TCW Insight that works for you.™

METWEST

UPDATED
July 22, 2010

Brian Loo
Senior Vice President
U.S. Fixed Income

Fixed Income Commentary

The Dodd-Frank Act: Consumer ABS Impact

The recently-passed Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") is arguably the most significant piece of financial market regulatory legislation since the Securities Act of 1933 (the "Securities Act"), part of FDR's "New Deal." We consider aspects of its impact on the consumer asset-backed securities (ABS) market.

The Bureau of Consumer Financial Protection will be established to monitor and regulate practices and standards related to consumer financial products. This relates to banks and other financial institutions, but will not apply to entities such as car dealerships, nor non-financial product retailers which often act as agent for purchase financing. Fees such as bank interchange, late fees and consumer charges could be affected by this regulatory body and directly have an impact on those related trusts, but other liquid sectors like autos or equipment trusts should be less impacted. The net effect to the consumer will thus be more regulation, which should address concerns such as predatory lending, but potentially reduce the overall availability of credit.

Issuers of securitized products will now be required to retain 5% of their transactions. This 5% is of course so that issuers maintain "skin in the game," and it may not be hedged nor transferred. Credit cards will be less impacted by this aspect, since card master trusts already entail a "seller's interest" which is typically greater than 5% anyway, but for practically every other asset class this will reduce overall leverage and limit the amount of issuance. This increases the cost of securitization and will ultimately impact the consumer and small businesses through reduced credit and higher lending rates.

Probably the most significant and controversial aspect of the Act is the repeal of Rule 436(g) of the Securities Act. Rule 436(g) had exempted Nationally Recognized Statistical Ratings Organizations (NRSROs) from expert liability related to the inclusion of ratings in documents related to new issuance. The NRSROs' consent is now required prior to ratings inclusion in the creation of registered documents, prospectuses, etc, and this consent would attach NRSROs in a manner akin to the representations made by issuers, underwriters, accountants and other due diligence providers involved in a securitization. While this may seem intuitive and perhaps even long overdue, the three primary NRSROs, Standard & Poor's, Moody's and Fitch Ratings, have issued statements in response to the Act along the lines that they will not be providing such consents, at least until further studies are performed to assess the impact of any potential new associated liability. The Office of Credit Ratings will be created by the Act to oversee and regulate this aspect of securitization.

Not providing the consents means that for all intents and purposes, new public securitization will not be accomplished. In the past, reduced disclosure related to new transactions had been achieved through the 144(A) market, but SEC revisions to Regulation AB, due in early August, could push requirements higher and close to the level required for public issuance, which

would make the 144(A) route a less-viable alternative. This does leave the less-used 4(2) private placement exemption as a possibility, but this restricts issuance to physical certificates without the potential for repo. And even without these nuances, 144(A) and 4(2) securities face a limited audience already as traditional money managers and other large participants often have restrictions in place related to participation in these types of securities.

Obviously the stoppage of public securitization would be a negative outcome, to issuers, consumers, underwriters, NRSROs and ultimately even politicians, to bring it full circle. There are possible workarounds: in its Regulation AB revisions, the SEC could remove the requirement for rating disclosure from registration statements. This would preserve the Act in its current form while allowing the securitization market to continue. In fact, the SEC today announced a short-term solution to the problem imposed from the repeal of Rule 436(g). Tomorrow (July 23), a 'no action' letter will be released permitting issuers to omit credit ratings from registration statements which were filed under Regulation AB. This letter will be effective for a period of six months to allow for market participants to discuss and implement the necessary long-term solution to the current problem. The SEC action should alleviate any short-term roadblocks to new issuance in the securitized market. Among possible long-term solutions, NRSROs could quantify their liability and charge higher fees to compensate.

Participants from syndicate heads to investors have already expressed the limitations which will be affected should the public securitization market be effectively shuttered as a result of this legislation; initial thoughts had suggested an overall securitization underwriting drop of *at least* 50% had the NRSROs' required consent not been addressed. It remains to be seen what the ultimate outcome will be as a result of the Act, but we think this was an unintended consequence and believe that it is in the best interest of all parties to reach a mutually-beneficial solution.

This publication is for information purposes only. While the information and statistical data contained herein are based on sources believed to be reliable, we do not represent that it is accurate and should not be relied on as such or be the basis for an investment decision. Any opinions expressed are current only as of the time made and are subject to change without notice. TCW assumes no duty to update any such statements. Copyright TCW 2010

METWEST IS A WHOLLY-OWNED SUBSIDIARY OF THE TCW GROUP, INC.
865 South Figueroa Street | Los Angeles, California 90017 | 213 244 0000 | www.tcw.com