

It Just Gets Better and Better: Reg AB Redux

By Rick Jones

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I just can't schedule enough time in my day to worry about all the things that seem to demand to be worried about. As I write, this week the Dow closed 630+ down one day and bounced 600 points the next. Yikes. Between that, the debt ceiling and downgrades, Dodd-Frank, the interminable drumbeat of hostility towards Wall Street and business coming out of the White House, the mess in Europe, the falling dollar, insanely low interest rates, high unemployment, the fact that somehow corporate America seems to still be earning bucket loads of money, and, in general the discomfiting disconnect between our still positive every day deal world and the angst, anxiety and drumbeat of awful news in the macro market, what should we think? It makes my hair hurt.

But, drawing on my deep and boundless reserve of existential anxiety, I've now found a few free moments to worry about the SEC's new re-proposal on shelf eligibility for asset-backed securities. This missive was released (pdf) on July 26, 2011, and comments are due by October 4, 2011.

A year ago, hundreds of CMBS industry professional spent hundreds of hours of time wrapping our brains around AB 2.0, which in the SEC's own words was a proposed rule that would "address the problems . . . by giving investors the tools they need to accurately assess risk and by better aligning the interests of the issuer with those of the investor." We worked with CREFC and MBA to provide comments, which I think were thoughtful and constructive. I had hoped, perhaps naively, that this should have formed the basis of an ongoing dialogue between regulators and market participants to address what everyone agreed were problems in the structured finance environment. And then...nothing. Crickets. The comment disappeared in the Stygian opacity of the SEC regulatory process and dialogue never happened. We waited.

Now the SEC has spoken again, delivering up a number of wholly new concepts around shelf-eligibility through a "Re-proposal" of part of AB 2.0.

As far as CMBS is concerned, the Re-proposal does the following:

- Eliminates investment grade rating criteria for shelf registration;
- Re-structures the new CEO certification regarding securitized assets and the design of securitization;
- Requires the appointment in the transaction documents of a "credit risk manager" to review performance when certain trigger events occur;
- Inserts a required dispute resolution mechanic for requests of the issuer to re-purchase assets;
- Bakes into the transaction documents the mechanics to allow investors to address other investors in the transaction about deal concerns; and

- Requires all final transaction documents to be filed five days before pricing.

The Re-proposal strikes from Reg AB the risk retention provisions in light of the (soon?) to be issued joint regulatory risk retention regulations and, blessedly, punts the waterfall computer program provision (the notorious Python program requirement) to a subsequent re-proposal initiative.

Some of these might be good ideas and others are susceptible to becoming good ideas through a robust and open industry dialogue (OK, and some are just plain bad). Off the top:

- No more investment grade rating test. Who cares?
- The CEO certification seems a bad idea. We have all the liability provisions of the existing securities laws to enforce good and transparent disclosure. This seems just another opportunity for gotcha (and a big incentive not to be a business line CEO!). What will this really do to improve disclosure? I don't think much.
- The credit risk manager seems a little like a part of what CMBS 2.0 operating advisors or trust advisors do today. The Re-proposal ties the credit manager investigatory duties to certain trigger events, which are really not particularly relevant to CMBS. But if the market is getting to a place which satisfies investors, why impose a new regulatory regime?
- I don't think the investors will like the new resolution mechanic, and I don't like it either.
- Providing a mechanic for investors to talk to each other is not the worst idea in the world, but the industry is already doing this with voluntary registration systems for investor communication.
- Providing transaction documents prior to the time of sale will be a nuisance. Frankly, I don't think investors get any benefit from it, but the world will not end if that has to become part of the game.

Personally, I've got to tell you, I don't have time for this right now. Don't we collectively have enough on our plates to deal with? It's not so much the content of the Re-proposal which annoys me, but just the notion that we actually have to pay attention to another set of rules which will change the game yet again. On the other hand, maybe since the original proposal was so flawed, this could be a net improvement, and the willingness of the SEC to re-propose here perhaps suggests the commencement of a positive dialogue.

We are going to re-launch a public CMBS market. This week, in fact. Public deals will broaden the investor base (albeit diminishing the quality and scope of information available to IG investors). As CMBS re-enters the public marketplace, the matters addressed by the original AB 2.0 and this new Re-proposal (and further promised re-proposals) will become increasingly relevant.

OK, so I'll stop whining. We need to get this public market right, and this is another chance to engage with the regulatory community to see if we can push it in that direction. Another set of rules, another 60 days to comment. Off we go!