

Throughout the development and final release of Regulation AB, the Securities and Exchange Commission (SEC) received numerous comments and requests for clarification regarding specific elements of delinquent and non-performing pool assets. In particular, the major topics for analysis and discussion within the SEC included issues relating to how these levels should be measured, transactions that permit non-performing or delinquent loans to be included, and calculations of thresholds for master trusts, along with commenters requesting more “flexibility” within the definition itself.

Calculation of Delinquency and Non-Performing Levels

The SEC’s 1997 no-action letter stated an asset pool having total delinquencies of up to 20% at the time of offering is still considered, and asset-backed security was reiterated by the SEC in its final ruling for Regulation AB. Furthermore, in response to these suggestions the SEC is “...adding an instruction specifying that the measurement date for the delinquency and non-performing thresholds is to be the cut-off date for the transaction...in the case of master trusts, the date as of which delinquency and loss information is presented in the prospectus for the securities.” (1)

Transaction Permitting Non-Performing or Delinquent Loans

Because some transactions allow non-performing or delinquent loans to be included, though the proceeds are not used for funding those assets for the pool or for the cash flows, the SEC sought to clarify this issue in particular.

In its final ruling, the SEC states that “We [SEC] are including an instruction clarifying that non-performing and delinquent assets that are not funded or purchased by proceeds from the asset-backed securities and that are not considered in cash flow calculations for the asset-backed securities need not be considered as part of the asset pool for purposes of determining non-performing and delinquency thresholds.” (2)

Calculations of Thresholds

Many comments arose regarding calculating thresholds for master trusts because of the issue that the same asset pools support different series of asset-backed securities over a timeframe. Thus, the SEC sought clarification on this matter by adding an instruction which states, “...that the thresholds are to be measured against the entire pool whose cash flows support the asset-backed securities and not just against any new assets that are added...” (3)



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Non-Performing Pool Assets

The SEC, not being persuaded by comments regarding the relaxation of the long-standing requirement for non-performing pool assets, has “defined” non-performing to be a pool asset if the following conditions hold true:

- The pool asset would be treated as wholly or partially charged-off under the requirements in the transaction agreements for the asset-backed securities.
- The pool asset would be treated as wholly or partially charged-off under the charge-off policies of the sponsor, an affiliate of the sponsor that originates the pool asset or a servicer that services that pool asset.
- The pool asset would be treated as wholly or partially charged-off under the charge-off policies applicable to such pool asset established by the primary safety and soundness regulator of any entity listed above or the program or regulatory entity that oversees the program under which the pool asset was originated. (4)

The SEC feels the “definition” clearly allows for flexibility for various asset classes, but also contains the necessary language disallowing non-performing assets in the securitized pool balance.

Delinquent Pool Assets

The SEC has clearly stated that delinquent assets that constitute 50% or more of the pool asset begin serious concerns about its validity as an “asset-backed security. Thus, consistent with the 1997 no-action letter, the SEC has adopted two separate delinquency limits: (a) Delinquent assets may not constitute 50% or more

So what’s the definition used by the SEC to define “delinquency”? A pool asset is delinquent if it’s more than 30 or 31 days, or a single payment cycle, past due from the due date in accordance with various provisions. (6)

of the asset pool and (b) regarding shelf registration, the existing 20% delinquent level is to be utilized. (5)

It’s important to note the SEC’s reliance on the 1997 staff no-action

letter regarding delinquent and non-performing pool assets. Though the SEC has clarified a number of issues, added additional provisions, or as they call them, instructions, they still hold fast to many elements of the 1997 letter. Again, the SEC displays flexibility, while incorporating many of the provisions that have been in place for the past ten years. The only real difference now is that their intentions have been formalized and promulgated in a way unseen before.

(1)(2)(3)(4)(5)(6) Securities and Exchange Commission 17 CFR Parts 210, 228, et al. Asset Backed Securities: Final Rule