WHITE PAPER

APPLICATION OF THE U.S. RISK RETENTION RULES TO

"INDENTURE-STYLE" CELLULAR TOWER SECURITIZATIONS

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*17 C.F.R. Part 246, adopted jointly by the Securities and Exchange Commission ("**SEC**") and five other federal agencies in October of 2014 (the "**U.S. Risk Retention Rules**"), requires a sponsor of asset-backed securities ("**ABS**") or a majority-owned affiliate of the sponsor to retain an economic interest in the credit risk of securitized assets in accordance with the requirements of the U.S. Risk Retention Rules for a specified period of time. Compliance with the U.S. Risk Retention Rules was required with respect to ABS collateralized by residential mortgages by December 24, 2015 and with respect to all other classes of ABS by December 24, 2016. Considerable uncertainty exists as to whether certain securities constitute ABS for purposes of the application of the U.S. Risk Retention Rules, in particular with respect to more esoteric asset classes.*

The purpose of this White Paper is to address whether the assets that collateralize the notes issued in a typical "indenture-style" cellular tower securitization[1] are "self-liquidating financial assets" that are the "primary" source of repayment such that the notes issued in such a securitization should be treated as ABS subject to the U.S. Risk Retention Rules. The guidance set forth in this White Paper is subject to change in light of future judicial opinions or regulatory actions interpreting the U.S. Risk Retention Rules or applicable legislative action.

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I. Background.

A typical "indenture-style" cellular tower securitization for purposes of this White Paper is a securitization transaction in which a cellular tower company directly or indirectly transfers its ownership interest in a portfolio of cellular tower sites and related real property interests—which may include equipment, ground leases, fee simple real property and other interests in real property—to one or more bankruptcy remote, special purpose entities. The special purpose entities are most often direct or indirect

[1] "Indenture-style" cellular tower securitizations are those in which the cellular towers and related real property interests held by an issuer or other guarantor entity and pledged directly to support payment obligations under the notes and the other obligations under the indenture, as more fully described under "Background" herein. An alternative structure, the "CMBS-style" structure, is also prevalent in the cellular tower securitization market in which a back-to-back mortgage loan structure is interposed between the underlying cellular tower-related collateral and the issued notes. This White Paper does not address the alternative "CMBS-style" structure.

wholly-owned subsidiaries of the cellular tower company. We refer to such special purpose entities collectively as the "***Issuer***" in this White Paper.

In a typical transaction, the Issuer enters into an indenture pursuant to which it issues one or more series of notes in a transaction exempt from registration under the U.S. Securities Act of 1933, as amended (the "***Securities Act***"). The Issuer pledges the cellular tower sites and related real property interests held by it to the trustee under the indenture to secure the Issuer's payment obligations on the notes. Amounts paid by the wireless telephone companies and other users of the cellular towers (the "***Tenants***") pursuant to leases, licenses and other agreements ("***Tenant Leases***") for the placement of wireless communication equipment on the cellular tower sites and for other purposes, together with the other proceeds of the collateral, are applied to pay current amounts due on the notes (as well as other fees and expenses payable by the Issuer, including operating expenses with respect the cellular tower assets) in accordance with the priority of payments for the application of funds set forth in the indenture. The cellular tower company, acting on behalf of the Issuer in its separate capacity as the manager, typically collects amounts due on the Tenant Leases and pursues the entrance into new Tenant Leases as space on the applicable cellular tower sites allows, as well as the coordination of renewal of existing Tenant Leases upon their expiration.

The notes issued in a cellular tower securitization typically have an anticipated repayment date on which the notes are expected to be either refinanced or repaid, with a longer-dated legal final maturity date. The failure to refinance or repay the notes by the anticipated repayment date is generally a rapid amortization event under the indenture that requires substantially all excess cash flow that would otherwise be released to the Issuer to be redirected to pay principal of the notes until paid in full, without treatment as an event of default that would permit the noteholders to exercise legal remedies. The notes may be subject to scheduled amortization prior to the anticipated repayment date. The failure to pay the notes by the longer-dated legal final maturity date will be an event of default under the indenture that permits the noteholders to exercise legal remedies including foreclosure and a liquidation of the collateral.

The cellular tower company that securitizes the cellular tower assets in a cellular tower securitization will typically maintain a 100% direct or indirect equity ownership interest in the Issuer, thus placing the cellular tower company in an effective "first loss" position with respect to changes in value of the securitized assets, while entitling the cellular tower company to the residual value of the securitized assets. As such, the cellular tower company effectively retains a substantial portion of the risk—namely the entire residual value—in a typical cellular tower securitization transaction aside from any efforts to achieve technical compliance with the U.S. Risk Retention Rules. However, it is our view that technical compliance with the U.S. Risk Retention Rules should <u>not</u> be required for a typical "indenture-style" cellular tower securitization transaction for the reasons explained below.

II. <u>Analysis</u>.

As noted above, the application of the U.S. Risk Retention Rules to ABS collateralized by residential mortgages was effective on December 24, 2015, and with respect to all other classes of ABS was effective on December 24, 2016. Compliance is required for assets a "portion of the credit risk for [which] . . . the securitizer, through the issuance of an *asset-backed security*, transfers, sells, or conveys to a third party."[2] Thus, there is a threshold question as to whether the notes issued in the "indenture-style" cellular tower securitization transaction constitute "asset-backed securities" for purposes of the U.S. Risk Retention Rules. The U.S. Risk Retention Rules incorporate the definition of "asset-backed security" set forth in Section 3(a)(79) of the U.S. Securities Exchange Act of 1934, as amended (the "***Exchange Act***"), which defines an "asset-backed security" as "a fixed-income or other security collateralized by any type

[2] 17 C.F.R. pt. 246(a) (2015) (emphasis added).

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" (emphasis added) (the "***Exchange Act Definition***"). Therefore the primary consideration in determining whether the U.S. Risk Retention Rules apply to a typical "indenture-style" cellular tower securitization should be whether payments on the notes issued pursuant to the indenture rely *primarily* on the cash flow from any type of "self-liquidating financial asset" within the meaning of the Exchange Act Definition.

The primary assets owned by the Issuer in an "indenture-style" cellular tower securitization are the cellular tower sites and related real property interests which may include equipment, ground leases, easements, fee simple real property and other interests in real property as noted above. We do not believe that these assets should be considered self-liquidating financial assets for purposes of the U.S. Risk Retention Rules because they are clearly not self-liquidating nor are they financial assets within the plain meaning of the term "financial asset." Instead, these assets should most accurately be characterized as interests in real property and certain related personal property. The payments made by the Tenants pursuant to the Tenant Leases typically are the primary source of current payments of interest on and scheduled principal of the notes, but generally do not support the ultimate repayment of principal of the notes or the residual value held by the cellular tower company. These Tenant Leases are more arguably financial assets for purposes of the U.S. Risk Retention Rules, and the Exchange Act Definition specifically cites as examples of self-liquidating financial assets "a loan, a lease, a mortgage, or a secured or unsecured receivable" without further elaboration. Therefore, for purposes of the present analysis it is critical to determine whether the payments on the notes rely primarily on (i) the long-lived cellular tower sites and related real property interests described above and the re-leaseability thereof or (ii) the pool of the lease payments made by the Tenants pursuant to Tenant Leases that exist upon the closing of the cellular tower securitization.

We believe that payments on the notes issued pursuant to a typical "indenture-style" cellular tower securitization do not rely primarily on the cash flow from the Tenant Leases that exist upon the closing of the securitization and therefore do not rely primarily for repayment on the cash flow of self-liquidating financial assets for purposes of the Exchange Act Definition for a variety of reasons, including the following facts which we understand to be prevalent in typical transactions of the type:

(i) The cellular tower sites, equipment, ground leases, easements, fee simple real property and other related real property interests pledged by the Issuer in a typical cellular tower securitization clearly are not themselves financial assets as noted above;

(ii) The lease payments on the Tenant Leases held by the Issuer upon the closing of a typical cellular tower securitization are not expected to be sufficient to pay the notes in full on the anticipated repayment date. At that point, the notes are expected to be refinanced or otherwise repaid using a source of funds other than the payments under the Tenant Leases;

(iii) The Tenant Leases in a typical cellular tower securitization are often expected to have a weighted average term that is shorter than the expected weighted average life of the notes (based on the anticipated repayment date) and generally far shorter than (x) the term of the notes based on the final maturity date and (y) the useful life of the cellular tower assets, which also demonstrates that the manager, acting on behalf of the Issuer, is required to actively renew and replace Tenant Leases on behalf of the Issuer as they expire in order to continue making payments on the notes and that the Issuer is required to actively maintain the long-lived cellular tower sites themselves; and

(iv) Upon the closing of a typical cellular tower securitization, a portion of the cellular tower sites may not be fully utilized by Tenant Leases, which requires the Issuer to engage the manager, acting on its behalf , to actively enter into Tenant Leases for such cellular tower sites.

The factors outlined above demonstrate that the payments on the notes issued by the Issuer in a typical "indenture-style" cellular tower securitization rely primarily on active management and re-leasing of the cellular tower sites and related real property interests themselves by the manager rather than lease payments on the pool of Tenant Leases that exist upon the closing of the cellular tower securitization. Since the cellular tower sites and related real property interests themselves are clearly not self-liquidating financial assets, it is our view that in a properly structured "indenture-style" cellular tower securitization transaction, the notes issued by the Issuer should not be considered ABS for purposes of the Exchange Act Definition triggering the credit risk retention requirements of the U.S. Risk Retention Rules.

As other commentators have noted with respect to other esoteric asset classes,[3] the legislative history of Section 3(a)(79) of the Exchange Act suggests that the phrase "self-liquidating financial assets" for purposes of the Exchange Act Definition was not intended to be interpreted broadly enough to cover the assets backing a cellular tower securitization transaction. In particular, Section 3(a)(79) of the Exchange Act was incorporated as part of Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "***Dodd-Frank Act***"). Upon an examination of the related legislative history, we note that the final U.S. House of Representatives bill[4] in connection with the Dodd-Frank Act would have incorporated by reference the Regulation AB definition of "asset-backed security" in effect at such time (the "***Reg AB Definition***")[5] as opposed to the Exchange Act Definition. The Reg AB Definition contemplated that an "asset-backed security" could depend on residual value from certain non-financial assets for repayment, to a specified extent subject to certain parameters. However, it is our view that the Reg AB Definition was originally drafted for a different legislative purpose, namely to allow certain lease-based transactions to come into the purview of Regulation AB as an accommodation for Regulation AB-style disclosure considerations outside the then-nonexistent scope of the objective of risk retention. The currently-effective Regulation AB Definition[6] places careful restrictions on the percentage of residual value of non-financial assets on which an "asset-backed security" can rely for repayment (thus requiring the issuer to comply with Regulation AB-style disclosures). Even if the Reg AB Definition had been chosen instead of the Exchange Act Definition in the final U.S. Risk Retention Rules, it is our view that a transaction with high percentage of residual value from non-financial assets in excess of the prescribed limits, such as is likely the case in a typical cellular tower securitization transaction with high residual-value real property and cellular tower assets, would have fallen outside the Reg AB Definition as well—thus leading to a similar result as we advocate in this White Paper under the Exchange Act Definition. As such, even though the final Dodd-Frank legislation[7] chose to adopt the Exchange Act Definition, it is our view that an "indenture-style" cellular tower securitization transaction should have fallen out outside of both definitions, expressing legislative support for the positions taken in this White Paper.

We also believe it important to mention an important analogue that exists with respect to Rule 15Ga-2 under the Exchange Act[8] ("***Rule 15Ga-2***"). Rule 15Ga-2 requires the filing of a Form ABS-15G by the "issuer or underwriter of an offering of any asset-backed security (as that term is defined in [the

[3] *See, e.g.* "Applicability of U.S. Risk Retention Rules to Structured Aircraft Portfolio Transactions" (December 2, 2016), available at https://www.milbank.com/images/content/2/5/25088/US-Risk-Retention-Aircraft-White-Paper.pdf, at n.9.
[4] Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 1502(a) (2009).
[5] 17 C.F.R. § 229.1101(c)(1) (2005).
[6] 17 C.F.R. § 229.1101(c)(2)(v) (2014).
[7] Restoring American Financial Stability Act of 2010, H.R. 4173, 111th Cong. § 941(a) (2010).
[8] 17 C.F.R. § 240.15Ga–2 (2015).

Exchange Act Definition]) that is to be rated by a nationally recognized statistical rating organization"[9] within certain prescribed timeframes. Rule 15Ga-2 took effect in June of 2015, prior to the effectiveness of the U.S. Risk Retention Rules for non-residential mortgage transactions. We note as a factual matter that Form ABS-15Gs have been filed for several "indenture-style" cellular tower securitization transactions prior to the effective date of the U.S. Risk Retention Rules. It is our view that, based on the same analysis as we have set forth above for application of the U.S. Risk Retention Rules, the filing of a Form ABS-15G in connection with a typical "indenture-style" cellular tower securitization transaction should not be required and issuers and underwriters of such transactions may wish to view such a filing and any past Form ABS-15G filings made in connection with typical "indenture-style" cellular tower securitization transactions as voluntary in nature.[10]

We also note that any securitization transaction is—by its nature—fact specific and that any particular transaction may differ from the hypothetical "indenture-style" cellular tower securitization addressed in this White Paper. Each transaction must be carefully analyzed under the facts at hand and representations should be obtained from the Issuer as to the nature of the securitized assets.

III. Conclusions.

While the scope of the application of the U.S. Risk Retention Rules to the securitization of more esoteric asset classes continues to be subject to discussion, it is our view that the U.S. Risk Retention Rules should not apply to the notes issued pursuant to a typical "indenture-style" cellular tower securitization because the notes in such a transaction do not depend primarily on the cash flow from "self-liquidating financial assets" within the meaning of the Exchange Act Definition for the reasons discussed above.

As noted above, the U.S. Risk Retention Rules became effective for classes of ABS other than residential mortgages at the end of last year. We therefore expect the scope of the application of the U.S. Risk Retention Rules to be subject to further development, including in response to future federal legislative, regulatory or judicial action and such specific guidance as may be provided by the SEC and the other federal agencies responsible for the implementation of the U.S. Risk Retention Rules. The conclusions set forth in this White Paper are subject to such future federal action and specific guidance as may be provided.

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[9] *Id.*

[10] This White Paper does not address the application of Rule 15Ga-2 to "CMBS-style" cellular tower securitization structures.