

TRANSACTIONAL ALERT

SEC Proposes Comprehensive Rules for Asset Backed Securities

by Daniel Lampert and Laura M. Holm

Responding to the burgeoning markets in asset-backed securities ("ABS"), on May 3, 2004 the SEC issued proposed rules (the "Proposed Rules") for ABS. The SEC release for the Proposed Rules (available at <http://www.sec.gov/rules/proposed/33-8419.htm>) largely codifies law established in no-action letters and the filing review process, but also provides comprehensive SEC guidance for ABS transactions. Although the Commission may amend the Proposed Rules before enacting them, ABS issuers in public and private transactions should begin to implement the new disclosure requirements.

The Proposed Rules (i) define ABS and the regulations' scope; (ii) regulate communications for ABS shelf offerings on Form S-3; (iii) provide comprehensive disclosure requirements; and (iv) provide ongoing 1934 reporting requirements. This report focuses on latter two items, the Proposed Rules' provisions regarding disclosure and ongoing reporting, which will change practices throughout the ABS industry.

OFFERING STATEMENT DISCLOSURE

The SEC proposes to codify offering disclosure in a new "Regulation AB". Regulation AB incorporates disclosure from Regulation SK; e.g., for the security description. Regulation AB also substantially enhances disclosure of parties to the ABS transaction, including: (i) the sponsor (the originator or purchaser of the ABS's pooled assets); (ii) the depositor (any intermediary purchasing assets for transfer to the ABS pool); (iii) the issuing entity (the trust or other entity that owns the ABS pool and issues the ABS); (iv) the servicer (the party engaged to collect, allocate and/or distribute the ABS assets); and (v) the trustee (named under the trust indenture to represent ABS holders).



Regulation AB's enhanced disclosure regarding these transaction parties focuses on matters material to each. Disclosure for the sponsor or depositor centers on these parties'

Do you know how the new SEC rules affect this important industry?

experience in securitizing similar or dissimilar assets, track record of growth or default, the extent they rely on third parties to perform various activities, or depend on ABS transactions for funding. Disclosure for the issuer includes tracing all transactions (and disclosing all fees and expenses) regarding the ABS assets from origination into the issuing entity, and disclosing the discretionary functions in administering the issuer, and the persons exercising that discretion. Disclosure for the services focuses on the specific functions they perform and their experience in discharging those functions, including (i) the growth in assets they service and their history involving defaulted or non-compliant transactions, and (ii) if material, the servicers' financial condition, and any recent changes in their policies or procedures. The Proposed Rules require additional disclosure on matters such as significant obligors (parties obligated under 10% or more of the pool's assets), credit enhancement and hedging agreements (including interest swaps, and disclosure regarding the counterparties to such arrangements), and affiliated or related party transactions (whether or not related to the ABS offering). These provisions expand existing regulations and market practice.

Regulation AB also requires statistical disclosure not presently required regarding the ABS pools' portfolio performance. This so called "Static Pool Data" analyzes ABS pool performance based on characteristics such as asset type, term or geographical distribution. Static Pool Data would cover up to three years of sponsor's portfolio prior performance (including the overall portfolio and the portions previously securitized), and disclose the performance of the pool being securitized. Only institutional investors now receive this information, and this aspect of Regulation AS advances the SEC position for equal access to information for all investors.

1934 ACT REPORTING FOR ABS ISSUERS

While the Proposed Rules retain most existing reporting requirements under the 1934

Act (e.g., ABS issuers remain exempt from 10-Q quarterly reporting and outside the scope of Section 16), the new rules propose three substantive changes: (a) creating a new Form 10-D for distributions to investors, (b) revising the general instructions for 10-K reports by ABS issuers, and (c) changing 8-K reporting requirements for ABS issuers.

The new Form 10-D would report on certain material matters, including: (i) distributions to investors, (ii) portfolio performance, (iii) newly commenced legal proceedings and significant developments in existing cases, and (iv) updated financial information; (e.g., regarding significant obligors, hedging counterparties, etc).

The Form 10-K amendments would require four new Exhibits: (i) Servicer Statement: disclosing the servicer's activities and compliance with the operative agreements; (ii) Sarbanes-Oxley Statement: certifying compliance with filing requirements (including the new Form 10-D); (iii) Servicer Compliance: reporting on the servicer's compliance with various criteria, including cash collections, ABS pool administration, distributions and reports to investors; and (iv) Accountants' Report: regarding the issuer's financial statements and replacing an annual audit report and Sarbanes-Oxley Section 404 report.

Finally, ABS issuers would be required to report on Form 8-K for matters such as : (i) changes in transaction parties (servicers, trustee); (ii) changes in credit enhancement or hedging positions; (iii) delays in required distributions to investors, (iv) sales of securities supported by the same asset pool or made by the ABS issuer; and (v) variances between the asset pool described in the offering statement and when the ABS transaction closes.

The comment period for the Proposed Rules closed on July 14, 2004. The SEC staff is now developing a final regulatory proposal, which it will recommend to the Securities and Exchange Commission. As of December 2004, no specific guidance has been given as to when the final regulatory proposal will be published; however, the project is a high priority for the SEC. The Proposed Rules reflect the increasing importance of ABS transactions to the national economy. While the final rules may differ from those outlined above, participants and investors in the ABS industry should monitor these developments carefully. ■



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Laura Holm specializes in corporate and securities law matters. Laura's practice includes a variety of business, corporate, securities and financing matters, focusing on public and private companies. She has represented a wide variety of clients, both public and private, in a wide variety of transactions, including but not limited to mergers and acquisitions, bank financings, general corporate issues and international contracting issues. Ms. Holm currently serves as outside general counsel to several public companies. She has

written and developed policies relating to the Sarbanes-Oxley Act, corporate governance requirements, insider trading, Regulation FD, Section 16 reporting, Foreign Corrupt Practices Acts and audit committee requirements. Ms. Holm also works with emerging growth companies in connection with formation issues, financing, acquisitions, IPO's and changes of ownership. She recently represented a venture capitalist in a \$20 million investment in a technology company.

Ms. Holm has lectured frequently on issues that are relevant to start-up companies and public companies. She currently serves as a Director of Gold Coast Venture Capital Club, a not-for-profit organization which assists early stage companies in raising capital. She is also an active member of Association of Public Corporations and the Association for Corporate Growth.

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