By Stephen Barlas, Lance A. Thompson, Kathy Williams

SEC Issues Revised Proposed Rule on Shelf Registration of ABS

By Stephen Barlas

On July 27, the U.S. Securities & Exchange Commission (SEC) put out a revised proposed rule for asset-backed securities (ABS) that are offered as part of shelf registrations. This is an important issue for companies such as Hertz Corp. and Starwood Hotels & Resorts—as well as auto dealers, equipment lessors, and many others—who were worried about the structure of the SEC's original proposed regulation published in April 2010. The SEC temporarily set that regulation aside after Congress passed the Dodd-Frank Act in July 2010 because it contained broad ABS provisions going way beyond those in shelf registrations, some of which negated or overrode what the SEC had proposed for shelf registration ABS just months before.

The SEC has finally gotten around to issuing a revised proposed rule adhering to the Dodd-Frank provisions on ABS as they apply to shelf registrations. The risk retention requirement in the April 2010 proposal is gone: At Dodd-Frank's directive, seven federal agencies proposed a risk retention rule for all sorts of ABS, which, when finalized, will apply to shelf registrations (see "Business Groups Roundly Criticize Proposed Rule on ABS Risk Retention").

Under the April 2010 proposed rule on shelf registration of ABS, issuers would have to get a credit rating agency to provide an investment grade rating for the securities contained in that shelf registration. That requirement is gone in the proposal the SEC issued in July. One reason is because Dodd-Frank also contained a provision (having nothing to do directly with ABS shelf registrations) that instructed the SEC and other federal agencies to eliminate all requirements that require credit rating agency action. To compensate for the absence of a requirement involving a credit rating agency, the SEC made some changes in the CEO certification requirement in the July rule. In addition to a CEO, the executive officer in charge of securitization could make the certification. The certification would state that the securitization isn't guaranteed to produce cash flows at times and amounts sufficient to service the expected payments on the asset-backed securities. Furthermore, the July rule revises the April 2010 language so that the certification no longer addresses how the securities "will" pay or perform but instead focuses on the design of the transaction.

Business Groups Roundly Criticize Proposed Rule on ABS Risk Retention

When finalized, the proposed rule on risk retention issued in May by seven financial regulators will affect each major asset class, including residential mortgage-backed securities, auto ABS, ABCP, credit card ABS, student loan ABS, and corporate debt repackagings. The Dodd-Frank Act requires "separate rules for securitizers of different classes of assets." The comment deadline ended on August 1, 2011.

It appears from the proposed rule that risk retention requirements would apply to corporate debt repackagings. The American Securitization Forum (ASF) argued that, unlike traditional ABS such as securities backed by mortgage or consumer loans, corporate debt repackagings aren't part of the process of directly or indirectly financing the origination of consumer loans or other financial assets. The ASF, which represents various industry sectors who package loans, asked the agencies to exempt repackagings from any risk retention

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requirements.

David Hirschmann, president and CEO of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness, says the proposed rule would hurt U.S. companies beyond corporate debt repackagings. He notes that commercial real estate (CRE) finance plays an essential role for American businesses. Specifically, portfolio lending, commercial mortgage backed securities (CMBS), and equity are all funding mechanisms that businesses use to purchase office buildings, factories, and storefronts that help create jobs and generate economic growth.

Hirschmann is particularly critical of the requirement for a Premium Capture Cash Reserve Account (PCCRA). "While we understand the goal of risk retention is to align incentives, the PCCRA steps far beyond the regulators' mandate and fundamentally alters the economics of securitization," Hirschmann states. "Specifically, the PCCRA creates a timing mismatch by forcing issuers to immediately absorb all the downside risk/losses associated with their interest rate exposure while requiring the issuer to wait years to recognize any potential profit for taking that risk." Hirschmann also thinks the proposed rule subjects collateralized loan obligations (CLOs)—important to small and medium-sized companies—to overly broad credit retention requirements.

Investors Defend Role of Credit Rating Agency

Some investors groups are, maybe surprisingly, pushing back against the Dodd-Frank requirement (Section 939A) that federal regulatory agencies eliminate any reliance on credit rating agencies. The revised proposed rule on ABS shelf registrations mentioned above does just that. Given the deleterious effect of erroneous ratings during the recession, one would think consumer and investment groups would be saying good riddance to credit ratings. Not so. Gregory W. Smith, general counsel and COO, Colorado Public Employees' Retirement Association, told the House Financial Services Subcommittee on Oversight and Investigations, "Just as it is not feasible or practical for us or other institutional investors to simply stop using credit ratings altogether, it may not be feasible or practical for federal agencies to strike, in one fell swoop, ratings from all of their rules and regulations." Smith was representing the Council of Institutional Investors.

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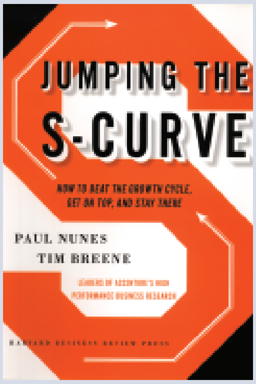
BOOKS

Sustained Success



High performance is about outperforming the competition again and again, even as the basis of competition in an industry or market changes. High-performance organizations are those that continually repeat their success, the difficult achievement discussed in *Jumping the S-Curve* by Paul Nunes and Tim Breene.

S-curves are the common pattern in which a successful business starts small with a few eager customers, grows rapidly as the masses seek out the new offering, and eventually peaks and levels off as the market matures. High-performance companies are those that somehow manage to climb the S-curve and then jump to a new one, again and again.

The secret isn't what you do at or near the top of the curve, but what you do to prepare for the jump while on the way up. The key is to move to the bottom of the next curve even as you climb the original. Outperforming the competition for long periods demands success on multiple S-curves as companies must both develop and respond to new technologies and ways of competing.

Nunes and Breene's work is based on an Accenture study that was used to develop a roadmap to climb and jump S-curves:

1. Build high performance through:

• Superior market focus (commit to big-enough market insights)

• Distinctive capabilities (build threshold competence before scaling)

• Serious talent (become worthwhile through shared expectations)

2. Sustain high performance through:

• Continual market relevance (define and execute edge-centric strategy)

• Ongoing top-team evolution (evolve top team early to build new capabilities)

• Constant talent surplus (create a hothouse of talent)

High-performance businesses achieve superior market focus by committing to and exploiting big-enough market insights. They create and develop distinctive capabilities before scaling the business, although they plan their approach to scaling well in advance. They create an organization that serious talent finds worthwhile as a place to invest its time, skills, and energy for decades.

But success can't last forever. Rapid, sustained growth eventually hits a ceiling. Capabilities lose their distinctive edge, and serious talent becomes disgruntled as opportunities dry up. Even at the best businesses, growth wanes. Without a focus on rebuilding the foundations of high performance with new market insights, distinctive capabilities, and a culture attractive to serious talent, companies will stall and begin to decline.

The secret to preventing a stall—and eventual decline—is to manage the business according to the pace and duration of the following hidden S-curves, which mature much faster than the financial curve:

1. The *market relevance S-curve* tracks the basis of competition in industry changes,

2. The *capabilities S-curve* tracks the uniqueness of business capabilities in the marketplace, and

3. *The talent development S-curve* tracks the flow of the talent pipeline.

S-curves are getting shorter. Advances in technology, shifts in access to talent, shrinking trade barriers, and changes in customer needs and demographics are disrupting companies in many industries. The authors describe eight such disruptors that may change the competitive landscape and turn industries upside down in the coming years: business analytics, digital marketing, cloud computing, consumers in emerging markets, mobility, global talent scarcity, smart infrastructure solutions, and sustainability.

Jumping the S-Curve is about simple concepts, challenging work, effective execution, and achieving recurring greatness. This excellent book provides a roadmap for business executives with the passion and fortitude to lead high-performing companies for long periods of time.—Lance A. Thompson, Thompson Management Consulting Services, LLC, lancephx@aol.com