SEC Adopts Rule 15Ga-2 and Rule 17g-10 Regarding Disclosure of Third-Party Due Diligence Services Relating to Asset-Backed Securities

On August 27, 2014, the Securities and Exchange Commission (the "SEC") adopted final rules[1] applicable to nationally recognized statistical rating organizations ("NRSROs"), including new Rule 15Ga-2 and new Rule 17g-10.[2] The new rules implement certain requirements of Section 15E(s)(4)[3] of the Securities Exchange Act of 1934 (the "Exchange Act") relating to the disclosure of third-party due diligence services employed in connection with the issuance of asset-backed securities. Section 15E was added to the Exchange Act by Section 932(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[4] Notably, as discussed in more detail below, the new rules require the disclosure of certain services that are typically performed by accountants pursuant to agreed-upon procedures ("AUP") and Rule 193 engagements.

Both rules will become effective on June 15, 2015.

Rule 15Ga-2

Rule 15Ga-2 requires the issuer[5] or underwriter of an asset-backed security, as defined in Section 3(a)(79) of the Exchange Act[6] ("Exchange Act ABS"), that is to be rated by an NRSRO to furnish Form ABS-15G to the SEC containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. The Form must be provided regardless of which party pays for the rating and whether the NRSRO uses the third-party due diligence report in determining its credit rating. The Form should be filed on EDGAR at least five business days prior to the first sale in the offering.[7]

The rule applies to all offerings of rated Exchange Act ABS, whether they are publicly or privately offered. However, the rule does not apply to offshore offerings (i.e., issuance by a non-U.S. Person in a non-registered offering to investors outside of the U.S.).[8]

Form ABS-15G furnished pursuant to Rule 15Ga-2 must contain "the findings and conclusions" of the applicable third-party due diligence report. The Adopting Release expressly states that a summary of the report and its findings will not satisfy this requirement. The SEC's rationale for the requirement is that the issuer or underwriter summaries run the risk of excluding important information from investors. In addition, the Adopting Release suggests that the Form should include disclosure of the criteria against which the underlying assets were evaluated and how the evaluated assets compared to those criteria along with the basis for including any loans not meeting those criteria in the securitization.

If the disclosure required by Rule 15Ga-2 is made in a prospectus in connection with the offering of the Exchange Act ABS, the Form ABS-15G may refer to the applicable section of the prospectus containing the required Rule 15Ga-2 disclosure (provided that the disclosure

in the prospectus identifies the applicable due diligence provider and the prospectus is publicly available at the time of the filing of Form ABS-15G). However, the rule does not require that the prospectus include a disclosure of a third-party due diligence report.[9] In addition, the requirements of Rule 15Ga-2 are not affected by whether an NRSRO has undertaken to publicly disclose the information that is required to be included on Form ABS-15G.

A Form ABS-15G that is filed by an issuer must be signed by the senior officer of the depositor in charge of securitization. A Form ABS-15G that is filed by an underwriter must be signed by a duly authorized officer of the underwriter. If both the issuer and the underwriter receive the same due diligence report, only one of them is required to file a Form ABS-15G with respect to that report.

The Adopting Release clarifies that Form ABS-15G is only required to be furnished with respect to the initial rating of asset-backed securities and that it is not necessary to file Form ABS-15G in connection with subsequent rating actions.

However, the Adoption Release does not directly address the applicability of the rule to certain pre-securitization due diligence activities, such as in preparation of the launch of a securitization program or in connection with the acquisition of the underlying assets from the originator or other third-party seller. Rather, the Adopting Release suggests that the requirement to disclose third-party due diligence reports broadly includes "all third-party due diligence reports obtained by the issuer or underwriter, including interim reports, related to an offering of asset-backed securities" whether or not the third-party due diligence report was provided to any NRSRO. Therefore, potential issuers of Exchange Act ABS should consider whether any preliminary or exploratory due diligence reports made in connection with the acquisition of underlying assets or in anticipation of a potential future securitization could be subject to the requirements of Rule 15Ga-2.

The term "third-party due diligence report" is defined in the rule as "any report containing findings and conclusions of any due diligence services as defined in new Rule 17g-10(d)(1) … performed by a third-party." The definition of due diligence services set forth in Rule 17g-10 is discussed in greater detail below.

Rule 17g-10

New Rule 17g-10 requires engaged third-party due diligence services providers to deliver the written certification required under Section 15E(s)(4)(B)[10] of the Exchange Act. The certification must be on new Form ABS Due Diligence-15E signed by an individual duly authorized to make such certification on behalf of the third-party due diligence provider.

In addition, the rule provides that the required certification will be deemed to satisfy the requirements of Section 15E(s)(4)(B) of the Exchange Act if the third-party due diligence provider delivers an executed Form ABS Due Diligence-15E promptly following the completion of the due diligence services to:

- Any NRSRO that requests the Form in writing (prior to or following the performance of the services); and
- To the issuer or underwriter of the related Exchange Act ABS that maintains the Internet website, if any, required under Rule 17g-5 (the "Rule 17g-5 Website") for such Exchange Act ABS.

In addition, the Adopting Release amends Rule 17g-5 to require that an NRSRO hired to rate an Exchange Act ABS must require the issuer, sponsor or underwriter to agree to post any executed Form ABS Due Diligence-15E to its Rule 17g-5 Website promptly after receipt. A third-party due diligence provider that provides third-party due diligence services relating to foreign transactions that do not require a Rule 17g-5 Website will be deemed to satisfy the requirements of Rule 17g-10 if it delivers Form

ABS Due Diligence-15E to NRSROs that request the delivery of the Form in writing.

Pursuant to new Form ABS Due Diligence-15E, engaged third-party diligence services providers are required to certify as to the following items:

- The identity of the third-party due diligence services provider;
- The identity of the person that paid for the third-party due diligence services;
- The identity of any NRSRO whose published due diligence criteria the due diligence services are intended to satisfy as well as the title and date of such published criteria;
- A detailed description of the scope and manner of the due diligence performed; and
- A summary of the findings and conclusions of the due diligence review.

In addition, the person signing Form ABS Due Diligence-15E on behalf of the third-party due diligence provider is required to certify that the third-party due diligence provider performed a thorough review in performing the related due diligence.

Unlike Rule 15Ga-2, which does not require the filing of a new Form ABS-15G for any subsequent rating actions following the initial rating, the Adopting Release provides that if a third-party due diligence provider has delivered an executed Form ABS Due Diligence-15E and is subsequently hired to perform additional due diligence services with respect to the Exchange Act ABS, then it will be required to deliver a new Form ABS Due Diligence-15E with respect to such subsequent due diligence services.

Definition of Due Diligence Services and AUP Letters

Rule 17g-10(d)(1) defines "due diligence services" fairly broadly as a review of the assets underlying an Exchange Act ABS for the purpose of making findings with respect to:

- The accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets;
- Whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements;
- The value of collateral securing the assets;
- Whether the originator of the assets complied with federal, state or local laws or regulations; or
- Any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the Exchange Act ABS will pay interest and principal in accordance with applicable terms and conditions.

The Adopting Release clarifies that the catch-all provision set forth in the last bullet above is intended to refer to any review of the assets underlying the related Exchange Act ABS that is "commonly understood in the securitization market to be third-party due diligence services or analogous services that may develop in the future but are not expressly covered by the first four prongs of the definition" and not a review of the Exchange Act ABS itself.

Notably, the Adopting Release recognizes that certain of the services typically performed by accounting firms pursuant to AUP would not be considered "due diligence services" under Rule 17g-10, such as the recalculation of projections of future cash flows or performing procedures that address other information included in the offering documents, which are performed for the primary purpose of assisting issuers or underwriters in verifying the accuracy of disclosures. However, the SEC expressly refused to categorically exempt all services provided by accounting firms pursuant to AUP from the scope of the definition, suggesting that any services performed under AUP that "are commonly understood as being due diligence services" are still required to be disclosed. In particular, the Adopting Release specifies that

any AUP services consisting of a comparison by the accountants of data on the loan tape to a sample of loan files would be considered due diligence services under Rule 17g-10. This type of review is customary in AUP letters delivered in connection with asset-backed offerings. Similar issues arise under Rule 193 letters that are commonly provided by accountants.

Recognizing that accounting firms will be reluctant to provide the certification required by Rule 17g-10, the Adopting Release notes that the SEC would not object to the inclusion of a description of the professional standards that govern the performance of AUP on Form ABS Due Diligence-15E required to be delivered under Rule 17g-10. At this point it is unclear whether this accommodation will provide accountants with the comfort needed to deliver reports that will be subject to the requirements of Rule 17g-10. Although the Adopting Release did not expressly discuss AUP reports in the context of Rule 15Ga-2, similar concerns arise under that rule.

For more information, please contact the author of this legal update:

Haukur Gudmundsson
+1 312 701 8622
hgudmundsson@mayerbrown.com

or any of the following contributors:

Amanda L. Baker
+1 212 506 2544
amanda.baker@mayerbrown.com

J. Paul Forrester
+1 312 701 7366
jforrester@mayerbrown.com

Julie A. Gillespie
+1 312 701 7132
jgillespie@mayerbrown.com

Carol A. Hitselberger
+1 704 444 3522
chitselberger@mayerbrown.com

Chadwick A. Hoyt
+1 312 701 8870
choyt@mayerbrown.com

Paul A. Jorissen
+1 212 506 2555
pjorissen@mayerbrown.com

J. Bradley Keck
+1 312 701 7240
jkeck@mayerbrown.com

Jason H.P. Kravitt
+1 212 506 2622
jkravitt@mayerbrown.com

Stuart M. Litwin
+1 312 701 7373
slitwin@mayerbrown.com

Elizabeth A. Raymond
+1 312 701 7322
eraymond@mayerbrown.com

Eric M. Reilly
+1 704 444 3581
ereilly@mayerbrown.com

Jan C. Stewart
+1 312 701 8859
jstewart@mayerbrown.com

Angela M. Ulum
+1 312 701 7776
aulum@mayerbrown.com

Jon D. Van Gorp
+1 312 701 7091
jvangorp@mayerbrown.com

Endnotes

[1] Nationally Recognized Statistical Rating Organizations, SEC Release No. 34-72936, available at http://www.sec.gov/rules/final/2014/34-72936.pdf.

[2] In addition to the two rules outlined in this Legal Update, the Adopting Release included several other new rules and amendment to existing rules regarding NRSRO policies, procedures and controls.

[3] 15 U.S.C. 780-7(s)(4).

[4] Available at http://www.banking.senate.gov/public/_files/Rept111517DoddFrankWallStreetReformandConsumerProtectionAct.pdf.

[5] Issuer is defined in Rule 17g-10(d)(2) to include a sponsor or a depositor that participates in the issuance of asset-backed securities.

[6] 15 U.S.C. 78c(a)(79).

[7] The date of first sale is the date on which the first investor is irrevocably committed to invest.

[8] Rule 15Ga-2 also does not apply to non-registered offerings by municipal issuers. Nevertheless, municipal issuers are required to comply with Section 15(E)(s)(4)(A) of the Exchange Act, which requires the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. The Adopting Release suggests municipal issuers may accomplish such disclosure by posting the information that would be included on Form ABS-15G on a publicly available website or by voluntarily posting the information on EDGAR or on EMMA, but they are not required to choice a particular publishing method.

[9] Note that such disclosure may be required under Rule 193. See 17 CFR 230.193.

[10] 15 U.S.C. 78o-7(s)(4)(B).