CLIFFORD
CHANCE

May 2010

Non-U.S. ABS Issuers face significant implications from the U.S. SEC's proposed revisions to the ABS disclosure and offering regime

Introduction

On April 7, 2010, the U.S. Securities and Exchange Commission (the "**SEC**") published sweeping proposals to update and expand the regulation of offerings of asset-backed securities and other structured finance transactions in the U.S. in both the public and, for the first time, the private markets. The proposals, which were made in a 667–page regulatory statement (the "**ABS Release**"), would involve substantial revisions to Regulation AB ("**Regulation AB**") under the U.S. Securities Act of 1933, as amended (the "**Securities Act**"), and other U.S. rules regarding the offering process, disclosure and reporting for asset-backed securities and other structured finance products. The ABS Release can be found at: http://www.sec.gov/rules/proposed/2010/33-9117.pdf.

If adopted in substantially their current form, the proposals in the ABS Release would have a wide-ranging impact on participants in the asset-backed securities markets in the United States, including on issuers and underwriters outside the U.S. who seek to access the deep investor base in the U.S. for products such as residential mortgage-backed securities ("**RMBS**"), asset-backed securities supported by credit card receivables ("**Cards ABS**"), synthetic securities and other structured finance transactions directly or indirectly backed by financial assets, asset-backed commercial paper ("**ABCP**") and, potentially, certain covered bonds.

While the ABS Release details major reforms for SEC-registered U.S. pubic offerings, if the proposals are adopted, the disclosure requirements for public transactions would also become effectively mandatory for private offerings in the U.S. under Rule 144A ("**Rule 144A**") and Regulation D ("**Regulation D**") of the Securities Act. Notwithstanding this harmonization of disclosure levels in the public and private markets, we believe that the overall impact of the proposals in the ABS Release would be to encourage non-U.S. issuers to prefer the private markets in the U.S. over the registered public market.

The table below sets out the primary implications for issuers of securities sold in the Rule 144A market, which remains the most commonly used distribution channel for non-U.S. issuers of asset-backed securities in the U.S. markets:

Summary of Key Changes

- For the first time, disclosure in Rule 144A transactions will be effectively subject to regulation by the SEC, even if the primary market for the securities offered is outside of the United States
- Non-U.S. issuers in Rule 144A transactions will be required to undertake to deliver to investors promptly upon request detailed portfolio information, including information about the underlying pool on an asset-by-asset basis
- The asset-level information must be accompanied by a computer program that allows investors to "stress test" the portfolio cash flows, so that they can make their own assessment of the ability of the assets to service the amounts payable on the securities in various scenarios
- Information required from issuers of synthetic securities will include details of the difference between cash and underlying credit spreads of the underlying assets
- Issuers will be required to deliver to the SEC details of each issuance of securities in Rule 144A transactions within 15 days of issuance on a prescribed form
- The approach to disclosure and the offering process in the public markets, as detailed below, is likely to set the standard for best practice in the Rule 144A market and, possibly, in the international markets

It is important for non-U.S. issuers to understand that the SEC has issued the ABS Release in the context of a politically charged environment in the United States, in response to perceived failures of the domestic securitization markets, particularly in the sub-prime RMBS and collateralized debt obligation ("**CDO**") sectors. Accordingly, the proposals are geared to address what the SEC believes were the causes of these failures, with only passing consideration for any impact that the proposals may have on markets for asset-backed securities outside of the United States. The ABS Release is also part of a constellation of overlapping (and, in places, inconsistent) regulatory initiatives in the U.S. intended to "fix" securitization, including proposed legislation in both the House of Representatives and the Senate and a major policy statement issued by U.S. bank regulators. The SEC has also adopted a number of separate rules regarding the "regulation of nationally recognized statistical rating agencies" ("**NRSROs**") including Rule 17g-5 (discussed below).

The proposals were published in the *Federal Register* on May 3, 2010 and are subject to a 90-day public consultation period with a deadline of August 2, 2010, during which industry participants submit comments and reactions to the SEC. Following the consultation period, the SEC will consider all submissions, and may revise the proposals in response to the feedback received. At that time, the SEC may choose to adopt some or all of the proposals found in the ABS Release. Alternatively, the SEC may choose to re-propose portions of the proposals if they feel that there was a sufficiently adverse response from commentators to portions of the original proposal to merit re-consideration.

At this point, it is very difficult to forecast when some or all of these proposals will come into effect. If adopted, the provisions of the ABS Release will strictly apply only to asset-backed securities and other structured finance products issued in the U.S. after the date set by the SEC for implementation of the proposals. However, as discussed further below, even prior to adoption, we expect that the proposals will start to establish a new level of "best practice" in the U.S. securitization markets. The strong position taken by the SEC in a number of areas, such as the provision of loan-level data by issuers, mirrors some of the recent proposals consulted on by the European Central Bank and the Bank of England. Further, the various proposals may well start to shape investor expectations prior to their formal effectiveness.

This memorandum focuses on the impact of the current proposals on non-U.S. issuers and underwriters of asset-backed securities and other structured finance products sold into the United States in either the public or most common private markets. In addition to sections describing the various proposals contained in the ABS Release, we also provide commentary on these proposals which we hope will help market participants better respond to the challenges and opportunities presented by the ABS Release.

If you have any comments or concerns relating to the impact of the ABS Release on your business, please do not hesitate to contact the authors of this memorandum or your normal Clifford Chance contacts.

Executive Summary

The ABS Release contains a number of proposed regulatory changes designed to increase transparency for investors in the securitization markets and to reduce reliance on rating agencies. However, the proposals will also significantly expand the disclosure and reporting obligations of issuers and underwriters of asset-backed securities in the U.S. and, if adopted, may discourage or make uneconomic certain types of securitization. Highlights of the proposals contained in the ABS Release include:

- Issuers of asset-backed securities or other structured finance products in most private transactions in the U.S. (including non-U.S. issuers conducting an offering in the U.S. pursuant to Rule 144A alongside a separate offering outside of the U.S.)

Investors – Not Rating Agencies

One of the main themes underlying the ABS Release is the perceived failure of the NRSROs most directly involved in the asset-backed securities markets to correctly assess the risk of default in many asset-backed securities and the over-reliance of investors on these rating agencies. Accordingly, the proposals in the ABS Release seek to provide to investors all the data and analytic tools necessary to allow them to make a full evaluation of the risks inherent in any structured product offering, effectively seeking to de-emphasize the role of the NRSROs going forward.

will be required to undertake to provide the same level of information as would be required in an SEC-registered transaction promptly upon request by any prospective purchaser. In addition, the issuer will be required to file a public notification of issuance with the SEC, setting out specified information about the offered securities and the underlying assets within 15 days after the offering.

- Significantly enhanced "loan-level" disclosure will be required on each of the underlying pool assets for virtually all U.S. offerings, with specific data fields identified by the SEC for 11 different asset types (although use of "grouped" data would be permitted for Cards ABS).
- In public offerings, the required loan-level data must be filed with the SEC in computer-readable form and, in both public and private transactions, this data must be accompanied by a computer program based on the "waterfall" contained in the transaction documents in order to permit investors to run their own analysis of the assets and the cash flows.
- In public offerings, an investment grade credit rating will no longer be a factor in determining eligibility for shelf registration; instead, eligibility for shelf registration will require the following:
  - Retention by the program's sponsor of a five percent "vertical" slice of each tranche of securities offered to investors or, in the case of Cards ABS, a five percent "seller" interest in the trust assets;
  - Periodic third-party verification of compliance with any asset repurchase provisions for violations of representations in the program documentation;
  - Certification by the chief executive officer of the depositor at the time of each offering that the asset pool is reasonably expected to generate cash flows sufficient to service the issuer's liabilities; and
  - Periodic reports by the issuer under the U.S. Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), are required for as long as the issued securities are outstanding (rather than only for one year, as presently).

- Each public offering of asset-backed securities under a program using "shelf" registration (*i.e.*, where the SEC approves an initial registration statement and not each "take down" offering from that registration statement) will have to be made using a single prospectus containing all material information relating to each individual issuance, other than pricing-dependent information. This prospectus must be provided to investors not less than five business days prior to any sale of the securities. Offerings by master trusts backed by non-revolving assets, such as traditional residential mortgage loans, will *not* be eligible for shelf registration.
- For public offerings, two new forms of "registration statement" (*i.e.*, the document containing the prospectus and other disclosure required to be publicly filed with the SEC) will be introduced exclusively for asset-backed securities issued in the public markets by both U.S. and non-U.S. issuers, and these forms will contain significantly expanded disclosure requirements. Issuers of structured finance products that do not meet the SEC's definition of "asset-backed security" such as CDOs will still be required to use the traditional forms of registration statement.
- Broker-dealers in public deals will be required to wait for at least 48 hours

between the distribution of any prospectus to investors and confirming sales.

- Issuers in both public and private offerings will be required to provide periodic data on assets that have been put back to the sponsor or originator for breaches of point-of-sale representations and warranties.

Key Provisions of the ABS Release for Non-U.S. Issuers

The ABS Release contains provisions which are primarily focused on the offering process and disclosure for asset-backed securities issued in ***public*** transactions registered with the SEC, whether on a stand-alone basis or under a program listed, for example, on a European exchange and registered as a "shelf" in the U.S. (this has historically been the U.S. distribution channel used primarily by non-U.S. issuers for large RMBS and Cards ABS transactions). The ABS Release also contains provisions that affect asset-backed securities offered on a ***private*** basis in the U.S. under the safe-harbors from the registration requirements of the Securities Act provided by Rule 144A and Regulation D, which has generally been the distribution channel used by non-U.S. issuers located in emerging markets or for transactions backed by assets that require a more bespoke selling effort, as well as by less-frequent non-U.S. issuers of RMBS and Cards ABS.

New Disclosure Requirements

Responding to a perceived lack of disclosure to investors, in the asset-backed market prior to the Credit Crisis, the SEC in the ABS Release propose substantially enhanced disclosure requirements. As noted above, while these requirements apply directly only to offerings in the U.S. public markets, because the proposals in the ABS Release would effectively harmonize disclosure in most private offerings with the new requirements for non-shelf public transactions, we believe that it is crucial that *all* non-U.S. issuers and underwriters who may seek to offer in the U.S. familiarize themselves with these new disclosure requirements.

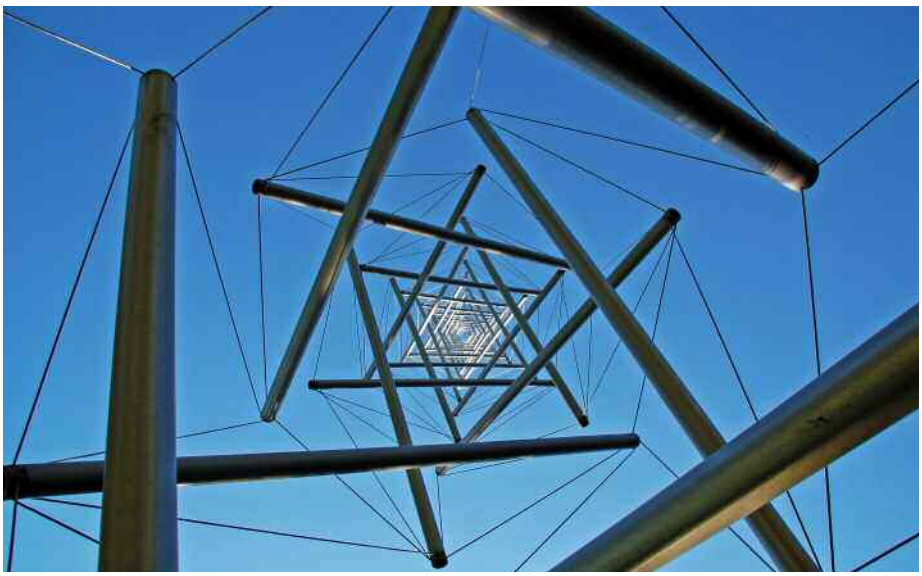
Asset-Level Reporting Requirements

- ***Proposed General Disclosure Requirements***

Historically, the only statistical data provided to investors in asset-backed securities was at the "pool" level. Under the proposals in the ABS Release, whether or not shelf registration is used, issuers will be required to include detailed asset-level data both in the prospectus at the time of initial offering and in their on-going reports to the SEC. This asset-level data will have to be provided in a standardized, computer readable format filed on EDGAR (the SEC's electronic system for data submission). Loan-level data would have to be provided at the time of issuance, when new loans, cardholder accounts or other assets are added to the pool underlying the securities, and on an on-going basis in periodic reports pursuant to Sections 13 and 15(d) of the Exchange Act.

With respect to each individual asset in the pool (or each "group" of assets in Cards ABS), the issuer will be required to provide specified data, including the terms of the asset, obligor characteristics, interest rates and primary servicer information. For Cards ABS, the "grouped" data is intended to be more granular than the pool-level information currently disclosed to investors and would be created by compressing the underlying asset-level data into combinations of standardized "distributional" groups.

Issuers would also be required to update the asset-level data for changes to the pool prior to the date that cash flows start being allocated to investors, if the initial data is from an earlier date. These data points would include the current asset balance, the number of days the obligor is delinquent, the



number of payments the obligor is past due as of the cut-off date and the remaining term to maturity.

The ABS Release seeks to address privacy concerns with respect to the public release of loan-level data by requiring only ranges or categories of coded responses instead of specific location, credit score or exact income or debt amounts.

Commentary: *As with U.S. issuers, non-U.S. issuers of asset-backed securities may struggle at first to meet this new requirement. The SEC believes that most of the information they propose to require is currently being provided voluntarily to the rating agencies. However, non-U.S. issuers may be able to negotiate with the rating agencies as to exactly what information they provide (and in what format), especially where the issuers face IT or other technical difficulties in obtaining the information. In most cases, the SEC's proposed requirements would need to be met to the letter (subject to a six-day "hardship" exemption discussed below) in order to effect a public transaction, potentially presenting greater challenges to issuers. Also, if the provision of asset-level data and the way in which it is provided to investors becomes the subject of market convention in the U.S., first-time or infrequent non-U.S. issuers of asset-backed securities may face greater challenges when seeking to effect a U.S. offering. It is also possible that, if this proposal is adopted, European or other regulators may seek to impose a similar requirement to obtain regulatory parity between markets. We believe that a number of proposals in Europe regarding loan level data, for example, from the European Central Bank and the Bank of England, very much point in this direction. Depending on the nature of the requirements adopted in various jurisdictions, non-U.S. issuers may face challenges in harmonizing the provision of asset-level data to U.S. investors with process and requirements for providing similar information to investors outside of the U.S. A level of international coordination would be desirable for data disclosure purposes.*

- ***Asset-Specific Data Points - RMBS***

For RMBS, the issuer will be required to provide specific information regarding each mortgage loan, with 137 specific data points required, including details of the loan, the property, the obligor's credit and employment status and any mortgage insurance.

Commentary: *Over the last several years, there has been extensive discussion in the U.S. about loan-level reporting in RMBS transactions and the SEC has indicated that the data points proposed in the ABS Release were derived from the disclosure and reporting fields produced by the American Securitization Forum through their Project RESTART (Residential Securitization Transparency and Reporting), which was developed with significant industry involvement in the U.S. The SEC expects that non-U.S. issuers will find a way to adapt to these requirements, even if they were developed from the perspective of the U.S. markets.*

- ***Asset Specific Data Points - Automobile Loans and Leases***

For asset-backed securities backed by loans for the purchase of automobiles or automobile leases, the issuer will be required to file specific data regarding the payment type of the loan/lease, dealer location, vehicle manufacture details, vehicle value and the obligor's credit and employment status.

- ***Asset Specific Data Points - Other Asset Classes***

The ABS Release contains detailed requirements for asset-level data for a wide variety of other asset classes, including commercial mortgage-backed securities, as well as securities backed by equipment loans or leases, student loans, dealer floorplan financings, corporate debt and "re-securitizations".

Commentary: *The asset-specific data points for other asset categories were also generally built around current U.S. market practice or experience, particularly in the area of commercial mortgage-backed securities ("**CMBS**"). Non-U.S. issuers will have to determine whether the SEC's required data points for any given asset class are applicable to the lending practices in their home markets.*

- ***Asset Data File***

Issuers in both "shelf" and standard public offerings in the U.S. will be required to file the relevant asset data (the "**asset data file**") on Form 8-K at various times during the offering process, including when a prospectus is filed with the SEC and when updating disclosure is otherwise required.

Commentary: *In addition to the administrative burden for issuers of preparing and updating asset data files, non-U.S. issuers in jurisdictions with robust data protection laws, such as most European jurisdictions, will need to take particular care to ensure that the identity of the obligors of the underlying assets is fully protected and cannot be inferred from the information contained in the asset data files. This may include*

ensuring that postal codes and other data points that could relate to a particular obligor are not included. Non-U.S. issuers will need to consider whether any such data would be required to be disclosed by the SEC's regulations, and, if so, remove from the portfolio any underlying assets which may result in the disclosure of protected personal information. This process could increase the cost and potential liability for any non-U.S. issuer.

If the registrant experiences unanticipated technical difficulties preventing the timely preparation and submission of an asset data file, the submission will still be considered timely if the asset data is posted on a web site on the same day it was due to be filed on EDGAR, the web site address is specified in the required exhibit, a legend is provided in the appropriate exhibit claiming the hardship exemption, and the asset data file is filed on EDGAR within six business days. The SEC proposes that failure to file the asset data file within that period will result in the loss of eligibility to use the shelf registration process.

Waterfall Computer Program

Issuers of asset-backed securities will be required to file on EDGAR a computer program (the "**waterfall computer program**") of the contractual cash flow provisions of the offered securities in the form of downloadable source code in Python, which the SEC notes in the ABS Release is a commonly used open source and interpretive computer programming language.

The filed source code for the waterfall computer program would be required to provide users with the ability to build in their own assumptions regarding the future performance and cash flows from the pool assets, including but not limited to, assumptions about future interest rates, default rates, prepayment speeds, loss-given-default rates, and any other assumptions required to be described under Item 1113 of Regulation AB. The waterfall computer program must allow the user to integrate those assumptions with the asset data file required to be made available by the issuer at the time of the offering and on a periodic basis thereafter.

The waterfall computer program will be required to produce a programmatic output, in machine-readable form, of all resulting cash flows associated with the offered securities, including the amount and timing of principal and interest payments payable or distributable to a holder of each class of securities, and each other person or account entitled to payments or distributions in connection with the securities, until the final legal maturity date. The issuer will be required to file with the SEC an example of the expected output for each tranche based on sample inputs with the waterfall computer program.

Like the asset data file, the waterfall computer program would be an integral part of the prospectus so that issuers would be required to provide the waterfall computer program at the time of filing the preliminary prospectus, with data accurate as of the date of the filing. Similarly, as a prospectus requirement, the waterfall computer program would be filed with the final prospectus with data accurate as of the date of the filing.

The registrant will be entitled to the same hardship exemption discussed under "Asset Data File" above.

Commentary: *Non-U.S. issuers, particularly smaller issuers, may be concerned about taking responsibility for the waterfall computer program, especially where, historically, the transaction "model" may have been prepared by the arranger on behalf of the issuer. A similar point is made in the Bank of England's current consultation on its Discount Window Facility, which also proposes cash flow model disclosure for issuers of asset-backed securities. In addition, underwriters of asset-backed securities will need to give consideration to what "due diligence" they need to perform with respect to the accuracy of the waterfall computer program.*

Matters Relating to Transaction Parties

■ *Identification of Originator*

Regulation AB currently provides that any party that has originated 10% or more of the assets underlying a transaction must be treated as an originator, even if that entity is not affiliated with the issuer or the sponsor. The SEC is concerned that this may result in minimal disclosure about the originators if a substantial part of the underlying assets comes from third-party originators but no single originator represents more than 10% of the asset pool.

Under the proposal, an entity will be identified as an originator even if such originator has originated less than 10% of the pool assets if the cumulative amount of originated assets by parties other than the sponsor (or its affiliates) comprises more than 10% of the total pool assets.

Commentary: *In our experience, very few non-U.S. issuers of asset-backed securities use multi-originator structures (which are common in the United States). Accordingly, we do not anticipate this portion of the proposals to have a significant impact on most non-U.S. issuers, although participants in the European wholesale loan*

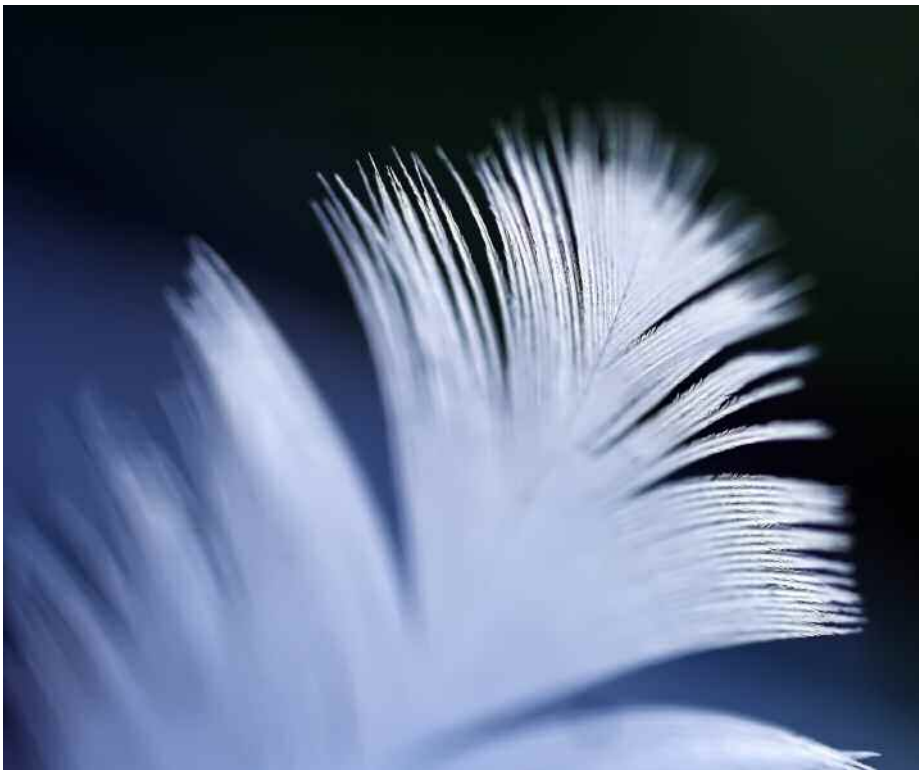
securitisation market that often pooled loans from multiple originators will need to take note of this proposal.

■ *Obligation to Repurchase Assets*

The detailed provisions of the proposals relating to asset-level warranties expand on those referred to above for determining eligibility for shelf registration. Under the proposals, the issuer would be required to disclose the amount, if material, of securitized assets originated or sold by the sponsor or an identified originator that were put back to the sponsor or originator for repurchase as a result of a breach of a point-of-sale representation and warranty on a rolling three-year basis. This disclosure is required to be provided on a pool-by-pool basis, together with the percentage of such assets that had not then been repurchased or replaced by the sponsor or originator.

The issuer would also be required to disclose whether an independent third party had given an opinion to the trustee confirming that any such assets that had not been repurchased did not in fact violate a representation or warranty.

Financial information of the party required to repurchase a pool asset for breach of a representation and warranty pursuant to the transaction agreements will be required, including the interest of that party in the securitization. Information regarding the financial condition of an originator that accounts for 20% or more of the pool assets will be required if there is a material risk that its financial condition could have a material impact on the origination of its assets in the pool or on its ability to comply with repurchase obligations for those assets. The SEC also focuses on disclosure of the steps taken by the



originator to verify borrower application data, including dislosure of whether the originator has made a representation that there was no fraud in the origination of the assets as well as on the availability of investor remedies in the transaction documents.

This information will be required for both shelf and other offerings. If the offering is being registered on Form SF-1, the issuer will be required to provide clear disclosure that the sponsor is not required by law to retain any interest in the securities and may sell any interest initially retained at any time.

Commentary: *While this provision is clearly cumbersome and will require non-U.S. issuers of asset-backed securities to bear additional costs to address a primarily U.S. issue, we do not anticipate this to create a significant stumbling block for non-U.S. issuers. Consideration will have to be given, though, to how some of these additional disclosure points are handled, as some may provoke sensitive discussions in the working group (such as the presence or absence of a "no fraud" representation).*

Prospectus Summary Requirements

The SEC is concerned that existing prospectus summaries for asset-backed securities tend to describe structural features that are common to all securitizations of a particular asset class, rather than concentrating on the variances that might be material to the specific securities described in the prospectus. The ABS Release contains provisions requiring prospectus summaries to include statistical information relating to the types of underwriting or origination programs, exceptions to the underwriting or

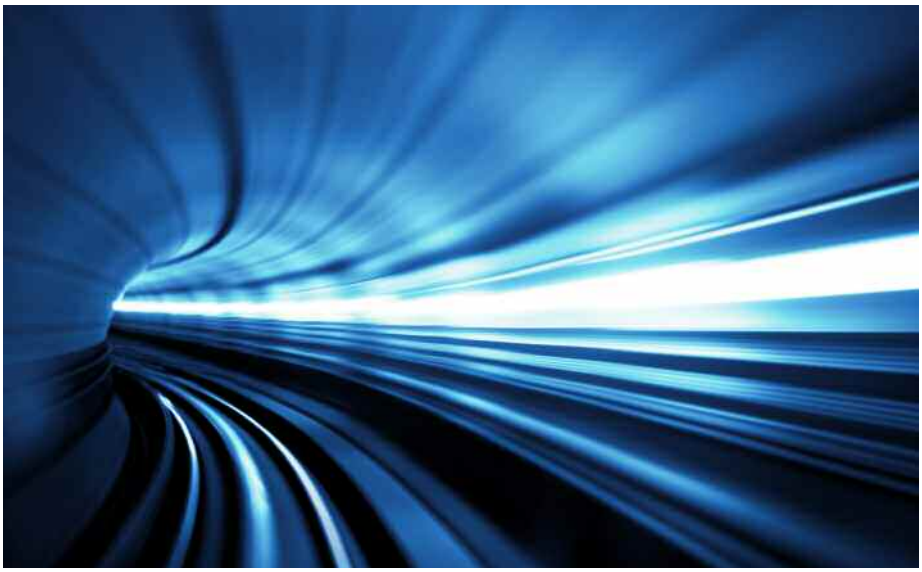
origination criteria and, where appropriate, modifications to pool assets after origination.

Commentary: *Although it may represent a significant change in current market practice, we do not anticipate this part of the ABS Release to present significant concerns for non-U.S. issuers. However, it is likely that non-U.S. issuers will need to spend a fair amount of time, initially at least, revising their prospectuses to align with the proposals. Further, because issuers will want to have only one form of prospectus for all investors, regardless of where they are located, non-U.S. investors will probably receive offering documents with expanded prospectus summaries as well. It is likely that prospectus summaries will be the part of the prospectus which changes the most as a result of the various disclosure reforms proposed in various jurisdictions, as the Bank of England has set out a list of information it proposes to require to be present in the summary section and the European Commission has also set out proposals for the "key information" which must be included in a prospectus that is compalint with the European Prospectus Directive.*

Enhanced Static Pool Disclosure

The initial version of Regulation AB intorduced the idea of pool providing investors with historic information on a "static" basis (*i.e.*, breaking down performance by asset "cohorts such as all assets either originated or securitised in a particular year). The SEC in the ABS Release has proposed four new disclosure requirements regarding static pool information:

- narrative disclosure describing the static pool information presented (for example, for a pool of RMBS, the disclosure would cover the number of assets, types of mortgages (*e.g.*, conventional, home equity, Alt-A, etc.), and the number of loans that were exceptions to standardized underwriting criteria);
- a description of the methodology used in determining or calculating the characteristics presented and a description of any terms or abbreviations used;
- a description of how the assets in the static pools shown in the prospectus differ from the pool assets underlying the securities being offered; and
- if an issuer does not include static pool information or includes disclosure that is intended to serve as alternative static pool information, an explanation of why they have not included static pool disclosure or why they have provided alternative information.



Static pool information related to delinquencies, losses and prepayments will also need to be presented for amortizing asset pools such as RMBS. Also, in public transactions, the SEC would no longer permit static pool data to be posted to a website - all static pool data would need to be filed with the SEC (although PDF format would be permitted).

Commentary: *In our experience, compliance with the existing requirements in Regulation AB to provide static pool data has been challenging for many non-U.S. issuers. We would expect that the expanded requirements proposed by the SEC will add to the challenges of preparing this data. In particular, non-U.S. issuers should bear in mind that, as a result of the harmonization of disclosure in the public and private markets, if the proposals are adopted, it will be very difficult to avoid preparing, and providing to investors, static pool data.*

Pool-Level Information

In addition to the requirements for loan-level data, the proposals in the ABS Release also seek to enhance the pool-level information traditionally provided in most offering documents.

- The issuer's disclosure regarding the underwriting of assets that deviate from the disclosed origination standards (for example, assets that are past due at the time of inclusion) must be accompanied by specific data about the amount and characteristics of those assets that did not meet the disclosed standards. To the extent that disclosure is provided regarding compensating or other factors, if any, that were used to determine that the assets should be included in the pool, despite not having met the disclosed underwriting standards, the issuer will be required to specify the factors that were used and provide data on the amount of assets in the pool that are represented as meeting those factors. An example would be when a very low loan-to-value ratio for a particular residential mortgage loan is considered by the originator to offset a poor credit score in the part of the borrower.
- The issuer will be required to disclose what steps were undertaken by the originator or originators to verify the information used in the solicitation, credit-granting or underwriting of the pool assets.
- The issuer will be required to include disclosure of the provisions in the transaction agreements governing modification of the assets, disclosure about how modification may affect cash flows from the assets or to the securities and disclosure of whether or not a fraud representation is included among the representations and warranties.

Commentary: *These disclosure requirements were clearly driven by well-publicized failures in the U.S. markets, particularly in the sub-prime RMBS sector. We expect that non-U.S. issuers will be able to address these points through due diligence and that they will not present a significant impediment to transactions, although there may be some non-U.S. issuers who may find it commercially sensitive to highlight some of this information.*

Other Disclosure Requirements that Rely on Credit Ratings

The ABS Release would eliminate existing exceptions to disclosure rules, which are based on investment grade ratings, including:

- removing an instruction to Item 1112(b) which provides that no financial information regarding a significant obligor is required if the obligations of the significant obligor are backed by the full faith and credit of a foreign government, and the pool assets are securities that are rated investment grade by an NRSRO;
- removing an instruction to Item 1114 of Regulation AB which relieves an issuer of the obligation to provide financial information when the obligations of the credit enhancement provider are backed by a foreign government and the enhancement provider has an investment grade rating.

Commentary: *This requirement could have a significant impact on issuers of transactions where the obligations of the underlying obligor are guaranteed by an agency of a foreign government (e.g., a residential mortgage loan guaranteed under a state-level guarantee program), because it would potentially require disclosure of financial information about the guaranteeing agency, which may not be readily available.*

New Registration Procedures and Forms for Asset-Backed Securities

New Forms SF-1 and SF-3

The ABS Release proposes two new forms of registration statement, to be used by issuers of asset-backed securities: Form SF-1 for stand-alone transactions and Form SF-3 for shelf programs. These new forms would be exclusively for use in the registration of securities that meet the definition of "asset-backed security" (see "Definition of 'Asset-Backed Security'" below). The main difference between proposed Forms SF-1 and SF-3 and the current Forms S-

1 and S-3 is the extent and nature of the information required to be disclosed on the underlying assets, as discussed below, and the extent to which such information can be incorporated by reference. As with current Forms S-1 and S-3, the new forms largely incorporate provisions of Regulation AB.

Commentary: *While the proposed new forms will not particularly impact foreign issuers, a proposed change in the definition of "asset-backed security" would mean that securities issued by master trusts which are backed by non-revolving assets, such as residential mortgages, would no longer be within the definition and, therefore, would not be eligible to use the new registration forms and, therefore, not be eligible for shelf registration. It is worth noting, however, that anecdotal information at the time of writing indicates that industry sentiment in the U.S. may be generally moving toward the conclusion that the proposed conditions to the use of shelf registration will be difficult to meet and that, as a result, if adopted as proposed, many issuers would choose voluntarily not to issue under shelf programs. Likewise, we believe that very few non-U.S. issuers will elect to make use of the shelf registration process if the proposals are adopted.*

New Shelf Eligibility Criteria

Currently, the eligibility of asset-backed securities programs for shelf registration is based in part on whether the securities to be issued would receive an investment grade rating from an NRSRO, such as Standard & Poor's, Moody's or Fitch. Under the proposals in the ABS Release, the ratings-based eligibility criterion will be eliminated and replaced by the following four new criteria:

- **"Skin-in-the-Game":** The sponsor will be required to retain risk in each tranche of the securitization on an ongoing basis, net of the sponsor's hedging, by either:
  - retaining a minimum of five percent of the nominal amount of each of the tranches sold or transferred to investors; or
  - in the case of revolving asset master trusts (primarily used in Cards ABS transactions), retaining a minimum of five percent of the nominal amount of the securitized exposures as an originator's interest, provided that the originator's interest and securities held by investors are collectively backed by the same pool of receivables, and payments of the originator's interest are not less than five percent of payments of the securities held by investors collectively.

Commentary: *The impact of this requirement on non-U.S. issuers will turn on where the issuer is based and how their home jurisdiction capital and asset-transfer rules are being applied. We would anticipate that, in the UK and in many other jurisdictions, Cards ABS would not be significantly affected because this asset class is issued primarily through master trusts that generally have seller interests at or above five percent. This standard will not be relevant to many non-U.S. issuers of traditional RMBS since non-revolving assets such as mortgages would not be permitted to use the shelf registration channel under the proposals.*

- **Originator Buy-Back Compliance Opinion:** The party required to repurchase pool assets for breach of representations and warranties will also be required to furnish to investors, at least quarterly, an opinion of an independent third-party as to whether the obligated party acted consistently with the terms of the relevant transaction documents, with respect to any loans that the issuer or the trustee put back to the relevant party for violation of representations and warranties and which were not repurchased or replaced by the obligated party.

Commentary: *Most securitizations by non-U.S. issuers currently require the originator or depositor to warrant as to the compliance of the assets with specified standards and criteria set out in the transaction documents. However, the requirement for mandatory verification of compliance with the provisions is new, and reflects the SEC's concern that originators (in the U.S. at least) were not consistent in meeting the buy-back obligations. Implementation of this requirement will involve additional administration and expense. It is also not clear who will perform the verification role as the ABS Release states that audit firms in the U.S. have already indicated that this sort of opinion would not be within the scope of their professional responsibilities. Further, because there are likely to be relatively few non-U.S. issuers using shelf registration, there may be few service providers focusing on helping issuers outside of the U.S. meet this requirement.*

- **CEO Certification:** The proposals in the ABS Release would require the chief executive officer of the depositor to file a certification at the time of each offering off of a shelf registration statement that the assets in the pool have characteristics that provide a reasonable basis to believe that they will produce, taking into account internal credit enhancements, cash flows to service any payments due and payable on the securities as described in the prospectus.

Commentary: *Many depositors in structures involving shelf offerings by non-U.S. issuers are special purpose vehicles. Consideration should be given to what comfort the directors of these entities (often supplied by corporate management companies) would require to give these certifications. It should be noted that this requirement is similar to the requirement in the European Prospectus Directive which requires issuers of asset-backed securities to make a statement in the prospectus that the assets backing the offered securities "have characteristics that demonstrate the capacity to produce funds to service any payments on the notes issued".*

- **Exchange Act Reporting:** The proposals would also require the issuer to undertake to file Exchange Act reports so long as non-affiliates of the depositor hold any securities that were sold in registered transactions backed by the same pool of assets.

Commentary: *This element of the proposal would require non-U.S. issuers to prepare servicer assessments and obtain auditor attestations under Item 1122 of Regulation AB for the life of the transaction. Preparation of these assessments and obtaining the attestations has proved very time-consuming for non-U.S. issuers, and this requirement may further discourage eligible non-U.S. issuers from utilizing shelf registration unless the benefits of shelf registration can be clearly shown to outweigh the challenges of being subject to Item 1122 for the life of the program.*

Shelf Offerings - Formal Requirements

Certain large non-U.S. issuers, particularly in the RMBS and Cards ABS markets, have used shelf programs to facilitate the quick and efficient issuance of securities when appropriate market conditions arise. The SEC has expressed concern that shelf programs generally may have confused investors or presented a lower level of disclosure than stand-alone offerings, because the disclosure relating to the securities is split between a pre-registered base, or program, prospectus and a transaction-specific prospectus supplement for each individual issuance. The base prospectus often omits important information relating to the underlying asset pool, and the prospectus supplement is generally not filed with the SEC until the second business day after the first use of the program. To address these concerns, the SEC has proposed new Rules 424(h) and 430D as a framework for shelf offerings of asset-backed securities.

Consistant with current practice, under the proposals, the form of prospectus which would be contained in a Form SF-3 registration statement may continue to omit any transaction structure or asset/pool-specific information or data at the time it is declared effective by the SEC. However, under proposed new Rule 424(h), the issuer would be required to file a preliminary prospectus (a "**Rule 424(h) filing**" or "**Rule 424(h) prospectus**") that contains all transaction-specific information about the proposed offering except very limited pricing information, such as the offering price/coupon and underwriting discount, at least five business days in advance of the first sale of securities in the offering, This five-day period is intended by the SEC to give investors sufficient time to analyze the transaction and loan-level data and run

their own scenario analysis with the waterfall computer program.

Proposed Rule 430D would require that, with respect to each offering, substantially all of the information that was omitted from the form of prospectus (except for information relating to the offering price, underwriting discounts or commissions, amount of proceeds or other matters dependent upon the offering price) must be filed with the SEC in a near-final preliminary prospectus filed in accordance with Rule 424(h). As a consequence, the proposals would result in each offering being made on the basis of a single prospectus, rather than the existing base-and-supplement format.

Commentary: *Non-U.S. issuers whose transactions are still eligible to use Form SF-3 and who have in the past have integrated a U.S. registered offering into their listed offering programs (e.g., on the London Stock Exchange) will need to focus on the implications of being required to use a single prospectus in the U.S., rather than a base prospectus and supplement and/or final terms document. This is particularly relevant where non-U.S. issuers utilize medium-term note ("**MTN**") programmes, which have allowed them to include stratification tables and other data in a final terms document that is not reviewed or approved by the relevant listing authority. Although there may be relatively few non-U.S. issuers in the SEC shelf-registered channel directly impacted by this element of the proposal, if investors become accustomed to receiving a single disclosure document, we may see more non-U.S. issuers voluntarily preparing supplemental prospectuses that are effectively stand-alone for each offering and that are significantly different from "final terms" style issuances currently in use. This could impact the time required to undertake an offering under MTN programmes for non-U.S. issuers.*

The proposed Rule 430D would also provide that a material change in the information provided in the Rule 424(h) filing, other than pricing information, would require a new Rule 424(h) filing and, consequently, a new five business day waiting period.

Definition of "Asset-Backed Security"

A core principle of Regulation AB's definition of an "asset-backed security" is that it is a security backed by a discrete pool of assets that, by their terms, convert into cash, absent any active pool management. Regulation AB contained an exception to this principle that allowed issuers to take advantage of master trust structures, prefunding periods and revolving periods to allow for changeable asset pools. This exception will change for each category:

Master Trust Structures: Under the ABS Release, the exception will be revised to prevent master trust issuers from using non-revolving assets (*e.g.*, mortgages) A master trust that is not supported by revolving assets would be outside of the general regime for "asset-backed securities". While SEC registration would still be theoretically possible, issuers in this situation would need to determine how they would comply with the broader requirements of Form S-1, or obtain exemptions from these requirements.

Revolving Periods: The permissible duration of the revolving period of non-revolving assets will be reduced from three years to one year.

Prefunding Periods: The amount of permitted prefunding will be decreased from the current 50% of the offering proceeds, or, in the case of master trusts, 50% of the aggregate principal balance of the total asset pool, to 10% of the offering proceeds or, for master trusts, 10% of the aggregate principal balance of the total asset pool.

Commentary: *Excluding non-revolving assets from master trusts in the definition of "asset-backed security" will make accessing the public markets in the U.S. much more difficult for non-U.S. sponsors of residential mortgage master trusts by eliminating the possibility of using the shelf registration channel and forcing these issuers to use "old" Form S-1, which was not intended for issuers of asset-backed securities. Non-U.S. issuers of Cards ABS will not be affected by these changes. Further, it is not yet clear how the SEC will treat covered bonds for purposes of this definition. The term "covered bond" does not appear in the ABS Release. While most observers are hopeful that the SEC will recognize covered bonds as something other than "asset-backed securities" (or other "structured finance products"), and thus outside the scope of the proposals contained in the ABS Release, this is not clear, and the SEC's final view may turn on the structure of the covered bond program and the way in which the covered bonds are being marketed to investors.*

Exchange Act Reporting

In the ABS Release, the SEC also expresses significant concern about the quality of on-going reporting to investors in public transactions and proposes several important changes to the existing requirements in this area.

Form 8-K and Reporting of Material Changes

Under the proposals, issuers will be required to file a current report with disclosure pursuant to Item 1111 and Item 1112 if any material pool characteristic of the actual asset pool at the time of issuance of the asset-backed securities differs by one percent or more from the description of the asset pool in the prospectus filed for the offering pursuant to Securities Act Rule 424 (other than as a result of the pool assets converting into cash in accordance with their terms), together with a description of the changes that were made to the asset pool.

The issuer will be required to file a Form 8-K to describe any material change in the sponsor's interest in the offered securities.

Application of 48-hour rule

Exchange Act Rule 15c2-8(b) currently contains an exception for ABS transactions from the requirement that broker-dealers must deliver a preliminary prospectus at least 48 hours before confirming any sale of the relevant securities. Under the proposals, this exception will be eliminated for all offerings of asset-backed securities, including those involving master trusts.

Commentary: *This proposal is unlikely to be of significant concern for non-U.S. issuers operating in markets such as Europe and most Asian markets where similar rules are already in place.*

Privately-Issued Structured Finance Products

The ABS Release, if adopted, would for the first time require disclosure in private offerings in the U.S. conducted in reliance on Rule 144A and Regulation D to be in line with that required in the U.S. public markets, effectively eliminating one of the main benefits of this distribution channel: the ability of transaction parties to make judgmental determinations as to what information they consider "material' for purposes of a given transaction. The proposal would introduce a definition of "structured finance products" which, in addition to traditional "asset-backed securities", will broadly cover, among other things, synthetic asset-backed securities and fixed-income or other securities collateralized by any pool of self-liquidating financial assets, such as loans, leases, mortgages, and secured or unsecured receivables. This portion of the proposal represents a major change from prior practice and evidences a clear intention on the part of the SEC to close what it perceives as a disclosure "loophole" in their disclosure regulation.

Commentary: *Although certain sectors of the U.S. securitization markets have utilized the Rule 144A distribution channel regularly (particularly, CDOs and synthetics), very few of the most commonly issued asset-backed securities, such as RMBS and Cards ABS, are offered by U.S. issuers in this fashion. However, non-U.S. issuers of traditional and more esoteric assets use Rule 144A offerings to a much greater extent and, accordingly, will experience a much greater impact from this change. Non-U.S. issuers may be less familiar with Regulation D offerings, which are generally targeted at smaller institutional investors than those covered by Rule 144A, as well as at certain high net worth individuals. It is worth noting that neither "traditional" private placements made by issuers pursuant to Section 4(2) of the Securities Act nor private re-sales under so-called "Section 4(1-1/2)" would be covered by the proposals in the ABS Release because the SEC does not have jurisdiction to amend legislation enacted by Congress. Also, the*

proposals would not apply to offerings conducted outside the United States pursuant to Regulation S under the Securities Act.

Additional Disclosure for Resales under Rule 144A

Additional disclosure to investors will be required for any resale made under Rule 144A or offering under Rule 506 of Regulation D. In particular:

- the underlying transaction agreements for the securities must grant to purchasers (and also, in the case of Rule 144A, any security holder or prospective purchaser designated by the security holder) the right to obtain from the issuer of such securities the information, promptly upon request, that would be required if the transaction were registered under the Securities Act, and, in the case of a Rule 144A offering, such ongoing information as would be required by Section 15(d) of the Exchange Act if the issuer were required to file reports under that section; and
- the issuer must represent that it will provide such information promptly.

Commentary: *Because the ABS Release seems to distinguish between Rule 144A offerings and Regulation D offerings, in terms of required on-going disclosure (with specific requirements for on-going disclosure only applicable to Rule 144A offerings), non-U.S. issuers may want to put greater focus on the requirements of Regulation D to conduct private offerings in the United States.*

Proposed Rule 144 Revisions

The SEC has also proposed to conform the public informational requirement of Securities Act Rule 144 to the revisions set out above. Accordingly, in the case of a non-reporting issuers of structured finance products, the issuer must agree in the underlying transaction agreement to provide to any purchaser, any security holder and any prospective purchaser of the securities designated by the holder the right to obtain, upon request of the purchaser or security holder, information that would be required if the offering were registered on Form S-1 or Form SF-1 under the Securities Act and any ongoing information regarding the securities that would be required by Section 15(d) of the Exchange Act, if the issuer were required to file reports under that section. Similarly, the issuer must have represented that it would provide such information to the purchaser, security holder, or prospective purchaser, upon request of the purchaser or security holder.

Notice of Initial Placement of Securities Eligible For Sale Under Rule 144A and Revisions to Form D

The issuer will be required to file with the SEC a notice on a new Form 144A-SF of the offering for the initial placement of structured finance products that are represented as eligible for resale under Rule 144A. The notice would include information regarding major participants in the securitization, the date of the offering and initial sale, the type of securities being offered, the basic structure of the securitization, the assets in the underlying pool, and the principal amount of the securities being offered. The notice would also provide that in submitting the notice, the issuer is undertaking to furnish the offering materials relating to the securities to the SEC upon written request.

This notice must be filed with the SEC no later than 15 calendar days after the first sale of securities in the offering, unless the end of that period falls on a Saturday, Sunday or holiday, in which case the due date would be the first business day following such period.

If an issuer has failed to file Form 144A-SF, then Rule 144A will not be available for subsequent resale of newly issued structured finance products of the issuer or affiliates of the issuer.

Form D will also be amended to collect the same information that the SEC is proposing to require to be provided in proposed Form 144A-SF.

Commentary: *Non-U.S. issuers may be particularly impacted by this requirement as they will be obliged to integrate this notice with other public notice requirements in their home jurisdiction and/or with the relevant listing authority (if the offered securities are listed).*

New Rule 192 of the Securities Act

An issuer of privately-issued structured finance products will be required to provide, upon the investors' request, information as would be required if the transaction were registered (or ongoing information). This rule is intended to provide a basis for sanction by the SEC of any issuer that fails to provide such information on a timely basis.

Implications for Sponsors of Asset-Backed Commercial Paper Conduits

On their face, the proposals in the ABS Release apply to offerings of asset-backed commercial paper ("**ABCP**"). Most ABCP sold in the United States is offered in private placements with very little disclosure on underlying pool assets or other matters covered by Regulation AB. However, unlike almost all other types of asset-backed

securities, ABCP either is, or may readily be, sold pursuant to the Section 4(2) exemption (which is not covered by the proposals in the ABS Release, as noted above). Accordingly, unless the proposals in the ABS Release are revised to address this point, it is possible that issuances of ABCP will not fall into the disclosure requirements in the proposals.

Commentary: *Non-U.S. sponsors of ABCP conduits should bear in mind that, even if offerings of commercial paper by their conduits wind up being not strictly covered by the ABS Release, they may want to consider whether "best practice" might not involve taking a closer look at the level of disclosure program documentation.*

Transition Period

The SEC anticipates that, if adopted, the new and amended rules set forth above would apply to asset-backed securities that are issued after the implementation date of the new requirements. In addition, a transition period will be provided by the SEC after the final version of the ABS Release is adopted.

Conclusion

From its broad scope and innovative provisions, the ABS Release represents the most significant governmental initiative in the U.S. to date in the area of regulation of the securitization markets. The requirement that effectively all investors in structured finance products receive loan-level data accompanied by a bespoke computer model has the potential to revolutionize the securitization markets in the U.S. and around the world. In addition, by harmonizing disclosure in the public and private markets, the SEC sends a strong signal that they expect a greater degree of integrity and "best practice" in the offering and sale of asset-backed securities.

The proposals in the ABS Release have the potential to benefit non-U.S. issuers of asset-backed securities and other structured products if U.S. investors embrace the new approach to disclosure and offering methodology, restoring a vibrant market for these products in the U.S. and providing non-U.S. issuers with a meaningful alternative to the European, Asian and other domestic markets.

At the same time, these potential benefits will come with a not insignificant cost as non-U.S. issuers will seek to adapt to the new requirements and harmonize them with other regulatory initiatives to which they may also be subject in their home markets. In addition, non-U.S. issuers are also currently grappling with the implications of the SEC's separate Rule 17g-5, effective June 2, 2010, which regulates conflicts of interest at NRSROs subject to regulation by the SEC but that places significant burdens on arrangers of asset-backed securities offerings where there is a rating from at least one NRSRO which is paid for by the arranger.

Market participants and other observers will be keenly following the comment process on the ABS Release with the SEC over the next several months for signs of the level of acceptance of these proposals and the chance that they will either be adopted largely in their current form or, alternatively, substantially revised prior to adoption. The degree of take-up of the proposals in the U.S. may also signal whether the ideas proposed by the SEC in the ABS Release wind up setting global standards for the industry.

Contacts

Kevin Ingram
T: +44 20 7006 2416
E: kevin.ingram@cliffordchance.com

Lewis Cohen
T: +1 212 878 3144
E: lewis.cohen@cliffordchance.com

Emma Matebalavu
T: +44 20 7006 4828
E: emma.matebalavu@cliffordchance.com

Christopher Walsh
T: +971 2419 2520
E: christopher.walsh@cliffordchance.com

David Felsenthal
T: +1 212 878 3452
E: david.felsenthal@cliffordchance.com

Steve Kolyer
T: +1 212 878 8473
E: steve.kolyer@cliffordchance.com

Gareth Old
T: +1 212 878 8539
E: gareth.old@cliffordchance.com

Frederick Utley
T: +1 212 878 3460
E: frederick.utley@cliffordchance.com

Robert Villani
T: +1 212 878 8214
E: robert.villani@cliffordchance.com

Peter Voisey
T: +44 20 7006 2899
E: peter.voisey@cliffordchance.com

J201004220035913