SEC Removes References to Credit Ratings from Certain Rules and Forms

On July 27, 2011, the Securities and Exchange Commission ("SEC") adopted amendments to its rules and forms under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to remove certain references to credit rating agencies.[1] The amendments are similar to those the SEC proposed in 2008[2] but did not adopt. However, Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[3] required the SEC to "remove any reference to or requirement of reliance on credit ratings."

The final rule amendments affect Forms S-3 and F-3, Form F-9, Forms S-4 and F-4, Schedule 14A, and Securities Act Rules 138, 139, 168 and 134. The amendments become effective 30 days after publication in the Federal Register except for those provisions relating to Form F-9. Form F-9 will be rescinded as of December 31, 2012.

I. Forms S-3 and F-3 — Amendments to Instructions I.B.2

Forms S-3 and F-3 permit eligible issuers to make primary offerings while relying on prior reports filed under the Exchange Act to satisfy certain disclosure requirements of the Securities Act. Issuers eligible to use Forms S-3 or F-3 may also make "shelf" offerings pursuant to Securities Act Rule 415. Thus, Forms S-3 and F-3, in conjunction with Rule 415, afford eligible issuers flexibility in timing their offerings to changing market conditions.

An issuer is eligible to use Form S-3 or F-3 if it meets (1) the form's registrant requirements and (2) at least one of the form's transaction requirements. Before the SEC's amendments were adopted, Instruction I.B.2 of the forms provided that offerings of non-convertible securities which were rated "investment grade" by at least one nationally recognized statistical rating organization ("NRSRO") satisfied the transaction requirements.[4] However, Section 939A of the Dodd-Frank Act required the SEC to eliminate references to credit ratings.

In response to the Dodd-Frank Act, the SEC had proposed to eliminate the existing "investment grade" standard and replace it with another that was based on part of the existing definition of a "well-known seasoned issuer" ("WKSI"). Under the proposed rule, in order to satisfy Instruction I.B.2, an issuer would need to have issued at least $1 billion in non-convertible securities under the Securities Act, other than common equity, over

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1 *Security Ratings*, Release Nos. 33-9245, 34-64975 (July 27, 2011), available at http://www.sec.gov/rules/final/2011/33-9245.pdf. (the "Adopting Release").

2 *Security Ratings*, Release Nos. 33-8940; 34-58071 (July 1, 2008), available at http://sec.gov/rules/proposed/2008/33-8940.pdf. The amendments that the SEC adopted on July 27, 2011 were proposed on February 9, 2011. *See Security Ratings*, Release Nos. 33-9186, 34-63874 (Feb. 9, 2011), available at http://sec.gov/rules/proposed/2011/33-9186.pdf (the "Proposing Release"). *See also* Firm Memorandum, Cahill Gordon & Reindel LLP, *SEC Proposes Rules to Remove References to Credit Rating Agencies from Certain Rules and Forms* (Feb. 15, 2011).

3 Pub. L. No. 111-203, 124 Stat. 1376 (2010), available at http://www.govtrack.us/congress/billtext.xpd?bill=h111-4173.

4 The NRSROs currently recognized are A.M. Best Company, Inc., DBRS Ltd., Egan-Jones Rating Company, Fitch, Inc., Japan Credit Rating Agency, Ltd., Kroll Bond Rating Agency, Inc. (f/k/a LACE Financial Corp.), Moody's Investor Service, Inc., Rating and Investment Information, Inc., Realpoint LLC and Standard & Poor's Rating Services. *See* Securities and Exchange Commission, *Rating Agencies—NRSROs*, http://www.sec.gov/answers/nrsro.htm.

the prior three years.[5] However, commentators expressed concern that this proposal would cause a number of issuers that were previously eligible to use Form S-3 or F-3 to lose their eligibility. The SEC agreed to modify its standard so that its amendments would "preserve . . . access to the shelf registration process for issuers who have a wide following in the marketplace."[6]

Therefore, under amended Instruction I.B.2, an issuer will qualify if:

(1) the issuer has issued "at least $1 billion in non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act, over the prior three years"; or

(2) the issuer has outstanding "at least $750 million of non-convertible securities, other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act"; or

(3) the issuer "is a wholly-owned subsidiary of a [WKSI]"; or

(4) the issuer is a "majority-owned operating partnership of a real estate investment trust ["REIT"] that qualifies as a [WKSI]"; or

(5) the issuer falls within the three-year "grandfather" provision which protects any issuer that is currently eligible to use Form S-3 or F-3 but would otherwise lose its eligibility under the new rule.

The grandfather provision requires an issuer to "disclose[] in the registration statement that it has a reasonable belief that it would have been eligible to register the securities offerings proposed to be registered" under the prior version of Instruction I.B.2. Factors that indicate a reasonable belief of eligibility would include, but not be limited to:

• An investment grade issuer credit rating;

• A previous investment grade credit rating on a security issued in an offering similar to the type the issuer seeks to register that has not been downgraded or put on a watch-list since its issuance; or

• A previous assignment of a preliminary investment grade rating.[7]

The SEC believes that this standard will avoid "substantially alter[ing] the pool of issuers eligible for short-form registration and access to the shelf registration process."[8]

II. Form F-9 — Rescission of Form

Form F-9 permits Canadian issuers to register non-convertible investment grade debt or preferred securities. Eligible issuers find Form F-9 preferable to Form F-10 because, unlike Form F-10, it does not require

5 Proposing Release at 14.

6 Adopting Release at 16.

7 Adopting Release at 25.

8 Adopting Release at 16. It should also be noted that the final rule does not remove all reference to "investment grade securities" from Forms S-3 and F-3. The term "investment grade security," which is defined in Instruction I.B.2, is also used in Instruction I.B.5, which relates to asset-backed securities. The definition of "investment grade security" will be moved to Instruction I.B.5 until the SEC adopts a rule to eliminate that reference. *See* Adopting Release at 28.

the issuer's audited financial statements be reconciled to U.S. generally accepted accounting principles ("GAAP") if they are prepared in accordance with Canadian GAAP. However, Canada has begun requiring its reporting companies to prepare their financial statements in accordance with the International Financial Reporting Standards published by the International Accounting Standards Board ("IFRS"). Because Form F-10 does not require a U.S. GAAP reconciliation for financial statements prepared in accordance with IFRS, the SEC believes that this change in Canadian accounting practices has obviated the need for Form F-9. Therefore, the SEC has decided to rescind Form F-9 as of December 31, 2012.[9]

Some commentators noted that certain issuers that use Form F-9 might not be eligible to use Form F-10 because Form F-10, unlike Form F-9, has a public float requirement. To address this concern, the SEC's final rule creates a three-year "grandfather" provision that will allow issuers who were previously eligible to use Form F-9 to file Form F-10.[10]

III. Other Forms and Rules

A. Forms S-4 and F-4 and Schedule 14A — Conforming Amendments to Instructions

Forms S-4 and F-4 previously allowed issuers to incorporate by reference to satisfy certain disclosure requirements if, inter alia, (1) the Form S-3/F-3 registrant requirements were satisfied and (2) the issuer was offering investment grade securities. The SEC has modified this second requirement to remove the reference to "investment grade securities." Therefore, issuers that satisfy the Form S-3/F-3 registrant requirements will no longer be able to incorporate by reference in Forms S-4 and F-4 solely because they are offering investment grade securities. Instead, such issuers must qualify under one of the criteria set forth in the amended Instruction I.B.2 of Form S-3, which is summarized above.[11]

Schedule 14A previously allowed issuers to incorporate by reference in proxy statements where the Form S-3 registrant requirements are satisfied and, inter alia, the matter relates to investment grade non-convertible debt or preferred securities. The SEC has now replaced the reference to "investment grade securities" with reference to Instruction I.B.2 of Form S-3, as amended.

B. Securities Act Rules 138, 139 and 168 — Conforming Amendments to Rules

Previously, Securities Act Rules 138, 139 and 168 provided that certain communications were not considered an offer to sell a security under Section 2(a)(10) and 5(c) of the Securities Act where the communications related to an offering of non-convertible investment grade securities. The SEC has now replaced reference to "investment grade securities" with reference to Instruction I.B.2 of Form S-3, as amended.

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9 One commentator noted that because Canada's IFRS requirement did not take effect until 2011, Canadian issuers with a later fiscal year would not necessarily have IFRS-compliant financial statements at the time that the SEC proposed to issue its final rule. The SEC adopted a delayed effective date to address this concern. Adopting Release at 30.

10 Adopting Release at 30-31.

11 The SEC does not propose to change the other criteria that allow for incorporation by reference. For example, issuers that meet the market value test of Instruction I.B.1 of Form S-3 will still be permitted to incorporate by reference on Forms S-4 and F-4 (assuming the issuer also satisfies the registrant requirements of Form S-3).

C. Securities Act Rule 134(a)(17) — No Ratings in Tombstone Advertisements

Securities Act Rule 134(a)(17) previously provided a safe harbor for issuers to disclose NRSRO ratings in "tombstone" advertisements.[12] The SEC's final rule rescinds Rule 134(a)(17), thus removing NRSRO ratings from the list of permitted disclosures in tombstone advertisements.[13]

IV. Conclusion

The SEC's rule amendments make significant progress in implementing the requirements of Section 939A of the Dodd-Frank Act, which require the SEC to "remove any reference to or requirement of reliance on credit ratings."

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com; or Jonathan Bolz at 212.701.3683 or jbolz@cahill.com.

[12] "Tombstone" advertisements are communications concerning the sale of securities that are deemed not to be prospectuses or free writing prospectuses under Rule 134.

[13] The SEC noted in its release that issuers can still disclose credit ratings in a free writing prospectus. *See* Adopting Release at 39.