

LEGISLATIVE AND REGULATORY DEVELOPMENTS IN U.S. SECURITIZATIONS

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AS THE SUBPRIME mortgage market remains in turmoil, the securitization industry faces increasing pressure and attention from federal and state policy-makers. Industry participants are seeking to avoid legally mandated forbearance for delinquent borrowers, imposition of liability on secondary market participants for mortgage lending violations (so-called “assignee liability”), and any banning of non-traditional mortgage products.

These and other issues relating to the subprime mortgage market, including predatory lending, have been the subject of recent congressional hearings and regulatory attention. Alternatives being advanced by the industry include full and aggressive enforcement of existing laws and regulations governing loan originations, better education of borrowers on the risks and benefits of mortgage products, and encouraging servicers to make use of the flexibility permitted in loan and servicing contracts to help borrowers avoid foreclosure.

Numerous major banks and other financial institutions signed on in May 2007 to a “statement of principles” put forth by Sen. Christopher Dodd (D-Conn.), Chairman of the Committee on Banking, Housing, and Urban Affairs, that, instead of new legislation, sets out principles designed to preserve homeownership—“consistent with applicable legal and contractual obligations”—upon rate reset.

Notably, the statement observes that if it is clear that a borrower will be unable to make new payments when a subprime ARM resets, “then the servicer may presume that default on the mortgage is reasonably likely to occur [and that] this conclusion may permit the servicer to modify the loan.”

Market participants are also now closely following a Proposed Statement on Subprime Mortgage Lending, 72 Fed. Reg. 10533 (March 8, 2007), put out by numerous federal banking agencies, that would, among other things, serve to tighten underwriting standards and enhance disclosures.

While supporting the agencies’ push for greater borrower education and effective disclosures, industry organizations are urging the development of uniform disclosures that would constitute a “safe harbor” for disclosure compliance. The industry is also seeking that any final statement constitute flexible guidelines rather than rigid underwriting requirements. Particular concern has been expressed in comment letters that the proposed statement, in its current form, is unclear in significant respects, and could elevate the basing of loans on a borrower’s

ability to repay to a “stand-alone consumer ‘right,’ whose remedies and liabilities are completely undefined in either statute or regulation.”

REGULATION AB

As these developments unfold, the securitization industry continues to adapt to the substantial regulatory changes resulting from the Securities and Exchange Commission’s (SEC) adoption of new and amended rules that sought—for the first time—to comprehensively address asset-backed securities (ABS).

The centerpiece of the new regime is Regulation AB, which became effective in March 2005, and set forth registration, disclosure and reporting requirements for ABS. Among the most significant and controversial changes brought by the new rules is that material static pool data now must be disclosed, including, to the extent material to the transaction, up to five years of static pool information regarding delinquencies, losses and prepayments.

Recognizing the difficulty of including such static pool data in a prospectus, the SEC is allowing issuers until December 31, 2009 to incorporate by reference static pool data posted on the internet, if certain conditions are met, including unrestricted free access to their respective Web sites containing the data. The SEC reportedly is currently reviewing the desirability and efficacy of such Web-based disclosure, and may consider making this accommodation permanent.

SEC staff recently stated that, instead of conducting a full review of all registration statements filed by domestic ABS issuers, the staff will focus on issuers’ static pool disclosures and periodic reports. (The registration statements filed by non-U.S. issuers will continue to be fully reviewed.)

A full review may be triggered if initial screening by the SEC staff uncovers any disclosure defects to which the staff is particularly sensitive, such as a disclosure suggesting that a securitization might include a type of derivative instrument that the SEC staff views as impermissible under Regulation AB (e.g., a credit default swap), or a disclosure indicating that the rate of return on the ABS might be based upon a stock or commodities index or other sources external to the transaction.

The staff reportedly will review reports filed on Forms 8-K, 10-K and 10-D for compliance with the new rules, with a particular interest on the reports, certifications and information required by Items 1121, 1122 and 1123 of Regulation AB.

Item 1121 covers the pool performance and distribution information required to be included in each distribution report on Form 10-D. Item 1123 requires ABS issuers to include in their Form 10-K annual reports a statement of compliance from each master servicer and each servicer that either is affiliated with the sponsor or services 10% or more of the pool assets.

Item 1122 (together with Rules 13a-18 and 15d-18 under the Securities and Exchange Act of 1934) requires ABS issuers to include in their Form 10-K annual reports a platform level report from each "participating party in the servicing function" assessing compliance with the servicing criteria set forth in Item 1122(d), as well as a report by a registered public accounting firm attesting to the assessment.

To the industry's relief, the SEC staff issued telephone guidance in February 2007 expressly allowing servicers to assume responsibility for assessing vendor compliance under the servicing criteria enumerated in Item 1122(d) of Regulation AB, if certain conditions are met.

Among these are that the vendor be engaged to perform only "specific and limited" or "scripted" activities, and that the servicer has policies and procedures in place designed to provide "reasonable assurance" that the vendor's activities comply in all material respects with the servicing criteria applicable to the vendor.

One practical effect of the new guidance is the avoidance of significant expense and effort by securitization industry participants. It also avoids widespread noncompliance by ABS issuers with servicers that are unable to obtain separate compliance assessments and attestations from vendors performing ministerial functions. With the subprime mortgage market sure to remain a focus of attention for the foreseeable future, the industry cautiously awaits further developments affecting securitization in this quickly evolving political and regulatory landscape. For more information, we invite you to contact us.

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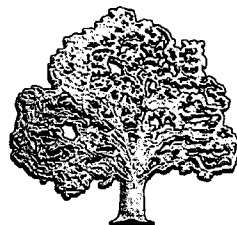
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