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Reporting rules

Market caught out by cashflow waterfall disclosure plan

The US SEC last week proposed new rules that, if adopted, would revise the disclosure, reporting and offering process for ABS. Although the market had been anticipating new requirements around loan-level data, the proposed disclosure of cashflow waterfalls came as a surprise.

"The new proposal bridges the gap between loan-level data and actually understanding the performance of an investment," explains Douglas Long, evp business strategy at Principia Partners.

In the past, a key issue was the lack of time investors had to make a decision about whether to invest in a new issue. This, in turn, spurred an overreliance on ratings instead of taking the time to build waterfalls to capture the dynamics of a securitisation structure.

However, says Long: "Doing the modelling themselves with a predefined script can give investors greater confidence in an investment because they're not having to translate pages and pages of deal documentation every time. It means they can focus more on the analysis of the deal itself rather than the individual loans behind it and only go to the loan level when really necessary."

The SEC has proposed that, with some exceptions, prospectuses for public offerings of ABS and ongoing Exchange Act reports contain specified asset-level information about each of the assets in the pool, according to proposed standards and in a tagged data format using XML. Along with the prospectus filing, the filing of a computer programme of the contractual cashflow provisions expressed as downloadable source code in Python (a scripting language) would also be required.

The move is expected to force issuers to standardise their models and assumptions and have an ongoing commitment to update them. "The aim is to make it easier and simpler to get investors back into the market. Ultimately, the barrier to entry for an investor will be much lower," Long notes.

However, he points out that questions remain around the format of the computer programme in Python, standardisation between issuers, which inputs/outputs will be used and how the programme will be delivered. While this can help provide a more level playing field, Long believes the proposals also leave room for innovation and competitive differentiation to emerge from issuers, investors and solution providers alike.

The SEC's proposals would also require filing deadlines for ABS offerings to be revised to provide investors with more time to consider transaction-specific information, including information about the pool assets. In addition, the current credit ratings references in shelf-eligibility criteria for asset-backed issuers would be repealed and new shelf -eligibility criteria established. This would include a requirement that the sponsor retain a portion of each tranche of the securities that are sold and that the issuer undertake to file Exchange Act reports on an ongoing basis, so long as its public securities are outstanding.

Finally, new information requirements for the safe harbours for exempt offerings and resales of ABS have been proposed.

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The SEC says the move is designed to provide investors with more detailed and current information about ABS products and more time to make their investment decisions. "The rules we are proposing stem from lessons learned during the financial crisis," explains SEC chair Mary Schapiro. "These rules, if adopted, would revise the regulatory regime for asset-backed securities in order to better protect investors."

SIFMA expressed its support, in principle, of the SEC's efforts to increase the transparency and effectiveness of the disclosure and marketing practices for ABS. "This includes reasonable risk retention requirements that are calibrated to align the interests of securitisation market participants according to the risks presented by various asset classes and transaction types. We look forward to working with the SEC to refine the risk retention provisions and other aspects of this proposal," comments SIFMA president and ceo Tim Ryan.

Indeed, notwithstanding the extra outlay for issuers in providing waterfall models to investors, the industry has generally welcomed the SEC's proposals as part of a broader effort to de-risk securitisations. However, some question the merit of singling out structured finance for overhaul within the risk asset universe.

Of particular concern is the requirement for issuers relying on Rule 144A to provide investors, upon request, all information that would be required if a transaction were registered using Form S-1 or SF-1. This is a radical departure from current information delivery requirements in the private market and likely diminishes the attractiveness of tapping this market for many issuers, according to ABS analysts at Barclays Capital.

"In proposing this change, the SEC specifically cites the CDO market as being primarily a private market and central to the financial crisis. In doing so, it overlooks asset classes that have for years used the private markets properly," they note.

The BarCap analysts add: "Clearly, additional disclosures were required for privately placed CDOs. However, in our view, the SEC is making a sweeping generalisation about the ABS market based on the experience of private CDO transactions and applying corrective actions to asset classes that do not necessarily need them."

Public comments on the proposed rules should be received by the Commission within 90 days after its publication in the Federal Register.

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