Statement at Open Meeting

Commissioner Luis A. Aguilar

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Today the Commission takes an important step to protect investors and promote capital formation, by enhancing the transparency of asset-backed securities ("ABS") and by increasing the accountability of issuers of these securities.[1] The securitization market is critical to our economy and can provide liquidity to nearly all the major economic sectors, including the automobile industry, the consumer credit industry, the leasing industry, and the commercial lending and credit markets.

Given the importance of this market, let's also remember why we are here and the magnitude of the crisis in the ABS market. At the end of 2007, the ABS market consisted of more than $7 trillion of mortgage-backed securities and nearly $2.5 trillion of other outstanding ABS.[2] However, by the fall of 2008, the securitization market had completely seized up.[3] For example, in 2006 and 2007, new issuances of private-label residential mortgage-backed securities ("RMBS") totaled $686 billion and $507 billion, respectively.[4] In 2008, private-label RMBS issuance dropped to $9 billion, and flat-lined in 2009.[5]

The market crisis also highlighted the unreliability of the credit ratings in mortgage-backed securities. For example, between the third quarter of 2007 and the second quarter of 2008, rating agencies lowered the credit ratings on $1.9 trillion in mortgage-backed securities.[6] In addition, credit ratings agencies downgraded over 90% of the AAA-rated subprime RMBS originated prior to the financial crisis to junk status.[7]

These facts reflect the serious structural flaws in the ABS market that resulted in significant investor harm. These flaws include the following:

- First, investors, as compared to other parties in the securitization chain, such as the originator of the underlying loans, lacked basic information and time to assess and correctly price ABS.[8] In addition, assets were securitized into increasingly complex and opaque instruments, which made it that much more difficult for investors to understand and to assess the risk.[9]

- Second, because there was very little available information about the quality of the underlying assets, investors often relied solely on the fact that ABS carried an investment grade rating. However, as has been well documented, these credit ratings spectacularly failed to accurately measure and describe the risks associated with certain ABS. In fact, during the crisis, securities worth allegedly billions of dollars and rated "investment grade" collapsed in value.[10] In this regard, I am pleased that today the Commission considers rules designed to address issues with the performance of the credit ratings agencies that came to light during the financial crisis.

- Third, making money in the ABS market relied more and more on securitizing increasingly risky assets, like subprime mortgages, and subsequently offloading the risk onto investors. Unfortunately, most investors had little ability to mitigate the opaqueness surrounding these investments. To compound the problem, some banks and finance companies knew they could quickly sell their loans into the securitization market where somebody else would end up owning the risk, so they turned a blind eye to, or worse, encouraged, shoddy lending practices and

increasingly risky loan structures.[11] Thus, not only did the interests of investors not align with the originators or sellers of ABS; but, ultimately, these predatory practices put investors at risk of serious harm.

Given the tremendous harm to investors in the ABS market, in April 2010, the Commission proposed major revisions to the registration, disclosure, and reporting requirements for ABS offerings.[12] Now, more than four years after the original proposal, the Commission is finally adopting rules intended to improve the reliability of registered ABS offerings.

Specifically, today's rules will require timely and standardized disclosure in the prospectus and in Exchange Act reports of asset-level information for issues that are backed by real estate mortgages, automotive loans and leases, and debt securities. Today's rules also provide investors with a minimum period of at least three business days to review transaction-specific information before making an initial investment decision.[13]

Beyond enhanced disclosure and reporting requirements, the Commission is also adopting new eligibility criteria for ABS shelf registration. The shelf registration process allows companies to access the market quickly, such as when conditions are favorable and investor demand is high, by offering and selling securities on an accelerated basis, without prior SEC staff review of transaction-specific disclosure. Under the prior rules, if a nationally recognized statistical rating organization ("NRSRO") rated the ABS as "investment grade" and the securities met other criteria,[14] the ABS could be offered "off the shelf."

As I previously mentioned, however, deficient credit ratings contributed significantly to the financial crisis. As a result, new eligibility requirements will replace the investment grade ratings requirements and will require ABS issuers to meet certain transaction-specific and registrant-specific criteria that are designed to ensure that ABS issuers exercise greater oversight and care in making required disclosures. These new shelf registration provisions should result in more reliable prospectus disclosure and more effective mechanisms for exercising investor rights under the transaction documents.[15] This is especially appropriate for a security that can be issued to the public in an expedited manner without prior SEC staff review.

However, even with today's action, the Commission has not completed its ABS-related work. I believe that asset-level disclosures are important to investors' ability to make informed investment decisions, and the disclosures provide real transparency to the market about these securities. Moreover, these disclosures impose discipline on issuers to provide a full and clear picture of the composition and characteristics of their ABS issuances. It is also important that investors get timely access to as much ABS transaction-related information as possible before they invest in such offerings. As I have heard from a wide variety of investors, these disclosures are necessary and useful.[16]

It is therefore crucial that the Commission complete the other outstanding ABS proposals in order to address the regulatory regime in this space. These include:

- Requiring issuers to provide asset-level information across almost all asset classes – including equipment loans and leases, student loans, and inventory financings – as was mentioned in the 2010 proposal;[17]

- Requiring issuers to provide the same disclosure for ABS issued pursuant to private offerings and resold under Rule 144A, as is required for registered offerings;[18]

- Requiring the filing of a "waterfall" computer program that models the contractual cash flow provisions of ABS; and

- Requiring that transaction documents be filed, in substantially final form, by the date the preliminary prospectus is required to be filed.

It is also critical that the Commission and other government agencies tasked with adopting risk retention rules promptly adopt final rules that fulfill that mandate.[19] These risk retention rules are necessary to address the concerns that, without skin in the game, the securitizer of the assets will not be incentivized to exercise appropriate diligence in putting together the asset pools.[20] The idea is to align the incentives of the securitizer with the interests of investors.

It is my hope that the Commission's staff prioritizes the outstanding proposals with all due haste. The Commission must complete its work in the ABS marketplace in order to provide greater investor protections, regulatory certainty, and clear rules of the road.

Today, I will vote to approve the rules being considered. Although I would have preferred that it had occurred sooner, I appreciate that the Commission is now taking action. While there is much work in front of us, the rules being considered today are an important step forward.

In closing, I would like to thank the staff from the Division of Corporation Finance, the Division of Economic Research and Analysis, the Office of the General Counsel, and the Office of Information Technology for their work on this rulemaking. I appreciate your dedication, and the important work you do to protect investors.

Thank you.

[1] *See Asset-Backed Securities Disclosure and Registration,* SEC Rel. No. 33-xxxx, File No. S7-08-10 ([adopting date], 2014) ("ABS Adopting Release").

[2] *Asset-Backed Securities,* SEC Rel. No. 33-9117 (Apr. 7, 2010), 75 Fed. Reg. 23328 (May 3, 2010) ("2010 Proposing Release"), at 10, *available at* http://www.sec.gov/rules/proposed/2010/33-9117fr.pdf.

[3] Nicole Gelinas, *Can the Feds Uncrunch Credit?* City Journal (Winter 2009), *available a*t http://www.city-journal.org/2009/19_1_credit.html.

[4] The Securities Industry and Financial Markets Association (SIFMA), US Mortgage-Related Issuance and Outstanding spreadsheet (updated as of Aug. 4, 2014), *available at* http://www.sifma.org/research/statistics.aspx.

[5] *See id*.

[6] Jon Birger, *The woman who called Wall Street's meltdown,* Fortune Magazine (Aug. 6, 2008), *available at* http://archive.fortune.com/2008/08/04/magazines/fortune/whitney_feature.fortune/index.htm.

[7] These subprime residential mortgage-backed securities were originated in 2006 and 2007. *See* United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Majority and Minority Staff Report, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, at 6 (Apr. 13, 2011) ("PSI Report"), *available at* http://www.hsgac.senate.gov//imo/media/doc/Financial_Crisis/FinancialCrisisReport.pdf?attempt=2.

[8] Today's rules, which seek to correct this transparency issue, only cover SEC-registered ABS transactions. ABS offerings also are sold as private placements that are exempt from SEC registration and do not require SEC-mandated disclosures. The private placement market reflects a large portion of overall ABS issuances, and like the overall ABS market, was quite a bit larger prior to the financial crisis than it is today. For example, in 2007, private placement of ABS transactions (including re-sales under Securities Act Rule 144A) amounted to approximately $623 billion. In 2013, private placement (including Rule 144A offerings) of ABS transactions amounted to approximately $223 billion. *See* The ABS Database: ABAlert.com and The CMBS Database: CMAlert.com.

[9] Investors in ABS could not assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs). S. Rep. No. 111-176, at 28 (2010) (Conf. Rep.). CDOs are a type of ABS that holds a pool of collateralized debt

(such as mortgages and auto loans) that may be subdivided into various tranches representing different levels of risk. Another complex form of ABS is known as the CDO-squared, in which the underlying assets are tranches issued by other CDOs. In this form, an investor would be investing in a stream of payments from a tranche of a CDO, which is backed by an underlying pool of other CDO tranches, each of which is ultimately backed by more underlying assets such as residential mortgages.

[10] PSI Report at 5-7, 263-67, *supra* note 7.

[11] *See, e.g., SEC v. Angelo Mozilo, David Sambol, and Eric Sieracki*, Lit. Rel. No. 21068A (June 4, 2009), , *available at* http://www.sec.gov/litigation/litreleases/2009/lr21068a.htm (charging Countrywide executives with deliberately misleading investors about the significant credit risks being taken by the company in its mortgage loan business in its efforts to build and maintain the company's market share; also noting that in one email, Mozilo referred to a profitable subprime lending product it sold as "toxic."); *SEC v. Brad A. Morrice et al*., Lit. Rel. No. 21327 (Dec. 7, 2009), *available at* http://www.sec.gov/litigation/litreleases/2009/lr21327.htm (describing New Century's practice of knowingly originating increasingly risky loans that it would sell off, which created a higher risk of triggering the company's repurchase obligations in case of underwriting deficiencies); *SEC v. Citigroup, Inc.,* Lit. Rel. No. 21605 (July 29, 2010), *available at* http://www.sec.gov/litigation/litreleases/2010/lr21605.htm (charging the company with misleading investors about its subprime exposure, because it failed to include its exposure to subprime-backed tranches of CDOs, which ultimately sharply declined in their value); *SEC v. Michael Strauss, Stephen Hozie and Robert Bernstein*, Lit. Rel. No. 21014 (Apr. 28, 2009), *available at* http://www.sec.gov/litigation/litreleases/2009/lr21014.htm (alleging that American Home Mortgage Investment Corp. failed to disclose that, among other things, it increased profits by originating billions of dollars of mortgages without verifying the income of the borrower, which was a highly risky underwriting practice and exposed the company to serious liquidity problems).

[12] 2010 Proposing Release, *supra* note 2. Some of the Commission's proposals were re-proposed in July 2011. *Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities,* SEC Rel. No. 33-9244 (Jul. 26, 2011), 76 Fed. Reg. 47948 (Aug. 5, 2011) ("ABS Re-Proposal"), *available at* http://www.sec.gov/rules/proposed/2011/33-9244fr.pdf.

[13] *See* ABS Adopting Release, at 339. I would also have supported a five day "speed bump," as both originally proposed and re-proposed. *See* 2010 Proposing Release, *supra* note 2; ABS Re-Proposal, *supra* note 12. However, as there was previously no requirement to provide transaction-specific information before sale, the rules we adopt today are a significant improvement over the prior rules.

[14] In addition to investment grade rated securities, an ABS offering under the prior rules was eligible for shelf registration using Form S-3 only if the following conditions were met: (i) delinquent assets must not constitute 20% or more, as measured by dollar volume, of the asset pool as of the measurement date; and (ii) with respect to securities that are backed by leases other than motor vehicle leases, the portion of the securitized pool balance attributable to the residual value of the physical property underlying the leases, as determined in accordance with the transaction agreements for the securities, does not constitute 20% or more, as measured by dollar volume, of the securitized pool balance as of the measurement date. *See* General Instruction I.B.5 of Form S-3. Moreover, to the extent the depositor or any issuing entity previously established, directly or indirectly, by the depositor or any affiliate of the depositor are or were at any time during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on Form S-3 subject to the requirements of Section 12 or 15(d) of the Exchange Act (15 U.S.C. 78l or 78o(d)) with respect to a class of ABS involving the same asset class, such depositor and each such issuing entity must have filed all material required to be filed regarding such ABS pursuant to Section 13, 14 or 15(d) of the Exchange Act (15 U.S.C. 78m, 78n or 78o(d)) for such period (or such shorter period that each such entity was required to file such materials). Such material (except for certain enumerated items) must have been filed in a timely manner. *See* General Instruction I.A.4 of Form S-3. These other conditions (excepting the investment grade rating requirement) are not being changed in today's adopting release.

[15] For example, today's rules require that for ABS to be eligible for shelf registration, the underlying transaction agreements include provisions requiring a review of pool assets in certain situations for compliance with the representations and warranties made with regard to those assets. In particular, the agreements must require a review, at a minimum, upon the occurrence of a two-pronged trigger based first upon the occurrence of a specified percentage of delinquencies in the pool, and if the delinquency trigger is met, then upon direction of investors by vote. *See* ABS Adopting Release, at 402-403.

[16] *See, e.g.,* Letter from Anne Simpson, Senior Portfolio Manager, Global Equity, CalPERS (Aug. 2, 2010), *available at* http://www.sec.gov/comments/s7-08-10/s70810-111.pdf (stating that CalPERS believes the proposed revisions to Regulation AB are positive for investors in terms of having access to more timely and transparent data, providing investors with more time to make investment decisions, and supporting maintenance of high quality collateral); Letter from James J. Sullivan, Senior Managing Director, Head of Fixed Income, Prudential Investment Management, Inc. (Aug. 2, 2010), *available at* http://www.sec.gov/comments/s7-08-10/s70810-95.pdf (stating that he believes the new rules generally will produce improvements to the ABS market by expanding disclosure, better aligning the incentives of sponsors and originators through risk retention and strengthening investor protections); Letter from Jonathan D. Urick, Analyst, Council of Institutional Investors (July 15, 2010), *available at* http://www.sec.gov/comments/s7-08-10/s70810-44.pdf (stating that "we believe the proposed revisions to Regulation AB and other rules regarding the offering process, disclosure and reporting for ABS will help address some of the problems plaguing this important market—namely, poor information and an overreliance on credit ratings."); Letter from Chris J. Katopis, Executive Director, Association of Mortgage Investors (July 31, 2010), *available at* http://www.sec.gov/comments/s7-08-10/s70810-63.pdf (stating that the SEC has correctly responded to problems facing securitizations by, in part, proposing rules for expanded disclosures, such as enhanced data requirements both at issuance and on a go-forward basis at the asset and pool level, as well as the historical experience of sponsors and originators involving repurchase claims; in addition, requiring from issuers a common platform cash flow model).

[17] The Commission's April 2010 proposal excluded ABS backed by credit card receivables, charge card receivables, and certain electric utility assets from the requirement to provide asset-level disclosures. All other asset classes were covered by the requirement for asset-level disclosure, which included a general category of data points applicable to all asset classes and additional specialized data points where applicable. In addition, credit and charge card ABS would have required grouped account disclosure. 2010 Proposing Release, *supra* note 2.

[18] As described above in note 8, today's rules do not cover private placements of ABS or re-sales of ABS pursuant to Rule 144A of the Securities Act. Rule 144A is a safe harbor exemption from the registration requirements of Securities Act Section 5 for certain offers and sales of qualifying securities by certain persons other than the issuer of the securities. *See* Rule 144A of the Securities Act. In particular, the Rule 144A exemption applies to re-sales of securities to qualified institutional buyers ("QIBs"), who generally are institutions that meet certain requirements. Securities acquired in a Rule 144A transaction are deemed to be "restricted securities" within the meaning of Rule 144(a)(3) of the Securities Act. As a result, these securities remain restricted until the applicable holding period expires and may only be resold under Rule 144, pursuant to an effective registration statement, or in reliance on another applicable exemption under the Securities Act.

[19] *See* Pub. L. No. 111-203, 124 Stat. 1376 (2010). Section 941 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 (the Exchange Act) and adds a new section 15G of the Exchange Act. 15 U.S.C. 78o-11. *See also, Credit Risk Retention,* SEC Rel. 34-70277 (Aug. 28, 2013), 78 Fed. Reg. 57928 (Sept. 20, 2013), *available at* http://www.sec.gov/rules/proposed/2013/34-70277.pdf.

[20] The term "securitizer" refers to both the issuer of the ABS transaction or a person who organizes and initiates an ABS transaction by selling or transferring assets, including through an affiliate or issuer. Accordingly, the securitizer could also encompass what is sometimes referred to as a

securitization sponsor or depositor. *Credit Risk Retention, supra* note 19.

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