KAYE SCHOLER LLP

Current as of June 2, 2010

Exchange Act Rule 17g-5

I. Introduction

A. Rule 17g-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires a nationally recognized statistical rating organization ("NRSRO") to manage and disclose certain conflicts of interest and prohibits certain other types of conflicts of interest outright.

B. In December 2009, pursuant to Release No. 34-61050 (the "Adopting Release"), the Securities and Exchange Commission (the "SEC") amended Rule 17g-5, to add paragraphs (a)(3), (b)(9) and (e), which impose additional disclosure and conflict of interest requirements on NRSROs that are hired by issuers, sponsors and underwriters (collectively, "Arrangers") of structured finance products.

1. Purpose: Address concerns about the integrity of the credit rating procedures and methodologies at NRSROs.
2. Compliance Date: June 2, 2010.
    a. On its face, Rule 17g-5, as amended, applies to all structured finance products as to which the initial credit rating was issued on or after June 2, 2010. See, however, "VII. ABCP Programs" below.
    b. It is open to debate as to whether Rule 17g-5, as amended, applies to structured finance products in situations where the rating process has commenced prior to June 2, 2010, but the initial credit rating will be issued on or after June 2, 2010.
        (1) At a series of meetings with the SEC, the American Securitization Forum (the "ASF") and a group of NRSROs have attempted to argue that, for practical reasons relating to transition, Rule 17g-5, as amended, should apply only where both the subject NRSRO is engaged and the initial credit rating will be issued on or after June 2, 2010.
        (2) The SEC has not formally stated its position as to this matter.
        (3) DBRS, Fitch, Moody's and S&P have publicly announced that they intend to comply with the amended rule for new structured finance transactions where they have been engaged, or where the ratings process is otherwise initiated, on or after June 2, 2010.
3. Effects on Others: Additional disclosure requirements on Arrangers of structured finance products.

C. NRSRO: Pursuant to Section 3(a)(62) of the Exchange Act, the term "nationally recognized statistical rating organization" means a credit rating agency that:

1. has been in the business as a credit rating agency for at least three (3) consecutive years immediately preceding the date of its application for registration under Section 15E of the Exchange Act;
2. issues credit ratings described in clause (B) of Section 3(a)(62) of the Exchange Act (which includes credit ratings of issuers of asset-backed securities); and
3. is registered under Section 15E of the Exchange Act.

D. Arranger

1. Issuer

a. With respect to asset-backed securities (within the meaning of Item 1101(c) of Regulation AB) under the Exchange Act, the "issuer" is the depositor (within the meaning of Item 1101(e) of Regulation AB) for such asset-backed securities acting solely in its capacity as depositor to the issuing entity for such asset-backed securities.

b. Pursuant to Item 1101(e) of Regulation AB, the term "depositor" means the person who receives or purchases the pool assets and transfers or sells such assets to the issuing entity. For asset-backed securities transactions where there is not an intermediate transfer of the pool 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.

c. As discussed below, the structured finance products covered by the new paragraphs being added to Rule 17g-5 are broader than the definition of "asset-backed securities" under Item 1101 of Regulation AB. Accordingly, the more general definition of "issuer" under the Exchange Act may also be applicable.

2. Sponsor

a. Not specifically defined under the Exchange Act or the rules promulgated thereunder. Presumably has the same meaning as "sponsor" under Item 1101 of Regulation AB.

b. Pursuant to Item 1101(l) of Regulation AB, the term "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.

3. Underwriter

a. Pursuant to Section 3(a)(20) of the Exchange Act, has the same meaning as in the Investment Advisers Act of 1940, as amended (the "Advisers Act").

b. Pursuant to Section 202(a)(20) of the Advisers Act, the term "underwriter" means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of such undertaking, but such term does not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission.

II. New paragraph (b)(9) of Rule 17g-5 ("New Paragraph (b)(9)")

A. New Paragraph (b)(9) makes it a conflict of interest for an NRSRO to issue or maintain a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, which credit rating was paid for by an Arranger of the security or money market instrument.

B. Securities and Money Market Instruments Covered by the Amendments to Rule 17g-5.

1. According to its commentary in the Adopting Release, the SEC intends New Paragraph (b)(9) to apply to a broad range of structured finance products, including, but not limited to, securities collateralized by static and actively managed pools of loans or receivables (*e.g.*, commercial and residential mortgages, corporate loans, auto loans, education loans, credit card receivables and leases), collateralized debt obligations, collateralized loan obligations, collateralized mortgage obligations, structured investment vehicles, synthetic collateralized debt obligations that reference debt securities or indices, and hybrid collateralized debt obligations.

2. Many market participants are of the view that covered bonds are not intended to be covered by Rule 17g-5, as amended. Covered bonds are secured, recourse obligations issued by financial institutions and do not possess the characteristics of more traditional structured finance products. For example, covered bonds are not credit tranched, have payment terms that are not defined or impacted by the cash flow characteristics of the underlying cover pool, and have an investor base generally different from the investor base for more traditional structured finance products. The SEC has not yet expressed a view as to whether covered bonds are within the scope of Rule 17g-5, as amended.

III. New paragraph (a)(3) of Rule 17g-5 ("New Paragraph (a)(3)")

A. New Paragraph (a)(3) provides that if an NRSRO has a conflict of interest identified in New Paragraph (b)(9) relating to issuing or maintaining a credit rating for any structured finance product covered by New Paragraph (b)(9), then such NRSRO (the "hired NRSRO" as to such structured finance product) must:

1. maintain on a password-protected Internet Web site a list of each such structured finance product for which it is currently in the process of determining an initial credit rating in chronological order and identifying −

   a. the type of structured finance product,

   b. the name of the issuer,

   c. the date the rating process was initiated, and

   d. the Internet Web site address where an Arranger of the structured finance product represents that the applicable Required Information (as described below) can be accessed;

2. provide access to such password-protected Internet Web site during the applicable calendar year to any non-hired NRSRO that satisfies the requirements discussed in III.D. below; and

3. obtain from an Arranger of each such structured finance product a written representation (an "Arranger Representation") that can be reasonably relied upon that such Arranger will −

   a. maintain the applicable Required Information at an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied upon to determine or monitor the credit rating,

   b. provide access to such password-protected Internet Web site during the applicable calendar year to any non-hired NRSRO that satisfies the requirements discussed in III.D. below, and

c. post on such password-protected Internet Web site the applicable Required Information at the same time that such information is provided to the hired NRSRO.

B. Duration of Posting

1. NRSRO Internet Web site: Information about a particular security or money market instrument may be removed from an NRSRO's Internet Web site when (a) the NRSRO publishes the initial credit rating with respect thereto or (b) the applicable Arranger terminates the rating process before the NRSRO publishes an initial credit rating.

2. Arranger's Internet Web site

a. Unclear based upon Rule 17g-5, as amended, and the SEC's commentary in the Adopting Release.

b. Information about a particular security or money market instrument may need to be maintained until such security or money market instrument is no longer outstanding or the applicable Arranger withdraws its request for a rating on such security or money market instrument.

C. Required Information

1. If an Arranger of any structured finance product covered by New Paragraph (b)(9) hires an NRSRO to issue and/or maintain a credit rating with respect to such structured finance product, then the information required to be maintained by such Arranger on a password-protected Internet Web site with respect to such structured finance product (the "Required Information") will consist of:

a. all information the Arranger provides to the hired NRSRO, or contracts with a third party to provide to the hired NRSRO, for the purpose of determining the initial credit rating for such structured finance product, including information about the characteristics of the assets underlying or referenced by such structured finance product, and the legal structure of such structured finance product; and

b. all information the Arranger provides to the hired NRSRO, or contracts with a third party to provide to the hired NRSRO, for the purpose of undertaking credit rating surveillance on such structured finance product, including information about the characteristics of the assets underlying or referenced by such structured finance product.

2. Oral Versus Written Communication

a. Rule 17g-5, as amended, does not purport to regulate oral communications between an Arranger and an NRSRO that it has hired to issue and/or maintain a credit rating with respect to a structured finance product. However, the concept of Required Information with respect to such structured finance product is arguably broad enough to pick up oral communications.

b. In its commentary in the Adopting Release, the SEC:

(1) acknowledged that the requirements of New Paragraph (a)(3) as a whole likely will formalize the process of information exchange from an Arranger to a hired NRSRO for structured finance products, including the written submission of information that may, in the past, have been provided orally; and

(2) stated that it believes this to be a positive development because −

(a) conveying information in writing rather than orally may promote credit rating accuracy in that the NRSRO analyst will be able to refer back to a document containing the information rather than his or her memory, and

(b) a more formal process of information exchange will create a better record of the data provided to the hired NRSRO, which will make it easier for the SEC staff to understand the process used to determine a credit rating during an after-the-fact review of whether the hired NRSRO adhered to its procedures and methodologies for determining such credit rating.

c. Market participants seem to be taking the following positions:

(1) Information used in the ratings process should be provided to a hired NRSRO in writing whenever possible.

(2) Oral communications between an Arranger and an NRSRO are not prohibited so long as such communications are not used to circumvent the requirements of Rule 17g-5, as amended.

(3) Where information used in the ratings process is inadvertently provided to a hired NRSRO orally, the substance of the oral communications should be promptly posted to the applicable Arranger's Internet Website

3. It appears to be the industry view that the standards outlined in III.C.1. and III.C.2. apply to information that an Arranger provides to a hired NRSRO, or contracts with a third party to provide to a hired NRSRO, during a rating agency visit or other regular rating agency communication that is used in the ratings process.

D. If an Arranger of any structured finance product covered by New Paragraph (b)(9) hires an NRSRO to issue and/or maintain a credit rating with respect to such structured finance product, then any non-hired NRSRO may access the password-protected Internet Web site to be maintained by such Arranger or by the hired NRSRO so long as:

1. the non-hired NRSRO provides such Arranger or the hired NRSRO, as the case may be, with a copy of the certification described in new paragraph (e) of Rule 17g-5 that covers the calendar year in which access is sought; and

2. such certification indicates that the non-hired NRSRO either −

a. determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to New Paragraph (a)(3) in the calendar year prior to the year covered by such certification, if the non-hired NRSRO accessed such information for ten (10) or more issued securities or money market instruments, or

b. has not accessed information pursuant to New Paragraph (a)(3) ten (10) or more times during the most recently ended calendar year.

E. Reasonable Reliance on an Arranger Representation

1. According to the SEC's commentary in the Adopting Release, the question of whether it is reasonable for a hired NRSRO to rely on an Arranger Representation from the Arranger that hired it will depend on the facts and circumstances of a given situation.

   a. Factors relevant to the analysis include:

      (1) ongoing or prior failures by the applicable Arranger to adhere to its representations; or

      (2) a pattern of conduct by the applicable Arranger where it fails to promptly correct breaches of its representations.

   b. A limited Internet Web site malfunction by itself would not cause a hired NRSRO to no longer be able to rely reasonably on a written representation from the affected Arranger.

2. An NRSRO is not required to enforce compliance with an Arranger Representation made to it. However, an Arranger that fails to comply with its Arranger Representations will risk:

   a. having a hired NRSRO withdraw the credit ratings paid for by that Arranger, and

   b. being denied the ability to obtain credit ratings from the hired NRSRO in the future.

IV. New paragraph (e) of Rule 17g-5 ("New Paragraph (e)")

A. In order to access a password-protected Internet Web site maintained by an Arranger of a structured finance product or by an NRSRO hired by that Arranger to issue or maintain a credit rating with respect to such structured finance product, a non-hired NRSRO must furnish to the SEC, for each calendar year for which it is requesting a password, a certification, signed by a person duly authorized by the certifying entity, generally to the following effect:

1. the certifying NRSRO will access the Internet Web sites described in New Paragraph (a)(3) solely for the purpose of determining or monitoring credit ratings;

2. the certifying NRSRO will keep the information it accesses pursuant to New Paragraph (a)(3) confidential;

3. the certifying NRSRO will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to New Paragraph (a)(3), if it accesses such information for ten (10) or more issued securities or money market instruments in the calendar year covered by the certification; and

4. either —

   a. in the most recent calendar year during which the certifying NRSRO accessed information pursuant to New Paragraph (a)(3), the certifying NRSRO accessed information for [Insert #] issued securities and money market instruments through Internet Web sites described in New Paragraph (a)(3) and determined and maintained credit ratings for [Insert #] of such securities and money market instruments, or

b. the certifying NRSRO previously has not accessed information pursuant to New Paragraph (a)(3) ten (10) or more times during the most recently ended calendar year.

V. Extraterritoriality

A. Issue: Should Rule 17g-5, as amended, apply to conduct outside the U.S. absent a substantial effect in the U.S. or on U.S. persons?

B. Current SEC Position

1. An NRSRO may define the parts of its business that operate under the NRSRO designation and can therefore control the scope of its conduct that is subject to Rule 17g-5, as amended.

2. Rule 17g-5, as amended, is clear on its face that it applies whenever an Arranger-paid NRSRO issues an initial credit rating to a structured finance product under the NRSRO designation, even if such Arranger is located outside the U.S. and such structured finance product is to be sold to non-U.S. persons.

C. Staff from the U.K. Financial Services Authority, the Japan Financial Services Authority, the Ontario Securities Commission and the German Federal Financial Services Authority, as well as a number of market participants, have notified the SEC staff that Arrangers of structured finance products located outside the U.S. generally were not aware that they would be required to make the Arranger Representations in order to obtain credit ratings from NRSROs. They also have expressed concern that the application of Rule 17g-5, as amended, would disrupt structured finance markets outside of the United States.

D. On May 19, 2010, the SEC issued an order stating that an NRSRO is not required to comply with New Paragraph (a)(3) until December 2, 2010 with respect to credit ratings where: (1) the issuer of the structured finance product is a non-U.S. person; and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any Arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S. The SEC also solicited comment regarding the application of Rule 17g-5, as amended, outside of the U.S.

VI. Confidentiality

A. Pursuant to the certification provided under New Paragraph (e), a non-hired NRSRO that accesses information pursuant to New Paragraph (a)(3) is required to keep such information confidential. However, such certification does not directly run to any Arranger.

B. The SEC has not required non-hired NRSROs accessing information pursuant to New Paragraph (a)(3) to enter into a confidentiality agreement with Arrangers.

C. An Arranger may employ a simple process requiring non-hired NRSROs to agree to keep information they obtain from such Arranger's Internet Web site confidential, provided that such a process does not operate to preclude, discourage, or significantly impede the access of non-hired NRSROs to the information, or their ability to issue a credit rating based on the information. As part of its commentary in the Adopting Release, the SEC provides the following example:

1. An Arranger can impose a confidentiality agreement in a window (click-through screen) on its Internet Web site that appears after a non-hired NRSRO successfully enters its password to access the information and which requires the

NRSRO to hit an "Agree" button before being directed to the information to be used to determine the credit rating.

2. The SEC assumes that this confidentiality agreement would contain the same terms as the confidentiality agreement between the Arranger and the hired NRSRO.

VII. ABCP Programs

A. Several market participants are taking the position that Rule 17g-5, as amended, applies to asset-backed commercial paper ("ABCP") programs initially credit rated before June 2, 2010.

B. On May 3, 2010, ASF ABCP Conduit Sponsor Subforum members submitted to the SEC a letter (the "ABCP Letter") proposing that, in the case of an existing ABCP program initially credit rated before June 2, 2010, an Arranger would be deemed to have satisfied the Required Information requirements of Rule 17g-5, as amended, if it posts and maintains on the relevant password-protected Internet Web site the following information:

1. Historical Information: On the date that NRSROs are first required to comply with New Paragraph (b)(9) in respect of existing ABCP programs initially credit rated before June 2, 2010 —

   a. all ABCP program documentation in its then-effective form,

   b. a copy of the most recent report of all assets then owned by the ABCP conduit, identifying the issuer of each asset, the type of asset and comprehensive data on the performance of each such asset (*i.e.*, the same report that each ABCP conduit currently provides to the hired NRSROs on a monthly basis), and

   c. all offering documents in their then current forms used in placing the ABCP; and

2. Prospective Information: Following the date referred to in B.1. above, all information the Arranger of the ABCP program provides to the hired NRSROs, or contracts with a third party to provide to the hired NRSROs, for the purpose of undertaking credit rating surveillance of the ABCP, at the same time such information is provided to the hired NRSROs.

C. As part of the ABCP Letter, the ASF ABCP Conduit Sponsor Subforum members requested that the SEC extend by one month the date by which NRSROs are first required to comply with the amendments to Rule 17g-5 with respect to existing ABCP programs initially credit rated before June 2, 2010. The SEC has not responded.

D. S&P and Moody's have each publicly stated that they consider Rule 17g-5, as amended, to apply to ABCP programs, including existing ABCP programs to which the subject NRSRO has assigned an initial credit rating prior to June 2, 2010. In order to be able to maintain its rating with respect to any such existing ABCP program, each such NRSRO is seeking an Arranger Representation from the Arranger for such existing ABCP program, and requiring the posting of information generally consistent with the proposal in the ABCP Letter on the Arranger's Internet Web site, by the following date:

1. Moody's: no later than the first date after June 2, 2010, that the applicable Arranger (or a third party with which it has contracted) provides Moody's with any information regarding the program documentation or collateral, other than information relevant for routine surveillance. By way of example, Moody's has stated that it would consider information regarding seller additions and

amendments to program documents to be information provided other than for routine surveillance.

2. S&P: the earlier of (a) the date on which the applicable Arranger provides S&P with information in connection with a request to consider a rating implication such as information about an amendment and/or an addition of a new pool of assets to the ABCP conduit and (b) June 30,2010.

VIII. Regulation FD

A. As one of the exceptions to the disclosure requirements under Regulation FD, the SEC is adding information provided to an NRSRO pursuant to New Paragraph (a)(3) for the purpose of determining or monitoring a credit rating.