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Registered Public Offerings Of Debt Securities And The Use Of Credit Ratings Information In SEC Filings After Dodd-Frank

The practice of marketing registered public offerings of debt securities with credit ratings information and related disclosure of issuer credit ratings in SEC filings will change with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").

One of the many reforms of Dodd-Frank was aimed at credit rating agencies. Dodd-Frank Section 939G repealed SEC Rule 436(g) promulgated under the Securities Act of 1933. Rule 436(g) stated that in general, credit ratings were not deemed "expertized" portions of registration statements. As non-expertized content, issuers did not need consent from credit rating agencies to use their ratings in registration statements, and credit rating agencies were not subject to strict liability under Section 11 of the Securities Act for the opinion reflected in their ratings. The sudden repeal of Rule 436(g) left uncertainty in the capital markets, and the SEC quickly stepped in with interpretations that enabled public debt and asset-backed offerings to continue while the SEC develops additional rulemaking to address the role of credit ratings and credit rating agencies in registered public offerings.

We discuss in this article the use of credit ratings in registered offerings of debt securities, the SEC's recent interpretations, and their potential impacts on disclosure practices and future debt offerings.

Background

Section 7 of the Securities Act and Rule 436(a) promulgated thereunder generally require an issuer to obtain written consent from an expert for use of its report or opinion in the issuer's registration statement. Section 11 of the Securities Act provides that the persons who sign a registration statement, the directors of the issuer, the underwriters and the experts who consent to be named in the registration statement are liable to purchasers of the securities sold under a registration statement for omissions and misstatements in the registration statement, subject to certain defenses. The standard for liability for the non-experts (i.e., the directors and underwriters) is lower for so-called "expertized" portions of a registration statement, where the experts themselves have the higher standard for liability.

Prior to the enactment of Dodd-Frank on July 21, 2010, Rule 436(g) provided that the credit rating assigned

to debt securities, convertible debt securities, or preferred stock by a nationally registered statistical rating organization (NRSRO[1]) would not be considered a part of the registration statement prepared or certified by an expert within the meaning of Sections 7 and 11 of the Securities Act. Thus, Rule 436(g) permitted issuers to include credit ratings information in a registration statement, prospectus or prospectus supplement without obtaining the consent of NRSROs and without subjecting NRSROs to potential liability under Section 11.

The Section 7 consent requirement does not apply to free writing prospectuses in compliance with Securities Act Rule 433 or in a term sheet or press release issued in compliance with Securities Act Rule 134.[2]

Historically, issuers of debt securities have included credit ratings in registration statements, prospectuses, term sheets and Rule 134-compliant press releases to market offerings and raise capital with debt. Corporate debt issuers often disclose their credit ratings in SEC filings that are subsequently incorporated by reference into registration statements and prospectuses. Underwriters of debt securities and broker-dealers typically disseminate credit ratings information with final pricing terms to purchasers through Bloomberg screens. Credit ratings affect the pricing of debt securities and also the ability of certain investors to purchase and hold the securities.

What changes now?

The Dodd-Frank Act repealed Rule 436(g) under the Securities Act. As a result, credit ratings generally may not be included in a registration statement or a prospectus without consent of the NRSROs that issued the ratings. Providing such consents would subject NRSROs to liability under Section 11 of the Securities Act, and the NRSROs all announced immediately that they would not give consent for use of their ratings in registration statements or prospectuses.

What are the potential impacts of the change?

The intent of repealing Rule 436(g) was to make NRSROs more accountable for the quality of their ratings. However, with NRSROs refusing to provide their consents, the potential consequences were (i) inability to include credit ratings information in registrations statements and related prospectuses for issuers, including information incorporated by reference from reports under the Securities Exchange Act of 1934 (e.g., Forms 10-K, 10-Q and 8-K), (ii) the need to amend Exchange Act reports to remove credit ratings information previously included, and (iii) a catch-22 for registered offerings of asset-backed securities, which are *required* to include credit ratings information in the prospectus.

What did the SEC do?

The staff of the SEC Division of Corporation Finance issued a number of Compliance and Disclosure Interpretations related to the repeal of Rule 436(g) and also issued a no-action letter allowing registered offerings to continue. Specifically:

- The SEC staff clarified that for non-asset-backed issuers, NRSRO consent is not required if credit ratings information is included in a registration statement or a statutory prospectus only for the purpose of satisfying disclosure requirements. This means that issuers may use credit ratings without obtaining NRSRO consent when the disclosure of the credit rating is related only to changes to an issuer's credit rating, the issuer's liquidity, the issuer's cost of funds or the terms of agreements that refer to credit ratings, which information is classified by the SEC as "issuer disclosure-related information." Specific examples of "issuer disclosure-related ratings information" include ratings information disclosed: (i) in the context of a risk factor discussion regarding the risk of failure to maintain a certain rating and the potential impact a change in credit rating would have on the issuer; (ii) when an issuer refers to or describes its credit ratings in the context of its liquidity discussion in the MD&A section of its periodic SEC reports; and (iii) when an issuer discusses credit ratings in its description of debt covenants, interest or dividends that are tied to credit ratings or potential support to variable interest entities.[3]

- The SEC staff indicated that issuers not subject to Regulation AB (for asset-backed securities) may rely upon Rule 401(a) under the Securities Act to allow continued use, for the limited period permitted under Rule 401(a), of a registration statement declared effective before July 22, 2010 that contains or incorporates by reference credit rating information beyond "issuer disclosure-related information," without NRSRO consent. This relief applies only to information and reports filed before July 22, 2010, and only until the next post-effective amendment to such registration statement. Reports incorporated by reference after July 22, 2010 should not contain credit ratings information other than "issuer disclosure-related information." The filing of the issuer's next annual report on Forms 10-K, 20-F or 40-F is deemed to be a post-effective amendment of any registration statement on Form S-3 or F-3. Upon such filing, prior periodic reports and Form 8-Ks filed prior the beginning of the issuer's fiscal year then in progress will no longer be incorporated by reference.[4]

- The SEC issued a no-action letter to Ford Motor Credit Company on July 22, 2010 stating that it would not recommend enforcement action against an issuer that omitted credit ratings disclosure otherwise required in a prospectus that is part of a registration statement relating to an offering of asset-backed securities.[5] This no-action position expires with respect to any registered offerings of asset-backed securities commencing with an initial bona fide offer on or after January 24, 2011.

What should you do now?

For non-asset-backed issuers:

1. No action is needed if credit ratings information included or incorporated by reference in an already effective registration statement is "issuer disclosure-related ratings information."

2. If a registration statement includes or incorporates by reference any credit rating information beyond what is considered "issuer disclosure-related ratings information" in an SEC filing before July 22, 2010, no amendment is required until the next post-effective amendment to such registration statement. However, this position applies only if no subsequently incorporated periodic or current report contains credit ratings information other than "issuer disclosure-related ratings information." Thus, assuming consent from the NRSRO is not available, an issuer will have until the filing of the next post-effective amendment or annual report on Form 10-K, 20-F or 40-F to amend the registration statement to remove the consent. In many cases, such amendment will occur merely by filing the Form 10-K, 20-F or 40-F with no credit ratings information other than “issuer disclosure-related ratings information.”

3. Make certain that any registration statements and Exchange Act reports filed in the future limit references to credit ratings to "issuer disclosure-related ratings information."

4. For takedowns of rated securities, if disclosure of credit ratings information is desired, disclose the credit rating for the particular issue in a free writing prospectus, which would generally be a term sheet or Bloomberg screen, or in a Rule 134-compliant press release, rather than in the prospectus supplement.

For asset-backed issuers subject to Regulation AB:

1. The SEC no-action letter to Ford Motor Credit Corporation was written for application to all asset-backed issuers, and until January 24, 2011, issuers of registered asset-backed securities may rely on it to omit credit ratings disclosure otherwise required in prospectus or prospectus supplement.

2. For offerings to be commenced on or after January 24, 2011, watch for SEC rulemaking or further Congressional action.

3. If your offering may not commence until January 24, 2011 or thereafter, consider structuring your offering of asset-backed securities as a private placement under Rule 144A or offshore under Regulation S as an alternative to a registered offering.

4. Follow the guidance in paragraphs 3 and 4 above for non-asset-backed issuers.

How will this impact the market for bond issuances?

While it is too early to draw conclusions as to how the market will react to the repeal of Rule 436(g), a potential consequence may be that more issuers elect to issue securities in private placements pursuant to Rule 144A or offshore pursuant to Regulation S, particularly issuers of asset-backed securities. For issuers of non-asset-backed securities in registered offerings, the result may simply be that credit ratings information is moved from the registration statement to a free writing prospectus that complies with Securities Act Rule 433, which would generally be a term sheet or Bloomberg screen, or to a Rule 134-compliant press release.

When is the new law effective?

The repeal of Rule 436(g) by Dodd-Frank Section 939G is effective now.

Are additional changes to be expected?

Further Congressional action or SEC rulemaking should be expected to clarify the use of credit ratings, particularly in registered offerings of asset-backed securities after January 24, 2011.

What if you have questions?

For any questions or more information on these or any related matters, please contact Louis Lehot, John Tishler, Camille Formosa or any attorney in the firm's corporate and securities practice group.

Disclaimer

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[1] At the time of this article, NRSROs include credit rating agencies such as Standard & Poor's, Moody's Investor Service and Fitch Ratings, among others.

[2]Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Q. 233.06.

[3]Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Q. 233.04.

[4]Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Q. 198.08, 233.07, 233.08.

[5] Ford Motor Credit Company LLC, SEC No-Action Letter (July 22, 2010).