

Coping with the Repeal of Rule 436(g): SEC Staff Provides Guidance and No-Action Relief Regarding Inclusion of Credit Ratings in Offering Materials

July 22, 2010

Yesterday, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). While most of the provisions of the Act will require months, if not years, of study and implementation by regulators, a handful of provisions became effective today, including the Act’s repeal of Rule 436(g) under the Securities Act of 1933, as amended (the “Securities Act”).¹

Rule 436(g) exempted nationally recognized statistical rating organizations (“NRSROs”), such as Moody’s Investors Service, Standard & Poor’s Ratings Services and Fitch Ratings, from being considered to be “experts” in the event their ratings were included in a Securities Act registration statement or prospectus. Under the Securities Act, the written consent of an expert (which includes any person who is named in the registration statement or prospectus as having prepared or certified a portion of the registration statement or prospectus) must be filed with the SEC,² and such consenting expert is subject to enhanced liability for the prepared or certified portion of the registration statement or prospectus.³

Moody’s, S&P and Fitch have stated that they are currently unwilling to consent to the use of their ratings in registration statements given the potential additional liability.⁴

The fixed income markets rely heavily on credit ratings.

- Issuers of debt securities typically include NRSRO’s credit ratings in term sheets and press releases relating to securities offerings.
- Corporate debt issuers commonly discuss credit ratings in periodic reports, which are incorporated by reference into their Securities Act registration statements and prospectuses.

¹ Section 939G of the Act.

² Securities Act Section 7(a) (15 U.S.C. §77g(a)).

³ Securities Act Section 11 (15 U.S.C. §77k).

⁴ See *Bond Sale? Don’t Quote Us, Request Credit Firms*, WALL ST. J., July 21, 2010, available at:

http://online.wsj.com/article/SB10001424052748704723604575379650414337676.html?mod=loomia&loomia_si=t0:a16:g2:r2:c0.0661899:b35877358.

- Underwriters of debt securities use “Bloomberg screens” containing NRSRO credit ratings to convey final pricing terms to purchasers.
- Purchasers of debt securities typically base their investment guidelines on credit ratings.

The asset-backed securities markets rely on credit ratings to an even greater extent. Asset-backed securities transactions are typically structured to create multiple tranches of asset-backed securities, each having a specified credit rating from one or more NRSROs. In addition, pursuant to Items 1103(a)(9) and 1120 of Regulation AB under the Securities Act, if an NRSRO credit rating is a condition of the offering of any class of the asset-backed securities, the identity of the NRSRO and the credit rating is required to be disclosed in the registration statement and prospectus.⁵

The repeal of Rule 436(g) and refusal of major NRSROs to consent to the inclusion of their ratings in registration statements and prospectuses threatened to significantly disrupt the fixed income markets. In response, the staff of the SEC Division of Corporation Finance today issued five Compliance and Disclosure Interpretations⁶ regarding issuers that are not subject to Regulation AB disclosure requirements, which we refer to as “corporate issuers”, and a no-action letter applicable to issuers of asset-backed securities.

Corporate Debt Issuers

In its Compliance and Disclosure Interpretations, the SEC staff confirmed that corporate debt issuers would generally need to obtain and file the written consent of a credit rating agency if information about such agency’s credit ratings is included in, or incorporated by reference into, a Securities Act registration statement, prospectus or prospectus supplement that is first filed on or after July 22, 2010.⁷

Free writing prospectuses and press releases

The SEC staff also confirmed that consents are required only with respect to credit rating information contained in Securities Act registration statements and Section 10(a) prospectuses. Credit rating information in free writing prospectuses filed pursuant to Rule 433 under the Securities

⁵ See Items 1103(a)(9) and 1120 of Regulation AB.

⁶ Questions 233.04-.08 of the Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations (C&DIs), available at: <http://sec.gov/divisions/corpfina/guidance/securitiesactrules-interps.htm>.

⁷ See C&DI Questions 233.04 and 233.05.

Act and in term sheets or press releases that comply with Rule 134 under the Securities Act do not trigger the consent requirements.⁸

Issuer disclosure-related ratings information

The staff stated that an issuer would not need the consent of a credit rating agency with respect to disclosure of credit ratings in a filing with the SEC that is related only to:

- changes in a credit rating, for example in a risk factor disclosure regarding the issuer's creditworthiness;
- the liquidity of the registrant, such as in the issuer's Management's Discussion and Analysis of Financial Condition and Results of Operations;
- the cost of funds for a registrant; or
- the terms of agreements that refer to credit ratings, for example in descriptions of debt covenants, interest or dividends that are tied to credit ratings and potential support to variable interest entities ("issuer disclosure-related ratings information").⁹

Grandfathered information

To the extent an issuer has included or incorporated by reference credit ratings information in a registration statement on Form S-3 or Form F-3 that was declared effective prior to July 22, 2010, the staff will not object to reliance on Rule 401(a)¹⁰ under the Securities Act to allow continued use of the registration statement without filing a consent of the credit rating agency, provided that:

- issuers may rely on Rule 401(a) for this purpose only until the filing of the next post-effective amendment to such registration statement (including the filing of the issuer's next annual report on Forms 10-K, 20-F or 40-F, which is deemed to be a post-effective amendment for the purposes of Section 10(a)(3) of the Securities Act); and
- no subsequently incorporated periodic or current report contains ratings information that is not limited to issuer disclosure-related ratings information.

⁸ See C&DI Question 233.06.

⁹ See C&DI Question 233.04.

¹⁰ Rule 401(a) under the Securities Act states: "The form and contents of a registration statement and prospectus shall conform to the applicable rules and forms as in effect on the initial filing date of such registration statement and prospectus."

Asset-Backed Securities Issuers

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Regulation AB requires issuers of asset-backed securities to include in the prospectus disclosure of ratings and the identity of the NRSROs if the offering is conditioned on such rating.¹¹ As several NRSROs have indicated their unwillingness to consent to the inclusion of their identities or ratings in registration statements, asset-backed issuers would, absent relief, effectively be prevented from conducting public offerings.

On July 22, 2010, the staff of the SEC Division of Corporation Finance issued a no-action letter in response to a no-action request letter from Susan J. Thomas, Secretary and Associate General Counsel of Ford Motor Credit Company LLC, that provided broad relief to asset-backed issuers.¹² The no-action letter stated that “[i]n order to facilitate a transition for asset-backed issuers, the Division will not recommend enforcement action to the Commission if an asset-backed issuer as defined in Item 1101 of Regulation AB omits the ratings disclosure required by Item 1103(a)(9) and 1120 of Regulation AB from a prospectus that is part of a registration statement relating to an offering of asset-backed securities.” The staff’s no-action position expires with respect to offerings commencing with an initial bona fide offer on or after January 24, 2011.

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¹¹ Item 1103(a)(9) of Regulation AB requires issuers to indicate in the prospectus relating to the offering whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies and, if so, identify each rating agency and the minimum rating that must be assigned.

Item 1120 of Regulation AB requires issuers to disclose whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies, and, if so, identify each rating agency and the minimum rating that must be assigned. Item 1120 also requires issuers to describe any arrangements to have such rating monitored while the asset-backed securities are outstanding.

¹² Ford Motor Credit Company LLC, SEC No-Action Letter (July 22, 2010), available at: <http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm>.