

# MARKETS IN MOTION

developments that matter in financial markets

## US Proposes New Rules for Investor Protection in ABS

"The rules we are proposing stem from lessons learned during the financial crisis. These rules, if adopted, would revise the regulatory regime for asset-backed securities in order to better protect investors."

SEC Chairperson Mary L Schapiro

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Ms Meena Kulkarni  
Tel: +91 22 6731 8842  
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The recent financial crisis in the US highlighted investors' lack of understanding of the asset-backed securities market and the extent to which it impacted the US economy as also economies worldwide. It has also brought to focus the efficacy of several aspects of regulation of asset-backed securities (ABS).

The US Securities and Exchange Commission (SEC) recently proposed rules regarding disclosure, reporting and offering process for ABS with a view to protect investors more effectively in the securitization market.

### Securitization and ABS Regulations

Asset-backed securitization is the transformation of illiquid assets into a security, i.e., an instrument that is issued and can be traded in a capital market. Assets that have been transformed in this manner include bank loans such as residential mortgages, auto loans, credit card receivables, leases and utility payments.

ABS regulations were originally adopted in 2004 by the SEC and came into effect on January 1, 2006, to provide consistency and conformity to the rules and procedures governing public offerings of ABS.

### Proposals

The new rules are intended to tighten the disclosure, offering and reporting process for ABS.

### Existing Rule on Disclosures

Information about the loans in an ABS pool is required only at the pool level.

### Proposal

As per the new SEC rule, ABS issuers will have to provide specific data for each loan in the asset pool, both at the time of securitization and on an ongoing basis.

### Existing Rule on Sequential Payment

The sequential payment structure is generally referred to as 'waterfall'. In case of insufficiency of funds in the securitized pool, the investors in the

most subordinate bond class will incur a loss with further losses impacting more senior classes in reverse order of priority.

### Proposal

The new rule requires filing of the computer programme of the waterfall structure to provide investors and the markets better tools to analyse an ABS offering. The structure should reveal how borrowers' loan payments are distributed to investors in ABS, how loss or lack of payment on those loans is divided among the investors, and when service providers are paid administrative expenses such as servicing those loans.

### Existing Rule on Minimum Time

Under the existing rule, issuers could sell ABS almost immediately, without providing investors a minimum amount of time to review the disclosure in the offering materials.

### Proposal

The new rule would give investors more time to consider transaction-specific information before an investment decision needs to be made.

### Existing Rules on 'Shelf' Eligibility

Under existing rules, an ABS issue is eligible for an expedited offering if the securities are rated investment-grade by a credit rating agency. By using 'shelf' registration under the current rules, the firm can fulfill all registration-related procedures beforehand, i.e., upto three years in advance, and quickly go to the market when conditions become more favourable.

### Proposals

The SEC proposes new ABS 'shelf' eligibility criteria to enhance the type of securities that are being offered and the accountability of participants in that securitization chain. 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.

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Financial Technologies Knowledge Management Company  
Exchange Square, 1st Floor, Suren Road,  
Chakala, Andheri (East), Mumbai - 400093, India.  
Tel: +91 22 6731 8888 • Fax: +91 22 6726 9541  
Email: [marketsinmotion@ftkmc.com](mailto:marketsinmotion@ftkmc.com) • Website: [www.ftkmc.com](http://www.ftkmc.com)

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