

# HAWKINS ADVISORY

## DISCLOSURE BY MUNICIPAL ISSUERS: THIRD-PARTY DUE DILIGENCE REPORTS RELATING TO ASSET-BACKED SECURITIES

### Introduction

On June 15, 2015, new and amended rules promulgated by the Securities and Exchange Commission (the “SEC”) under the Securities Exchange Act of 1934 (the “Exchange Act”) will go into effect.<sup>1</sup> Such rules implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) with respect to the rating process, including required disclosures by issuers and underwriters of findings and conclusions of certain third-party due diligence reports relating to asset-backed securities.

Boldface terms used throughout this Hawkins Advisory are defined below.

### Section 15E(s)(4)(A) of the Exchange Act

Section 932(a)(8) of the Dodd-Frank Act includes various amendments to Section 15E of the Exchange Act, including the addition of paragraph (s)(4). Subsection (A) of that paragraph provides that: “The **issuer** or underwriter of any **asset-backed security** shall make publicly available the findings and conclusions of any **third-party due diligence report** obtained by the issuer or underwriter.”<sup>2</sup> Rule 15Ga-2 implements this provision.<sup>3</sup>

### Rule 15Ga-2

Rule 15Ga-2(a) requires that the issuer or underwriter of an offering of any asset-backed security that is to be rated by a nationally recognized statistical rating organization must furnish Form ABS-15G to the SEC, containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, at least five business days prior to the first sale in the offering.

Rule 15Ga-2(f) exempts **municipal issuers** of asset-backed securities from this requirement of Rule 15Ga-2 to file Form ABS-15G, but only if the offering is not required to be, and is not, registered under the Securities Act of 1933 (the “Securities Act”).<sup>4</sup>

However, municipal issuers of asset-backed securities are not exempted from the statutory requirement of Section 15E

(s)(4)(A) of the Exchange Act that they make “publicly available” the findings and conclusions of third-party due diligence reports. See Rule 15Ga-2(h). The SEC advises in the Adopting Release that municipal issuers may make such information available through any means reasonably accessible to the public, including (i) posting the information on an issuer-sponsored website, (ii) voluntarily furnishing Form ABS-15G on the SEC’s Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system, or (iii) voluntarily submitting a Form ABS-15G on the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (EMMA) system.<sup>5</sup>

### Defined Terms

**Asset-backed security:** means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including (i) a collateralized mortgage obligation; (ii) a collateralized debt obligation; (iii) a collateralized bond obligation; (iv) a collateralized debt obligation of asset-backed securities; (v) a collateralized debt obligation of collateralized debt obligations; and (vi) a security that the SEC, by rule, determines to be an asset-backed security for purposes of Section 3 of the Exchange Act.<sup>6</sup>

**Depositor:** means the depositor who receives or purchases and transfers or sells the pool assets to the issuing entity. For asset-backed securities transactions where there is not an intermediate transfer of the assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust.<sup>7</sup>

**Due diligence services:** means a review of the assets underlying an asset-backed security for the purpose of making findings with respect to:

- (i) the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or

<sup>1</sup> SEC Rel. No. 34-72936 (Aug. 27, 2014) (the “Adopting Release”); <https://www.sec.gov/rules/final/2014/34-72936.pdf>.

<sup>2</sup> 15 U.S.C. § 78o-7(s)(4)(A).

<sup>3</sup> 17 C.F.R. § 240.15Ga-2.

<sup>4</sup> Generally, municipal securities are exempt securities under Section 3(a)(2) of the Securities Act, subject to Rule 131 (17 C.F.R. §230.131) and the “separate security” provisions therein. Rule 131 defines as a “separate security” an obligation evidenced by governmental debt that is payable “by

or for [an] industrial industrial or commercial enterprise” from payments made under a “lease, sale, or loan arrangement.” Rule 131 must be read in light of its own exemptions in the Rule, and in light of subsequent amendments to Section 3(a)(2), which, as a practical matter, limit the application of Rule 131 to taxable municipal securities.

<sup>5</sup> Adopting Release at 382-383.

<sup>6</sup> 15 U.S.C. § 78c(a)(79).

<sup>7</sup> 17 C.F.R. § 229.1101(e).

- originator of the assets;
- (ii) whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements;
- (iii) the value of collateral securing the assets;
- (iv) whether the originator of the assets complied with federal, state, or local laws or regulations; or
- (v) any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the asset-backed security will pay interest and principal in accordance with applicable terms and conditions.<sup>8</sup>

**Issuer:** includes a sponsor (as defined below) or depositor that participates in the issuance of an asset-backed security.<sup>9</sup> A municipal issuer of asset-backed securities as defined above should generally presume that it is an issuer (as used in Section 15E(s)(4)(A) and Rule 15Ga-2) even if its financing structure does not involve a transfer of assets to a separate issuing entity.

**Municipal issuer:** means an issuer that is any State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory or the District of Columbia, or any public instrumentality of one or more States, Territories or the District of Columbia.<sup>10</sup>

**Sponsor:** means the person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.<sup>11</sup>

**Third-party due diligence report:** means any report containing findings and conclusions of any due diligence services performed by a third party.<sup>12</sup>

The definition of the term “asset-backed security” is statutory, while the other terms described herein are defined by Rule 15Ga-2. Although municipal securities are exempt from Rule 15Ga-2, it can be expected that the SEC would refer to these definitions as a starting point in construing the terms “issuer” and “third-party due diligence report” in connection with a municipal issuer’s statutory obligation under Section 15E(s)(4)(A) of the Exchange Act.

**Other Considerations**

It can be expected that municipal due diligence and primary and post-issuance disclosure practices will evolve in response to the implementation of Section 15E(s)(4)(A) of the Exchange Act and Rule 15Ga-2, at least in connection with portfolio financings. Given the exemptive approach taken in the Rule 15Ga-2 and the Adopting Release, only limited guidance is available at this time as to scope of the statutory requirement to municipal transactions. Questions arising from specific fact situations involving third-party reports concerning pledged assets may require consultation with counsel in light of developing rating agency, underwriter, and issuer practices and any further SEC guidance that may become available.

Please contact any Hawkins partner for further information regarding any of the issues in this Hawkins Advisory or if we can otherwise be of assistance.

<sup>8</sup> 17 C.F.R. § 240.17g-10(d)(1).

<sup>9</sup> 17 C.F.R. § 240.17g-10(d)(2).

<sup>10</sup> 17 C.F.R. § 240.15Ga-2(g).

<sup>11</sup> 17 C.F.R. § 229.1101(l).

<sup>12</sup> 17 C.F.R. § 240.15Ga-2(d).

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