

The registration, disclosure, and reporting requirements for publicly issued asset-backed securities (ABS) are governed by the Securities Act of 1933 and the Exchange Act of 1934. The modern asset-backed securities market did not exist at the time of the creation of these laws, and as a result, the process of asset-backed security registration has been revised several times by Congress and the Securities and Exchange Commission (SEC) to better reflect the needs of the ABS market.

Understanding Regulation AB



PricewaterhouseCoopers Structured Finance Group and Consumer Finance Group

Regulation AB – At a glance:

- ◆ Updates and clarifies the Securities Act registration requirements for Asset Backed Securities (“ABS”) offerings
- ◆ Consolidates existing positions that allow modified Exchange Act reporting that is more relevant to ABS
- ◆ Provides disclosure guidance and requirements for Securities Act and Exchange Act filings involving ABS
- ◆ Establishes a consistent servicing standard that is used as the basis for measuring the performance of each party participating in servicing activities
- ◆ Requires an accountant’s attestation report for each servicer assertion

Understanding Regulation AB

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The registration, disclosure, and reporting requirements for publicly issued asset-backed securities (ABS) are governed by the Securities Act of 1933 and the Exchange Act of 1934.¹ The modern asset-backed securitization market did not exist at the time of the creation of these laws, and as a result, the process of asset-backed security registration has been revised several times by Congress and the Securities and Exchange Commission (SEC) to better reflect the needs of the ABS market.

On December 22, 2004, the SEC published final regulations, labeled “Regulation AB²”, that, among other things, consolidate and codify existing interpretative, primarily client-specific positions that clarify the Securities Act registration requirements for asset-backed securities offerings. We will highlight the three key changes required by this new regulation:

1. Changes to the required disclosures associated with the securities registration process
2. Changes to the Exchange Act reporting requirements for ABS
3. A new annual servicing assertion and accountant’s attestation report

Transition Timeline

Only those securitizations that meet the definition of “Asset-Backed Security” issued through the SEC registration process (S-1 and S-3) are covered by Regulation AB. Therefore, privately issued securitizations are not subject to the regulation.

All public asset-backed issuances commencing after December 31, 2005 will be subject to the new regulatory requirements.

Those issuances commencing on or prior to December 31, 2005 will be grandfathered in their entirety. Nearly all issuers will need to file amendments to their outstanding registration statements, ensuring compliance for takedowns after December 31, 2005 under the new rules. In some cases, registrants will have a grace period extending through the first quarter of 2006.

Assuming ABS registrants file on a calendar year basis, the first 10-K filed under the new rules would be due no later than March 2007. However, master trusts not filing on a calendar year basis may be subject to the new rules as early as March 2006. The new monthly report, Form 10-D, will be required to be filed as early as January 2006.

New Disclosure Regulations for ABS Securities

The new Form S-3 instructions for ABS, as described in “Regulation AB³”, specify incremental information that must be

reported in the registration documents. Issuers will need to determine which information is applicable and material for each offering.

Perhaps one of the most significant of the new requirements is the static pool analysis. The static pool information presents the performance for specific types of assets originated at different points in time. By comparing the performance of originations at similar points in the asset life cycle, investors can evaluate trends or patterns that may not be apparent from overall portfolio data.

The SEC believes that investors will benefit from static pool data regarding delinquency and loss history critical information in evaluating their investment in asset-backed securities. The new SEC regulations require disclosure of static pool data if material to the transaction.

In general, static pool data will be required with respect to the delinquency and loss experience of the sponsor's overall portfolio, or from prior securitized deals, for the past five years, or a shorter period when appropriate. The data should be presented in increments, monthly or quarterly, that are material or significant to the asset type being securitized.

Given the enormous amount of historical data for which disclosure may now be necessary, the SEC will provide issuers with the option of posting static pool data on a web site rather than including it in the prospectus. The process of finding, capturing, reviewing and reporting static pool data will be a challenge for even the largest of ABS sponsors.

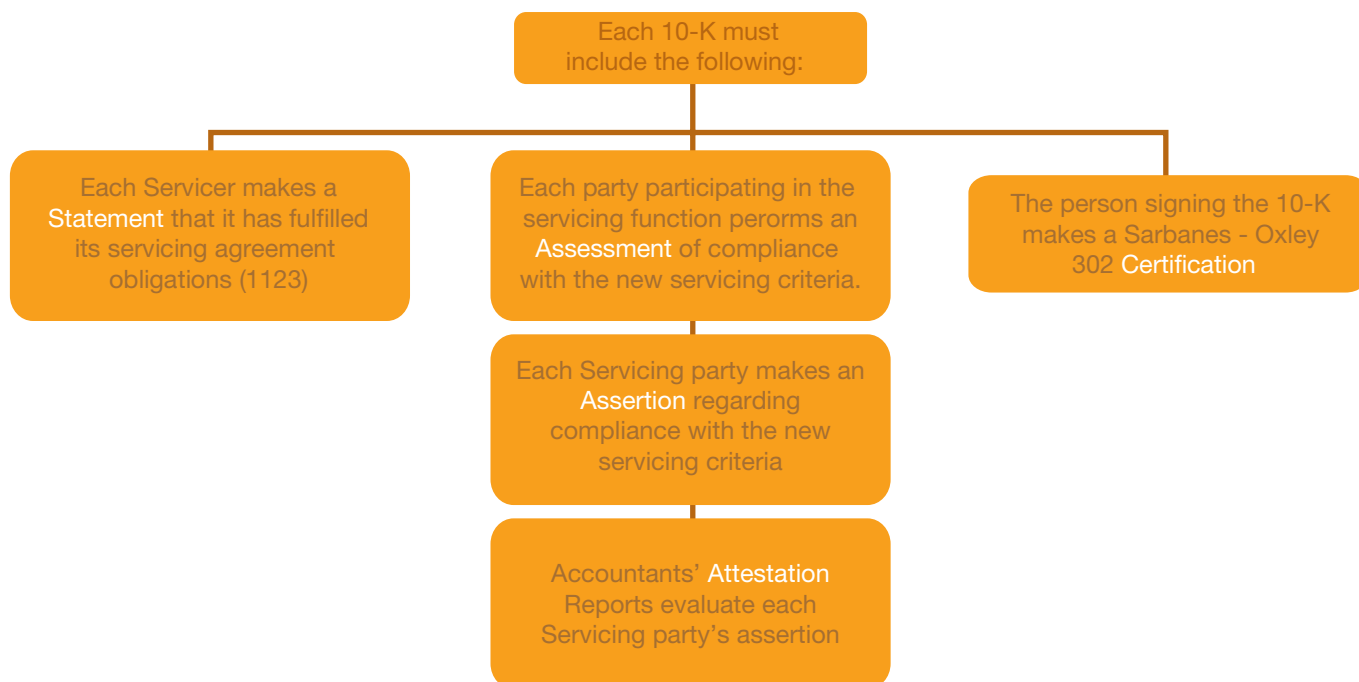
Changes to the Exchange Act reporting requirements

Under the existing reporting system, periodic distribution and pool performance information is generally filed on Form 8-K in lieu of filing quarterly reports on Form 10-Q. However, investors are not able to easily distinguish these Form 8-K reports from other reporting on Form 8-K, such as the reporting of extraordinary events or the filing of transaction agreements.

The SEC is adopting a new Form 10-D, to act as the report for the periodic distribution and pool performance information. Every asset-backed issuer subject to Exchange Act reporting requirements will have to make such reports on Form 10-D and to file the report within 15 days after each required distribution date. A report will be necessary regardless of whether the required distribution was actually made or whether a distribution report was in fact prepared or delivered under the governing documents.

With Form 10-D, issuers must provide information required by Item 1121 of Regulation AB and attach as an exhibit to Form 10-D the distribution report delivered to the trustee or security holders. The stated expectation is that all or most of the distribution and pool performance information required by Item 1121 will be included in the distribution report. If all of the required information is not in the distribution report, the missing information must be provided in the Form 10-D itself.

The final regulations add a separate general instruction to Form 10-K – Instruction J – to specify how the form is to be used



with respect to ABS. Key changes include a specific Sarbanes-Oxley 302 certification and a statement of compliance with the applicable servicing criteria (defined in Regulation AB) from all parties participating in the servicing function.

The final regulations are specific and limiting with respect to who is permitted to sign ABS Exchange Act reports. For Forms 10-D and 8-K, the report must be signed by the depositor. “In the alternative,” however, the report may be signed on behalf of the issuing entity by a duly authorized representative of the servicer. With respect to Form 10-K, such annual reports must be signed either (i) on behalf of the depositor by the senior officer in charge of securitization of the depositor or (ii) on behalf of the issuing entity by the senior officer in charge of the servicing function of the servicer.

Servicers and depositors have already begun to analyze the additional information that will need to be reported on Forms 10-D and 10-K. The new forms will require changes to both information systems as well as the processes by which organizations gather and report the required information.

The annual servicing assertion and accountant’s attestation report

A servicer assessment report will be required from each party participating in the servicing function of an ABS, containing the following:

1. A statement of the party’s responsibility for assessing compliance with the servicing criteria applicable to it.
2. A statement that the party used the servicing criteria (as defined in 1122 of Regulation AB) to assess compliance with the applicable servicing criteria.
3. The party’s assessment of compliance with the applicable servicing criteria as of and for the period ending at the end of the fiscal year covered by the Form 10-K report. The report must include disclosure of any material instance of non-compliance identified by the party.
4. A statement that a registered public accounting firm has issued an attestation report on the party’s assessment of compliance with the applicable servicing criteria as of and for the period ending at the end of the fiscal year covered by the report on Form 10-K.

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. Also, 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 is backed by assets of the type backing the ABS covered by the Form 10-K report.

A new “Attestation report on assessment of compliance with servicing criteria for asset-backed securities” in which a registered public accounting firm expresses an opinion, or states that an opinion cannot be expressed, concerning an asserting party’s assessment of compliance with servicing criteria, will be required under the Regulation and in accordance with standards on attestation engagements issued or adopted by the Public Company Accounting Oversight Board. (AT § 601).

The report issued by the registered public accounting firm must be available for general use and not contain restricted use language. The SEC believes that the servicing criteria adopted as part of Item 1122 of Regulation AB are suitable criteria, as that term is defined in the SSAE No. 10, and are available to enable a registered public accounting firm to issue a report on a party’s assertion without restricted use language. These procedures will largely be incremental to procedures often performed today under the Mortgage Banker’s Association “Uniform Single Attestation Program”.

Material instances of non-compliance during the reporting period, even if such non-compliance was subsequently corrected during the reporting period, must be disclosed on Form 10-K.

Conclusion

PwC views the implementation of Regulation AB as a positive initiative for the U.S. structured finance markets in general. However, some issuers may be challenged initially as they attempt to grasp the breadth of the regulation’s requirements and the exact interpretation of certain sections.

With the deadline for compliance rapidly approaching, key considerations include ensuring enterprise-wide compliance with the regulation, development of contingency plans for possible non-compliance, monitoring the process and expense of implementation, and managing significant system/data changes which may be necessary to comply with the new reporting requirements. These issues, if not addressed properly, could cause timing delays in new issuances and restatement of non-compliant servicer reports, and while the SEC’s potential reaction to such issues is difficult to predict, it could lead to a

sponsor's loss of shelf registration eligibility if a sponsor of an ABS transaction fails to comply with Exchange Act reporting requirements. The compliance requirements extend beyond the issuing entities established by the depositor, and affects any issuing entity established directly or indirectly by any affiliate of the depositor with respect to the same asset class.

PwC is working with many of our clients in preparing them for the new requirements and assisting them in assessing their readiness. For more information on Regulation AB, please contact Catherine Hay at 646.471.8366.

References

¹ PricewaterhouseCoopers has prepared this article regarding Regulation AB in order to provide a framework for a general understanding to a user of such information. PricewaterhouseCoopers does not practice law, and is not in this article interpreting the requirements of the U.S. securities law and regulations or providing legal advice. Readers should seek advice from legal counsel with regard to any matters of law related to the preparation or understanding of information related to Regulation AB

² Securities Act Release No. 8518 (Dec. 22, 2004) [70 FR 1506] (the "ABS Adopting Release"), available on the Web at <http://sec.gov/rules/final/33-8518fr.pdf>

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