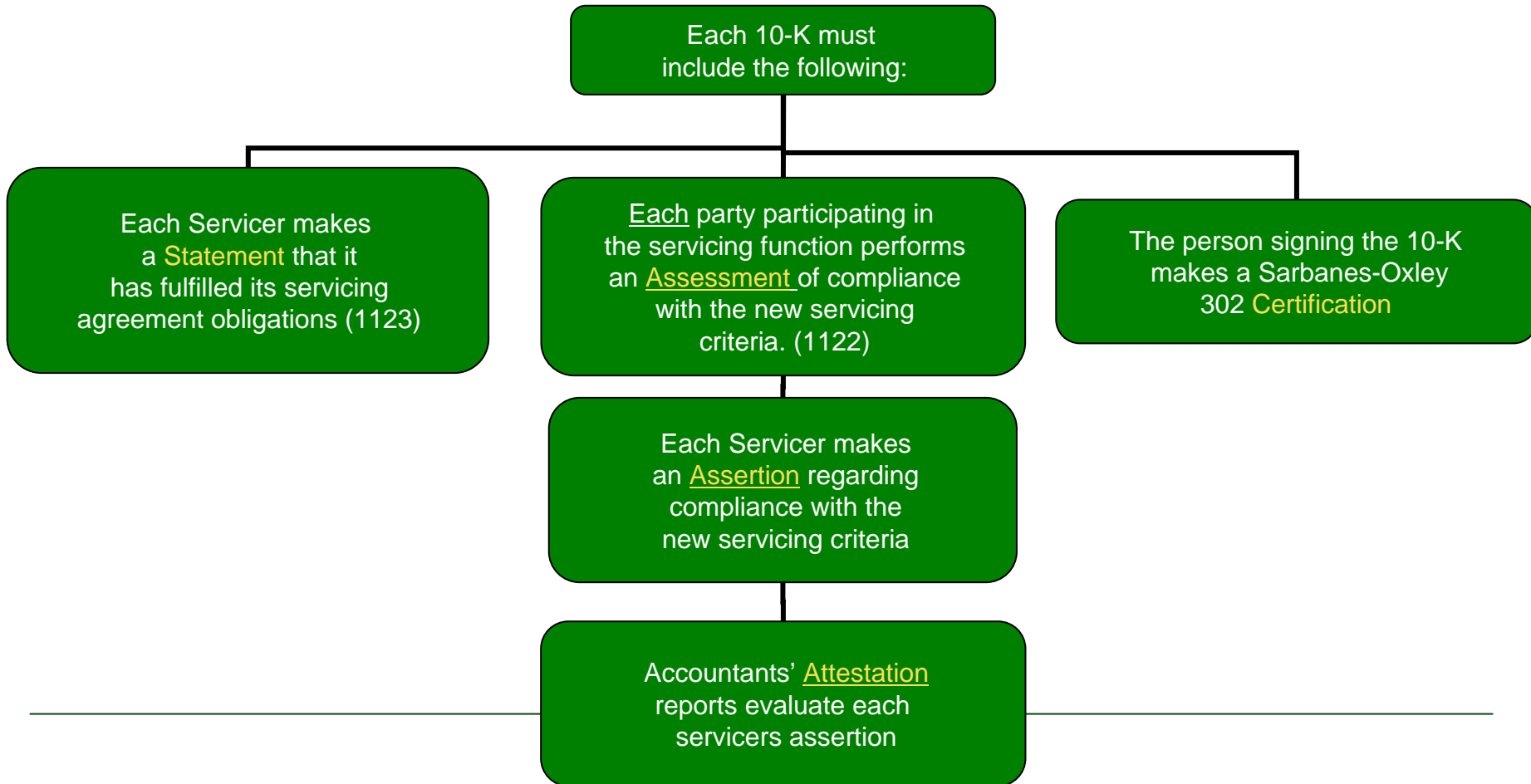
## Impact on ABS

- Ability to use written communications during the offering period under the free writing prospectus rules, as an alternative to the ABS ICM rules
- Principal advantages of the new rules are that the content of these communications is not restricted, and liability to some parties may be reduced
- Creates need to modify offering procedures in order to manage and limit the risk of potential liability under Rule 159
- Effective date of the Offering Reform rules was December 1, 2005

# Review of Form 10-K Issues

- Platform Level Assertions
- Use of Vendors and the SEC telephone interpretation 17.06
- Determining Applicable Criteria
- Contractual vs. Regulatory compliance
- Material instances of non compliance
- Missing 1122 Reports

# Servicer Compliance Regime



# Servicer concerns

- Compliance considerations / SEC actions
- Platform definition
- Interim servicing requirements
- Managing third-party requirements
- Ensuring compliance with new, expanded criteria for the entire year
- Materiality

# SEC Telephone Interpretations

- The SEC received requests throughout 2005 and 2006 to clarify several disclosure and reporting items in Regulation AB
- The SEC released first round of interpretations in December, 2005.
- Subsequent requests and meetings with the SEC, including letters from the MBA resulted in additional interpretations being released in August 2006.
- The last and (perhaps) final interpretation was released February 2, 2007

# Platforms

- The SEC (17.03) provided flexibility for an asserting party to define their platform. Key points are:
  - » (i) platforms should not be artificially designed;
  - » (ii) they should mirror actual servicing practices of the servicer
  - » (iii) they represent a group of transactions that the servicer services that are backed by the same asset type.
  - » (iv) there are circumstances that would allow an asserting party to divided by geographic locations or segregated among separate computer systems
  - » (v) the platform should remain constant from period to period, and
  - » (vi) if the servicer includes in its platform less than all of the transactions backed by the same asset type that it services, the servicer should describe the scope of the platform in its Item 1122 report.

## Vendors and the SEC telephone interpretation 17.06

- Instruction 2 to section 1122 states that “If multiple parties are participating in the servicing function, a separate assessment report and attestation report must be included for each party participating in the servicing function”. A PPSF is defined as “any entity that is performing activities that address the criteria.....”
- The ASF and the MBA jointly sent a letter to the SEC on December 21, requesting relief on the vendor issue, as the instructions implied there was no accommodation for servicers to take responsibility. The ASF/MBA letter proposed a specific telephone interpretation.

## Vendors and the SEC telephone interpretation 17.06

- On February 2, The SEC published the telephone interpretation (17.06) that will allow a servicer to take responsibility for the activities of a vendor in support of a criteria in some circumstances. These conditions include:
  - » 1. The vendor is engaged to perform specific and limited or scripted activities.
  - » 2. The vendor is not a servicer, as defined in 1101(j) of RegAB.
  - » 3. The servicer elects to take responsibility for monitoring and assessing compliance with respect to the activities covered by the criteria and performed by vendor.
  - » 4. The servicer has P&P designed to provide reasonable assurance that the vendor's activities comply in all material respects with the servicing activity applicable to the vendor.

## Vendors and the SEC telephone interpretation 17.06

- The Servicer's assertion would need to disclose the following:
  - » 1. The servicing criteria or portion of the criteria applicable to the vendor's activities for which the servicer is assuming responsibilities,
  - » 2. Any material instance of non-compliance by the vendor that the servicer identifies or is aware, and
  - » 3. Any material deficiency that is identified in the Servicer's policies and procedures to monitor the vendor's compliance.

## Vendors and the SEC telephone interpretation 17.06

- Compliance with the applicable criteria will be met if:
  - » A. The policies and procedures are designed to provide reasonable assurance that the vendor's activities comply in all material respects with the related criteria.

AND

- » B. The P&P are designed to provide reasonable assurance of compliance and those P&P are operating effectively.

# Applicable Criteria

- Pooling and servicing agreement (or other ABS governing agreement) specifies who must sign the Form 10-K: either the depositor, or the servicer (if 1 servicer) or master servicer (if > 1 servicer)
- PSA or servicing agreement requires various PPSFs to provide 1122 assessment and attestation reports
- In some cases, a PPSF is contractually obligated to provide 1122 reports even though its activities related to < 5% of the pool assets
- PSA typically has as an exhibit a matrix which indicates the Item 1122 criteria that must be covered by each PPSF 1122 reports. This is only a contractual obligation.

# Contractual vs. Regulatory Compliance

- Each PPSF in its Item 1122 assessment of compliance is allowed to specify which of the Item 1122 servicing criteria it considers to be "not applicable" to its platform
- Question - what if the asserting party's statement of non-applicable criteria differs from its contractual requirements under the PSA matrix?
- Answer (language added to Form 10-K report):
- *Although each servicing criterion required by Item 1122(d) of Regulation AB is addressed in one or more of the Assessments of Compliance with Servicing Criteria and related Attestation Reports included with this report, the Servicer's, [ use full legal name of actual servicer], Assessment of Compliance and related Attestation Report did not address each of the servicing criteria that the Servicer was required to address under the terms of the related Servicing Agreement. The Servicer has not identified such failure to provide an Assessment and Attestation for these items as a material failure to fulfill its obligations under the related servicing agreement in the Servicer's Compliance Statement provided under Item 1123 of Regulation AB, because the Servicer asserts that those items are not applicable to the Servicer."*

# Material instances of non compliance

- “Material Instances of Non-Compliance” definition : none
- Market participants have difficulty assessing if instances of non-compliance were material. Many use statistical analysis: if exceptions exceed a threshold, there are “Material Instances of Non-Compliance”
- Attestation report addresses only the frequency of non compliance, not severity or significance
- Qualitative analysis of noncompliance is not provided
- Significant examples are not described
- Relevance to any deal or group of deals is not provided

# Missing 1122 Reports

- Generally, the ABS markets did an excellent job of complying with the new requirements for Item 1122 reports
- In a small number of cases, a PPSF was not able to provide its Item 1122 reports
- Examples:
  - » PPSF is a servicer that went bankrupt and ceased operations during 2006
  - » PPSF is a servicer which merged into another entity during 2006, but its existing servicing platform was dissolved and can no longer be tested.
  - » PPSF is a subprime originator whose accountants resigned a week before the Item 1122 reports were due
  - » PPSF is a subprime originator which filed for bankruptcy on the day the Form 10-K reports were due to be filed

# Possible consequences of filing a Form 10-K with a missing Item 1122 report

- Depositor may be out of compliance with 1934 Act reporting requirements
- Depositor may be an "ineligible issuer" under Rule 405, and therefore unable to use a free writing prospectus in future offerings (except if content limited to ABS ICM excluding computational material)
  - » This would apply to all offerings by that depositor that had not commenced as of the date the Form 10-K was due
  - » This would continue for 12 months, unless deficiency was cured (late), or unless waived by the SEC
  - » Non FWP disclosures could be used, such as ABS ICM, or a preliminary prospectus
- Depositor, and any affiliated depositor securitizing the same asset type, may be ineligible to file a Form S-3 shelf registration statement
  - » This would continue for the next 12 months, unless waived by the SEC
  - » This would not affect the ability to do a takedown from an effective shelf registration statement

# What to do if you are missing an Item 1122 report

- Consider filing a Form 12b-25 extension, if there is reason to think missing report may be provided in the next 15 days
- File a Form 10-K report, timely, as complete as possible
  - » Form 10-K report must identify the missing Item 1122 report and provide as complete an explanation for why it is missing as possible
- If missing Item 1122 report can be provided late, then file a Form 10-K/A, and comply with FWP restrictions in the interim.
- Submit a letter requesting staff to agree that the Form 10-K report as filed resulted in “materially sufficient” compliance with Item 1122.

# Possible outcomes of “materially sufficient compliance” submission

- SEC may view the reporting requirements as having been materially complied with
  - » No further action would be required
- If not, then the issuer should:
  - » Request a waiver from "ineligible issuer" status
    - Under Rule 405, SEC may grant such a waiver on showing of "good cause"
  - » Request a waiver allowing future filing of a Form S-3 registration statement
    - The staff has indicated they would not discuss this issue until 30 days prior to the proposed time of filing the Form S-3

# Best Practices in Preparation for 2007

- Begin internal and external dialogue discussions as soon as possible. Additional communication between Sponsor, Servicer and Trustee is critical.
  - Look at transaction documents vs disclosure requirements. Avoid unnecessary instances of non-compliance by amending the transaction documents, allowing such provisions to be as flexible as possible.
  - Under Item 1122, make clear that inapplicable items are not applicable. Make such knowledge easy for accountants to find. Furthermore, begin conversations early with participating parties regarding the criteria matrix.
  - Be aware of deadlines. Spread the work around both internally and externally to reach completion.
  - Continued focus on policies, procedures and controls.
-

# Panelist Questions

---