

Highlights of Securitization Provisions in Dodd Bill

Risk Retention and Hedging

- Requires securitizers to retain an economic interest in a material portion of the credit risk of any asset they transfer, through issuance of an ABS, to a third party. Defines “securitizer” as issuers or one who initiates a transaction by selling or transferring assets to an issuer.
- The amount of risk retained will be at least 5%, but can be lower if the securitized assets meet underwriting standards that indicate low credit risk that will be developed by regulators.
- Rules shall “prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset.”
- Separate rules must be developed for distinct asset classes, such as home mortgages, commercial mortgages, commercial loans, and auto loans.
- Regulations will set duration of retention and specify permissible forms of retention. Regulations may also provide for the allocation of risk retention requirements between securitizers and originators (defined as a person who sells an asset to a securitizer). In determining such allocation, regulators must consider (1) whether the assets sold to securitizers have terms and characteristics that reflect reduced credit risk, (2) whether secondary market activity creates incentives for imprudent lending, and (3) the impact of risk retention requirements on access to credit by consumers and business.
- The risk retention rules shall provide for total or partial exemption of any *securitization*, “as may be appropriate in the public interest or for the protection of investors.”
- The regulators are also authorized to adopt or issue exemptions for classes of institutions or assets relating to the risk retention and hedging rules. Any exemption must meet these criteria: (1) help ensure high quality underwriting standards for assets that are securitized; (2) encourage appropriate risk management practices by the securitizers and originators of assets, improve the access of consumers to credit on reasonable terms [we note that this criteria does not include “businesses,” and will work to see that it does], or otherwise be in the public interest and for the protection of investors.
- The regulations are to be jointly developed by the OCC, FDIC and SEC. The appropriate banking agency will enforce the rules for banking institutions, and the SEC will enforce for all others.
- The regulations must be published by 270 days after enactment. They must go into effect two years after publication of final rules for all assets other than residential mortgages. The rules for residential mortgages must go into effect one year after publication of final rules.
- Unlike the House bill, there is no provision requiring that rulemaking be preceded by a study of the combined effects of risk retention and accounting rules.

Disclosures

The SEC must adopt rules to impose the following disclosure requirements for ABS:

- for any ABS that must be registered with the SEC, the issuer must perform a due diligence analysis of the underlying assets and must disclose the nature of the analysis (these rules must be adopted within 180 days of enactment);
- issuers must disclose information regarding the assets backing the ABS for each tranche or class of security, including:
 - asset-level or loan-level data necessary for investors to independently perform diligence;
 - data with unique identifiers relating to loan brokers or originators;
 - the nature and extent of broker or originator compensation; and
 - the amount of risk retained by the originator and securitizer of the assets.
- as part of the credit rating agency reform provision, issuers or underwriters must publicly disclose the findings and conclusions of any third-party due diligence report they obtain;
- Excludes ABS from the automatic reporting suspension in Section 15(d) for securities with less than 300 holders. Permits the SEC to allow for the suspension or termination of reporting for any class of issuer of ABS upon terms and conditions as it deems necessary.

Representations and Warranties

Within 180 days of enactment, the SEC must prescribe rules for ABS to do the following:

- Require NRSROs' credit rating reports to include information on the representations, warranties and enforcement mechanisms available to investors with respect to the rated ABS, and provide information on how these representations, warranties and enforcement mechanisms differ from those in issuances of similar securities. The SEC must adopt these rules within 180 days of enactment.
- Require disclosure in reps and warranties of any unfulfilled or fulfilled repurchase requests across all trusts aggregated by the securitizer.

Exempted Transactions

- The bill removes the exemption from '33 Act registration for transactions involving offers or sales of one or more promissory notes directly secured by a first lien on a single parcel of real estate upon which is located a dwelling or other residential or commercial structure.

Credit Rating Agency Reform

- There is no mandate of differentiated symbols for structured finance products. There is a "universal rating symbols" provision requiring that each NRSRO establish and maintain written policies that assess the probability of default for a particular instrument and define and

disclose the meaning of any symbol the NRSRO uses to denote a credit rating, and they must apply any such symbol consistently for all types of securities for which the rating is used. This provision is followed by a “rule of construction” stating that the universal rating symbol provision does not prohibit use of distinct symbols to denote ratings for different types of securities.

- There are numerous oversight and reporting requirements for NRSROs, including establishment of a new office with the SEC to regulate them, annual examinations, and a requirement that credit rating analysts meet qualifications standards to be developed by the SEC.
- There are numerous new requirements addressing ratings transparency, including public disclosure of assumptions underlying ratings, data relied upon, information on uncertainty, and whether third-party information was relied upon. Issuers and underwriters must publicly disclose the findings and conclusions of any due diligence report obtained by the issuer or underwriter. Third-party due diligence services must certify (in a form and content to be established by the SEC) that they have conducted a thorough review of data, documentation, and other relevant information necessary for the NRSRO to provide an accurate rating. NRSROs must make such certifications. public
- NRSROs will be obligated to consider credible information about an issuer that the NRSRO has or obtains from a third party if the information would be “potentially significant” to a rating decision.
- A private right of action will be created to allow suits against credit rating agencies for a knowing or reckless failure to conduct a reasonable investigation of the facts or to obtain analysis from an independent source (§ 933). NRSROs will also have an affirmative obligation to report suspected legal violations on the part of issuers being rated by the NRSRO.