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July 5, 2011

Via E-mail: rule-comments@sec.gov

Securities and Exchange Commission,
100 F Street, N.E.,
Washington, DC 20549-0609.

Attention: Elizabeth M. Murphy, Secretary

Re: Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934 – File No. S7-15-11

Ladies and Gentlemen:

We appreciate the opportunity to comment on the Commission's proposal to amend certain of its rules under the Securities Exchange Act of 1934 to remove references to credit ratings. [1] The proposed changes were intended to implement the requirements of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Our comments will focus on the proposed amendments to Regulation M and Rule 10b-10. We believe that in these two cases, the proposed rule changes, while literally encompassed by Section 939A's directive, would not advance the fundamental purpose underlying Section 939A, and would tend to reduce investor protection and raise other practical problems that are better avoided.

[1] Release No. 33-64352 (April 27, 2011).

Regulation M

The proposed amendments to Rules 101 and 102 of Regulation M would replace the current exception for "investment grade nonconvertible and asset-backed securities" with new a standard relating to the trading characteristics of the covered securities, which would in all cases be subject to verification by an "independent third party." The new standard would except nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities from Rules 101 and 102 if they: (1) are liquid relative to the market for that asset class; (2) trade in relation to general market interest rates and yield spreads; and (3) are relatively fungible with securities of similar characteristics and interest rate yield spreads.

As a purely conceptual matter, we think the new standard is logical and consistent with the principles underlying Regulation M, as they have been developed over time. In practical terms, however, we believe the proposed new exception, and the conditions to its use, could be difficult and expensive for market participants to apply. We therefore expect this change would reduce the relative attractiveness, to issuers, of raising capital through registered offerings. More important, we do not perceive any real purpose being served by this proposed change. While we agree with the proposing release that the impact of the change should not be substantial, that is not a good reason to make it.

The principal concern underlying Dodd-Frank Section 939A was that over time, various market participants had in various ways become overly reliant on credit ratings, as a substitute for their own credit analysis, and that regulators had encouraged this poor practice by incorporating credit ratings in their rules. The Net Capital Rule, also addressed in the proposing release, might be seen as an example of this phenomenon. The proposed changes to that rule would very directly require broker-dealers to rely to a greater extent on their own processes for determining creditworthiness, rather than on credit ratings. The use of credit ratings in Regulation M does not implicate the same concern. Regulation M is not addressing a situation in which distribution participants must make a determination of creditworthiness, and choose to substitute credit ratings for their own judgment. Rather, it is regulating trading practices in the context of distributions, and using credit ratings solely as a criterion for defining the circumstances under which restrictions will apply.

We do not see how the use of credit ratings as a criterion for this Regulation M exception is in any way related to investors' use of credit ratings. Investors do rely on credit ratings in determining whether to purchase securities, but they will continue to do so whether or not Regulation M is amended as proposed, and the amendment would have no effect on their behavior in this regard.

The current investment-grade exception to Rules 101 and 102 has the considerable advantage of providing a bright-line standard. This promotes efficiency, and enhances the likelihood of compliance. We think that replacing a bright-line standard with individual judgment calls will lead to inconsistent approaches among issuers and market participants, particularly in marginal cases. This could result in competitive disadvantages and undermine compliance with Rules 101 and 102. We also think the current exception works well in terms of defining a category of securities that are less susceptible to manipulation. We think the Commission was correct, in 1983, in its judgment that the price of investment-grade fixed-income instruments is very difficult to manipulate, and we are not aware of – and the proposing release does not cite – evidence to the contrary.

There is still the question of how significant would be the impact of the proposed change. The proposing release notes the Commission's position that Regulation M restricts bids for and purchases of outstanding nonconvertible debt securities only if they are identical in all of their terms to the securities being distributed. We believe this position is of critical importance to the continued effective functioning of

Rules 101 and 102 in the context of debt distributions (and would be even more important if the proposed changes are implemented). As a result of this position, application of Regulation M to fixed income securities is basically limited to securities for which the distribution continues after the securities begin to trade. Most underwritten investment-grade offerings are priced after a marketing period on the basis of a book of indications of interest; as a result, most distributions are completed immediately after pricing. However, there are exceptions to that paradigm, for example, where underwriters (for any number of reasons) may be willing to price a less than fully sold offering, or where an investor may fail to honor a previously given indication of interest. Under the current rules, underwriters of investment-grade securities could, in those scenarios, make a market in the distribution securities while the distribution continued. Under the proposed amendment, on the other hand, distribution participants would, in advance of an offering, have to weigh (a) the risk of such a continuing distribution occurring, against (b) the possible disruptive effect of having no underwriters making a market in the immediate post-pricing period, and the cost of taking preemptive steps, in advance of the offering, to ensure availability of the new Regulation M exemption.

In practical terms we think the new exception would require preparation in advance of an offering, thus serving as a possible impediment to quick market access unless done routinely by all issuers. In particular, we are quite skeptical that independent third party verification of the required determinations will be readily obtainable in timely fashion or at reasonable cost (and certainly not at the estimated rate of $4,800 per offering), particularly if the third party would be subject to the "qualified independent underwriter" requirements of FINRA Rule 5121(f)(12). While we are not in a position to quantify these expected impacts, it is clear to us that the proposed change could only be expected to have a negative impact on the speed and efficiency of the registered offering process. Given the ongoing Regulation M exception for Rule 144A securities, the proposed change could be expected to make Rule 144A offerings relatively more attractive compared to registered offerings. From a policy perspective, the Commission should see these as negative effects. Since we don't think the proposed change is advancing any positive goal, we submit that these negative effects should be avoided. We therefore suggest that the proposed Regulation M changes not be adopted.

Rule 10b-10

We think the proposed amendment to Rule 10b-10, to delete the requirement to disclose when a security is unrated by an NRSRO, also serves no useful purpose. Although we have never thought that Rule 10b-10 confirmations were a particularly effective vehicle for conveying useful information to investors—because, among other things, they only get to the investor after the investment decision has been made—paragraph (a) (8) of Rule 10b-10 simply provides for a particular risk disclosure. We do not see how requiring disclosure of the *absence* of a credit rating in any way encourages greater reliance on credit ratings. If paragraph (a)(8) is deleted from the Rule, we would urge the Commission not to replace it with any further disclosures.

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If you would like to discuss our letter, please feel free to contact the undersigned at 212-558-3876 or David Harms at 212-558-3882.

Very truly yours,

Sullivan & Cromwell LLP

Sullivan & Cromwell LLP
(by Robert E. Buckholz)