FACT SHEET

Asset-Backed Securities: Improving Investor Protection

SEC Open Meeting
April 7, 2010

Overview:

The SEC will vote today on a set of proposed rules revising the disclosure, reporting and offering process for asset-backed securities. The proposals are designed to better protect investors in the securitization market.

Asset-backed securities (ABS) are created by buying and bundling loans – such as residential mortgage loans, commercial loans or student loans – and creating securities backed by those assets, which are then sold to investors.

Often, a bundle of loans is divided into separate securities with different levels of risk and returns. Payments on the loans are distributed to the holders of the lower-risk, lower-interest securities first, and then to the holders of the higher-risk securities.

Most public offerings of ABS are conducted through expedited SEC procedures known as “shelf offerings.” ABS offerings also are sold as private placements which are exempt from SEC registration. ABS private placements are typically sold to large institutional investors known as qualified purchasers (QIBs).

The Recent History:

During the financial crisis, ABS holders suffered significant losses and the securitization market has been relatively dormant ever since. The crisis revealed that many investors were not fully aware of the risk in the underlying mortgages within the pools of securitized assets and over-relied on credit ratings assigned by rating agencies, which, in many cases, turned out to be wrong.

The proposed rules seek to address the problems highlighted by the crisis and to head off the next one, by giving investors the tools they need to accurately assess risk and by better aligning the interests of the issuer with those of the investor.

The Proposed Rules:

Among other things, the proposed rules would better inform investors about the content of an asset-backed security by:

- Requiring the filing of tagged, computer-readable, standardized information about the specific loans in the pool. This so-called “loan-level information” would be provided at the time the asset is securitized and on an ongoing basis.
• Requiring the issuer of the ABS to file on the SEC website a computer program that allows investors to analyze information about specific loans within the pool of assets. This computer program would show the effect of the so-called “waterfall” so investors can see how the borrowers’ loan payments are distributed to investors in the ABS, how losses or lack of payment on those loans will be divided among the investors, and when administrative expenses, such as loan servicing fees, are paid to service providers.

• Providing investors with more time to consider information about the pool of securitized assets before they need to make an investment decision.

• Repealing an existing condition that issuers must receive an “investment grade” rating for an ABS in order to be granted “shelf” or expedited eligibility. Instead, the rules would establish new conditions for ABS shelf-eligibility.

• Increasing transparency in the private ABS market by requiring issuers in the private market to:
  
  o File a notice for ABS offerings made in reliance on an SEC safe harbor. These safe harbors are rules that issuers follow in order to be statutorily exempt from registering.

  o Provide investors with the same information about the securities that would be provided if the offering were publicly registered.

Commission Actions:

Today, the Commission will vote on proposals that would:

Require the Filing of Tagged Computer-Readable, Standardized Loan-Level Information

Under the current ABS rules, information about the loans in an ABS pool is required only at the pool level. The SEC will consider whether to propose new disclosure rules that would require ABS issuers to provide specific data for each loan in the asset pool both at the time of securitization and on an ongoing basis.

The loan-level data would cover items such as the terms and underwriting of the loan, credit information about the borrower, and/or characteristics of the property securing the loan. To make the required information comparable among issuers of the same asset class and more useable to investors, the rules require that the data be provided according to proposed standards and in a format tagged in eXtensible Markup Language (XML) so
that it may be processed by computer. This would enable investors to synthesize large amounts of data about the underlying assets.

Examples of the types of information that would be provided for each loan in the pool include:

- A number identifying each loan so that the loan and its performance can be tracked throughout the life of the security.
- Disclosure of whether or not the loan was made without following the stated loan underwriting standards.
- Disclosure of the extent to which the obligor’s income was verified (e.g. did the lender look at W-2 forms and tax returns?).
- Detailed information about the steps being taken by the servicer to limit losses on loans that are not being paid in full.

The proposal requiring loan-level information would apply to ABS issuers that offer securities backed by residential mortgages, commercial mortgages, automobile loans and leases, equipment loans and leases, student loans, floorplan financings, corporate debt, and ABS backed by other ABS.

ABS that are backed by credit card receivables may have millions of accounts in the pool, so those offerings would be exempt from loan-level information requirements. However, proposed new rules would require issuers to disclose more granular information regarding the underlying credit card accounts in tagged, computer-readable and standardized groupings. Under the proposed rules, issuers of ABS backed by credit cards would present statistical data about accounts with similar characteristics grouped by credit score range, age of account, payment status, and geographic location.

**Require the Filing of a Computer Program That Gives Effect to the Waterfall**

The SEC will consider a proposal requiring, along with the filing of a prospectus for an ABS transaction, the filing of a computer program that demonstrates the effect of the “waterfall.” As noted above, the waterfall dictates how borrowers’ loan payments are distributed to investors in the ABS, how losses or lack of payment on those loans is divided among the investors and when administrative expenses such as servicing those loans are paid to service providers. Currently, a narrative description of the waterfall must be disclosed to investors in the prospectus. The computer program of the waterfall would allow the user to input the loan level data that would also be required to be provided, as described above, giving investors and the markets better tools to analyze an ABS offering.

**Provide Investors with More Time to Consider Transaction-Specific Information**
The SEC will consider whether to impose time limits before a sponsor of the ABS can conduct the first sale in a shelf offering. Under current rules, issuers may sell ABS almost immediately, without providing investors a minimum amount of time to review the disclosure in the offering materials.

The SEC will consider whether to propose requiring that issuers, for each off-the-shelf takedown or offering, file a preliminary prospectus at least five business days before the first sale in the offering. This would give investors time to consider transaction-specific information, including the loan level data described above, before an investment decision needs to be made.

**Repeal the Investment Grade Ratings Criterion for ABS Shelf-Eligibility**

Under existing rules, an ABS offering is not eligible for an expedited offering unless the securities are rated investment-grade by a credit rating agency. The SEC will consider whether to propose new ABS “shelf” eligibility criteria to enhance the type of securities that are being offered and the accountability of participants in that securitization chain.

The proposals would require, as a condition for shelf-eligibility, that:

- The chief executive officer of the ABS issuer certify that the assets have characteristics that provide a reasonable basis to believe that they will produce cash flows as described in the prospectus.
- The ABS sponsor hold five percent of each class of asset-backed securities and not hedge those holdings.
- The ABS issuer provide a mechanism whereby the investors will be able to confirm that the assets comply with the issuer’s representations and warranties, such as representations and warranties that the loans in the ABS pool were underwritten in a manner consistent with the lenders’ underwriting standards.
- The ABS issuer agrees to file Exchange Act reports with the Commission on an ongoing basis (rather than stop reporting with the Commission in the first year, which the Exchange Act currently permits many ABS issuers to do).

While ratings would continue to be allowed for ABS offerings, the proposed rules would eliminate the ratings requirement from the SEC’s expedited shelf-eligibility test. Additionally, the added information and time provided under the proposals should allow investors to perform their own analyses and rely less on ratings.

**Increase Transparency in the Private Structured Finance Market**

The SEC will also consider whether to propose disclosure requirements that would increase transparency in the exempt private structured finance market where some types
of asset-backed securities, such as collateralized debt obligations (CDOs), are sold. Under these proposals, where an SEC safe harbor (e.g., Rule 144A or Regulation D) is relied upon for the unregistered sale of securities, the issuer must provide investors, upon request, at the time of the offering and on an ongoing basis, the same information that would be required if the offering were registered with the SEC or if the issuer were required to report with the SEC under the Exchange Act.

The SEC also will consider a proposal to require that an ABS issuer file a public notice of the initial placement of securities to be sold under Securities Act Rule 144A. This notice would require information about those ABS offerings and would be publicly filed with the SEC in its EDGAR database. Form D, the notice of an offering made in reliance on Regulation D, also would be revised to collect information on structured finance products.

**Make Other Revisions to the Regulation of ABS**

The SEC also will consider whether to propose other revisions regarding ABS. Among other things, the SEC will consider whether to propose to:

- Standardize certain static pool disclosure.
- Amend the Regulation AB definition of an “asset-backed security” to better ensure that investors have sufficient information about the securities.
- Require additional information regarding originators and sponsors, such as information for certain identified originators and the sponsor relating to the amount of the originator’s or sponsor’s publicly securitized assets that, in the last three years, has been the subject of a demand to repurchase or replace.
- Lower the threshold change in the material pool characteristics that triggers the filing of a Form 8-K (pursuant to Item 6.05) from five percent to one percent.
- Specify, in addition to the loan-level proposed requirements, the disclosure that must be provided on an aggregate basis relating to the type and amount of assets that do not meet the underwriting criteria that is described in the prospectus.