

Regulation AB:

Insights and Lessons Learned for Year One

Panelists

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Agenda

- **Regulation AB Overview**
 - **Registration & Disclosures**
 - **Servicer Compliance Regime**
 - **SEC Telephone Interpretations**
 - **Panelist Questions**
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Regulation AB Background

- The SEC adopted new and amended rules and forms to address comprehensively the registration, disclosure and reporting requirements for asset-backed securities under the Securities Act of 1933 and the Securities Exchange Act of 1934.
- The heart of the new rules is “Regulation AB”, which consists of 24 items numbered 1100 through 1123.

Regulation AB Requirements

Final rules and forms intended to accomplish the following:

1. Update and clarify the Securities Act registration requirements for ABS offerings, including expanding the types of securities that may be offered in delayed primary offerings on Form S-3;
 2. Consolidate existing positions that allow modified Exchange Act reporting that is more relevant to ABS;
 3. Provide disclosure guidance and requirements for Securities Act and Exchange Act filings involving ABS;
 4. Streamline existing positions that permit the use of written communications in a registered offering of ABS in addition to the statutory registration statement prospectus; and
 5. Establish a consistent servicing standard that is used as the basis for measuring each Servicer's performance.
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Regulation AB Requirements

Which securities are within scope of Regulation AB?

- Only those securities that meet the definition of “Asset-Backed Security” issued through the SEC registration process (S-1 and S-3) are covered by Regulation AB.
- Privately issued securities are not subject to the regulation.
 - » Expect 144A Market to follow Regulation AB requirements

Regulation AB Disclosures

Categories of Disclosure

- Disclosure requirements concerning the following transaction parties: sponsors, depositors, issuing entities, servicers, trustees, and originators.
- Disclosure relevant to assessing the performance of the assets being securitized: static pool disclosure and pool asset disclosure.
- Catch-all category that covers disclosure concerning significant obligors, providers of credit enhancement and other support, certain types of derivatives, and presentation of alternative third-party information.

Regulation AB Disclosures

“Principles-Based” Disclosure

- The SEC opted for a “principles-based” approach to disclosure.
 - » New rules provide principles that must be followed rather than specific guidance by asset class or transaction structure; and
 - » “Material” is the word (though not defined)
- Implementation of Regulation AB is evolving over time as market participants grapple with judgment calls in the application of the “rules” to particular facts and circumstances.

Regulation AB Disclosures

Servicer Disclosures

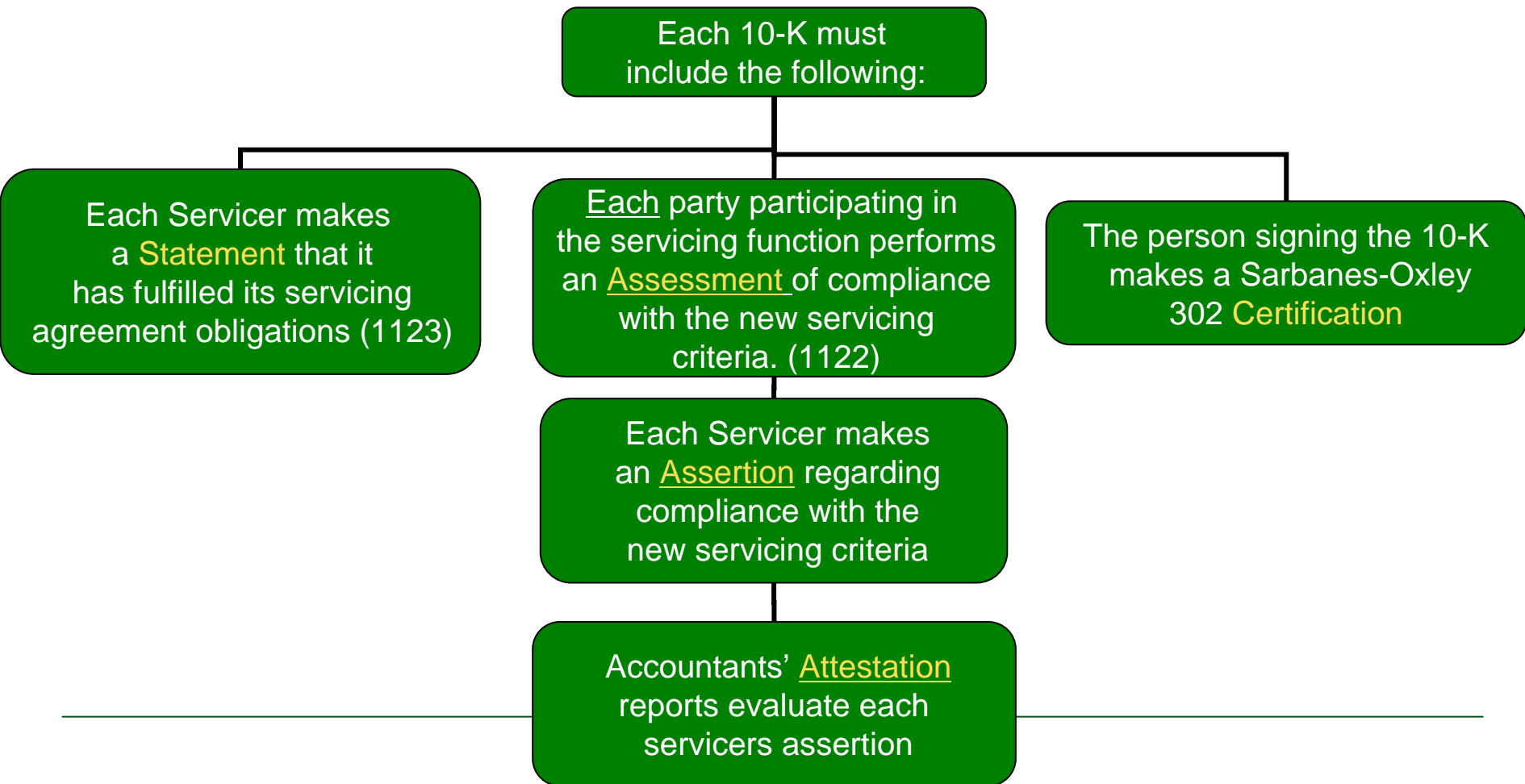
- Item 1108 of Reg AB requires the disclosure to include identification of *each*:
 - » master servicer,
 - » affiliated servicer,
 - » unaffiliated servicer servicing at least 10% of the pool assets, and
 - » other material servicer managing a material aspect of servicing such as work-outs or foreclosures (generally the “special servicer”).
 - If multiple servicers are involved in the securitization, an introductory description of the roles, responsibilities, and oversight requirements for the entire servicing structure is required.
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Regulation AB Disclosures

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.

Servicer Compliance Regime



Servicer Compliance Regime

Compare: 1122 Report and 1123 Report

- 1122 Report.
 - Statement of compliance with servicing criteria applicable to all ABS transactions – statement made by each party participating in the servicing function.
 - Statement made on a “servicing platform” basis – one statement for each “platform” and same report filed for all transactions serviced by such platform.
 - New requirement added by Reg AB.

 - 1123 Report.
 - Statement of compliance with particular servicing agreement – statement made by each “servicer”.
 - One 1123 Report for each securitized pool – unique filing for each Form 10-K.
 - Similar statement given in pre-Reg AB regime.
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Section 1122 Requirements

Report to Cover the Entire Servicing Function

- Each party participating in the servicing function is to provide a separate report regarding its compliance with the servicing criteria covering the entire servicing function. Reports will be required by any “party participating in the servicing function,” which is defined as any entity that performs activities that address the servicing criteria, unless such entity’s activities relate only to 5% or less of the pool assets.
- The final regulations are not “role-based,” as any party participating in the servicing function (including trustees) may be required to provide an assessment and related attestation report if the assets covered by their activities relate to more than 5% of the pool assets.

Section 1122 – Reporting Periods and Levels

- Period to be Covered by Report
 - » The report is to include an assessment of the servicing function as of the end of, and for a full fiscal period (or the applicable partial period in the case of the initial report), rather than at a single point in time. Compliance began January 1, 2006.

 - Level of Reporting
 - » Servicing compliance is to be determined at a “platform” level, rather than at a transaction-specific level. This platform level reporting approach assumes that the asserting party will assess compliance with respect to all ABS transactions involving such party that are backed by assets of the type backing the ABS covered by the Form 10-K report.
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Section 1122 Servicing Criteria

- Section 1122 disclosure-based servicing criteria to be used by each party providing an assertion regarding servicing compliance and an attestation report by registered public accounting firms in assessing servicing compliance.

- The minimum servicing criteria are separated into four categories:
 1. General Servicing Considerations
 2. Cash Collection and Administration
 3. Investor Remittances and Reporting
 4. Pool Asset Administration

Section 1122 Reporting Exclusions

- A party may exclude in its assessment report those specific servicing criteria that are not applicable to the asserting party based on the activities it performs with respect to ABS transactions, taken as a whole, that are backed by assets of the type backing the subject ABS. A party does not, however, have discretion to exclude from its report specific servicing criteria if such criteria are otherwise applicable to that party.
- If servicing criteria are excluded, the inapplicability of the excluded criteria must be disclosed in the asserting party's assertion and the related registered public accounting firm's report.

Section 1122 Reporting Non-Compliance Penalties

What are the penalties for noncompliance?

- The final regulations do not include a specific line item requirement to disclose any material impact or effects as a result of material instances of noncompliance. The SEC has, however, adopted a requirement that material instances of noncompliance during the reporting period, even if such noncompliance was subsequently corrected during the reporting period, must be disclosed.
 - The SEC Staff expects (or won't be surprised) by material instances of non-compliance given the “higher bar” set by RegAB. They have stated their interest is on getting Company's on to the RegAB regime, recognizing there will be some bumps in the road in the initial year of application.
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Accountants' Attestation Report

- Under the final rules, each party providing an assessment of compliance is responsible for ensuring an attestation engagement is performed by a registered public accounting firm. Each attestation report is to be filed as an exhibit to the report on Form 10-K, and must be made in accordance with the standards for attestation engagements issued or adopted by the Public Company Accounting Oversight Board. (AT § 601)

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

SEC Telephone Interpretations

- In August 2006, seven new interpretations, identified in the Regulation AB Supplement as Interpretations 11.02, 11.03, 11.04, 15.02, 17.03, 17.04 and 17.05 were released.
 - 11.02 This item was intended to address who is responsible for 1122d(3)(1) and 1122d(3)(2). The SEC's use of the word "Servicer" is representative of the "party participating in the servicing function". This could be a Master Servicer or Trustee, not just a primary servicer. There are 2 examples in the release. The party asserting to 1122d(3)(2) will likely be either the Trustee or the master servicer.
 - 11.03 The New Key guidance is "...In addition to assessing Servicer A's maintenance of the records and other activities, this Item requires assessment of Servicer A's aggregation and conveyance of such information to Servicer B....". The asserting party must include the aggregation and conveyance of information to another transaction party. This suggests that the SEC is expecting that "every link in the reporting chain" is covered by the assertions. Most market participants believe that the primary servicer and/or the master servicer would be captured by this requirement.
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SEC Telephone Interpretations

- 11.04 addressed the safeguarding of pool assets issue and the possibility that an auditor would need to provide a legal opinion on the status of pool assets. The SEC clarified that the safeguarding of pool assets should only extend to the documents, and not to the physical assets. The MBA in a member call stated that UCC would be included in the corpus of the asset documents.
- 15.02 is the "auditor consent" issue. It would appear that future S-3 registrations may not need to incorporate by reference the prior 10-K report. This would eliminate the need to obtain an auditor consent regarding any attestation report that is associated with a 10-K report.

SEC Telephone Interpretations

- 17.03, This issue was in response to the question of how much flexibility an asserting party has 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.

SEC Telephone Interpretations

- 17.04 This is the "grandfathering" provision. A Servicer's platform may, but is not required to, include transactions registered prior to compliance with Regulation AB. This flexibility is extended to non-public deals as well.
- 17.05, Differences between the scope of the 1122 and the 1123 report. This interpretation clarified that there may be instances of noncompliance that are material to the transaction, but not material to the platform. In these cases, the issue must be reported as a part of the 1123 report.

SEC Telephone Interpretations

- Many Servicers desired to take responsibility for the work of vendors or subservicers in asserting to outsourced activities pertaining to the RegAB criteria in Section 1122. Servicers want elect to assert to compliance with specific criteria on behalf of the vendor or subservicer based on their “control” and “monitoring” of the vendor.
- 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.

SEC Telephone Interpretations

- Paula Dubberly shared the views of the SEC staff at an Industry conference last month. 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.

SEC Telephone Interpretations

- 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.

SEC Telephone Interpretations

- 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.

SEC Telephone Interpretations

- Implications of the vendor interpretation:
 - » It is the Servicer's choice, not the Vendor's choice. "...if the servicer engaging and monitoring such vendor elects to take responsibility..."
 - » Not all Vendor's will qualify for the interpretation. "The vendor can't be an 1101(j) Servicer..."
 - » Can this be adopted retroactively for 2006? Yes, but to be in compliance, policies and procedures would need to have been in place and operating effectively for the full assertion period.
 - » 2 paths to reporting material noncompliance: "...The Servicer's assessment .. should include disclosure of any material instance of noncompliance by such vendor or, a material deficiency in the design or operation of the Servicer's policies and procedures..."

Panelist Questions

Reporting Matters

Disclosure Matters

Cost / Benefit analysis of Reg AB
