

A background image showing several hands in business attire holding white puzzle pieces, symbolizing teamwork and problem-solving. The puzzle pieces are arranged in a circular pattern, with some hands holding pieces that are being brought together.

Third-Party Due Diligence Report Rules

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Introduction

In August 2014, the SEC approved final rules implementing Section 932 of the Dodd-Frank Act, which required the SEC to, among other things, adopt new requirements for issuers, underwriters and third-party due diligence service providers to promote the transparency of the findings and conclusions of third-party due diligence as it relates to asset-backed securities.

- **Disclosure of ABS Third-Party Due Diligence Reports:** New Exchange Act **Rule 15Ga-2** requires an issuer or underwriter of an ABS that is to be rated by a nationally recognized statistical rating organization (**NRSRO**) to furnish a Form ABS-15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. Rule 15Ga-2 applies to both registered and unregistered offerings of ABS.
- **Certification of ABS Third-Party Due Diligence Provider:** The Dodd-Frank Act amended the Exchange Act to require a provider of third-party due diligence services for ABS to provide a written certification to any NRSRO that produces a credit rating to which the services relate. New **Rule 17g-10** establishes the form and content of that written certification in new Form ABS Due Diligence-15E. The rule requires the NRSRO to disclose any certification it receives with each rating action to which such certification relates.

Both Rule 15Ga-2 and Rule 17g-10 will become effective on **June 15, 2015**.

Definitions

Third-party due diligence report means any report containing findings and conclusions of any **due diligence services** performed by a third party.

The term due diligence services encompasses a review of the assets underlying an asset-backed security for the purpose of making findings with respect to:

- (1) the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets;
- (2) whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria or other requirements;
- (3) the value of collateral securing the assets;
- (4) whether the originator of the assets complied with federal, state or local laws or regulations; or
- (5) 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 the applicable terms and conditions.

Definitions:

The “Catchall” Provision

Although the fifth prong of the definition of “due diligence services” is quite broad, the SEC clarifies in the Adopting Release that it is intended to refer to any review of the assets underlying the related Exchange Act-ABS that is **“commonly understood in the securitization market to be third-party due diligence services** or analogous services that may develop in the future but are not expressly covered by the first four prongs of the definition” and not a review of the Exchange Act-ABS itself.

Definitions: Agreed-Upon Procedures Engagements

Agreed-upon procedures engagements performed by accounting firms generally include one or more of the following:

- (1) comparing the loan tape to the loan file;
- (2) recalculating projected future cash flows due to investors; and
- (3) performing procedures that address other information included in the offering document.

- In the Adopting Release, the SEC indicates that the 2nd and 3rd examples are not commonly understood as being due diligence services and should not trigger the requirements of Section 15E(s)4). However, **comparing the information on a loan tape with the information contained on the hard-copy documents in a loan file is an activity that falls within the definition of “due diligence services”** because the work involves a review of the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets.
- Accountants’ AUP reports generally describe the requirements and limitations resulting from relevant accounting professional standards and the SEC indicates in the Adopting Release that it would not object to the inclusion of the same description in the written certification on Form ABS Due Diligence-15E.

Overview of Rule 15Ga-2

Rule 15Ga-2 requires an issuer or underwriter of an ABS that is to be rated by an NRSRO to furnish a 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.

Applies to any offering of ABS:

- that is to be **rated** by an NRSRO regardless of:
 - who pays for the credit rating
 - whether the NRSRO receives a copy of the third-party due diligence report or uses the third party due diligence report in determining its credit rating
- that meets the **Exchange Act definition of “asset-backed security”** regardless of whether the ABS is sold in a registered or unregistered transaction

Does not apply to certain offshore offerings Exchange Act-ABS or to certain offerings of Exchange Act-ABS by municipal issuers.

Rule 15Ga-2: Form ABS-15G

Form ABS-15G must contain the findings and conclusions of the applicable third-party due diligence report. The SEC stated in the Adopting Release that a summary of the report and its findings will not satisfy this requirement.

Form ABS-15G should also include disclosure of:

- The criteria against which the loans were evaluated
- How the evaluated loans compared to those criteria
- The basis for including any loans not meeting those criteria

Rule 15Ga-2: Furnishing of Report

- The issuer or underwriter must furnish Form ABS-15G at **least five business days** prior to the first sale in the offering.
 - For purposes of the rule, the **date of the first sale** is the date on which the first investor is irrevocably contractually committed to invest, which, depending on the terms and conditions of the contract, could be the date on which the issuer receives the investor's subscription agreement or check.
- The disclosure is **only required for an initial rating** and does not need to be furnished in connection with any subsequent ratings actions.
- If the disclosure required by Rule 15Ga-2 has been made in the prospectus, the Form ABS-15G **may refer to the applicable section of the prospectus** containing the required disclosure rather than providing the findings and conclusions directly in the Form ABS-15G if:
 - The disclosure in the prospectus identifies the applicable due diligence provider; and
 - The prospectus is publicly available at the time of the filing of Form ABS-15G.

Rule 15Ga-2: Execution of Form

- A Form ABS-15G furnished by the **issuer** must be signed by the **senior officer of the depositor in charge of securitization**.
- A Form ABS-15G furnished by the **underwriter** must be signed by a **duly authorized officer** of the underwriter.
- A **single Form ABS-15G** may be furnished when the issuer and one or more underwriters have obtained the same third-party due diligence report related to a particular ABS transaction.
 - For example, if the issuer and an underwriter obtain the same third-party due diligence report related to a particular ABS and the issuer timely furnishes a Form ABS-15G for that report, the underwriter has not obligation to furnish a Form ABS-15G for that same third-party due diligence report.

Overview of Rule 17g-10

- Section 15E(s)(4)(B) of the Exchange Act requires that a third party providing due diligence services to an NRSRO, issuer or underwriter with respect to an Exchange Act-ABS provide a written certification to any NRSRO that produces a credit rating to which the due diligence services relate.
- Rule 17g-10 requires that required pursuant to Section 15E(s)(4)(B) of the Exchange Act must be on Form ABS Due Diligence-15E.
- The written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.

Rule 17g-10: Safe Harbor

A person employed to provide third-party due diligence services will be deemed to have satisfied its obligations under Section 15E(s)(4)(B) of the Exchange Act if the person promptly delivers an executed Form ABS Due Diligence-15E after completion of the due diligence services to:

- (1) An NRSRO that provided a written request for the form prior to or after the completion of the due diligence services stating that the services relate to a credit rating the NRSRO is producing; and
- (2) The issuer or underwriter of the ABS for which the due diligence services relate that maintains the Rule 17g-5 website with respect to the ABS.

Rule 17g-10: Related Amendment to Rule 17g-5

- The SEC made a corresponding amendment to Rule 17g-5 designed to provide for the prompt posting of Form ABS Due Diligence 15-E to the Rule 17g-5 website for the related ABS so that other NRSROs can have access to it contemporaneously with an NRSRO that knew that the third party was performing due diligence and requested that the form be delivered upon completion of the services.
- Under the amendment, an NRSRO hired to rate a structured finance product must obtain an additional representation that can be reasonably relied upon from the issuer, sponsor or underwriter of the ABS that it will post to the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E containing information about the security delivered by a person employed to provide third-party due diligence services with respect to the security.

Rule 17g-10: Certifications by Service Provider

Form ABS Due Diligence-15E requires that third-party due diligence providers certify as to the following items:

- The identity of the third-party due diligence services provider;
- The identity of the person that paid for the third-party due diligence services;
- The identity of any NRSRO whose published due diligence criteria the due diligence services are intended to satisfy as well as the title and date and such published criteria;
- A detailed description of the scope and manner of the due diligence performed; and
- A summary of the findings and conclusions of the due diligence review.

Rule 17g-10: Description of Due Diligence

Form ABS Due Diligence-15E requires that the person providing third-party due diligence services provide a **detailed description of the scope and manner of the due diligence services** performed in connection with the review of the assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review. The Form instructs the due diligence provider to include a description of:

- The type of assets that were reviewed
- The sample size of the assets reviewed
- How the sample size was determined and, if applicable, computed
- Whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted
- Whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria or other requirements was reviewed and, if so, how the review was conducted
- Whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted
- Whether the compliance of the originator of the assets with federal, state and local laws and regulations was conducted and, if so, how the review was conducted
- Any other type of review that was part of the due diligence services conducted by the person executing the form

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