

and all other preliminary indications of a rating. A preliminary rating includes ratings on a particular structure of a security even if not tied to a specific registrant or group of assets. Disclosure of a preliminary rating is required even if there have been changes to the security for which a final rating is disclosed pursuant to this paragraph 6.

5. For purposes of determining whether disclosure of any preliminary rating or unused final rating is required, a credit rating is obtained from a credit rating agency if it is solicited by or on behalf of a Registrant from a credit rating agency.

6. If the prospectus relates to securities other than senior securities of the Registrant that have been assigned a credit rating by a credit rating agency, the information required by this paragraph may be provided in the Statement of Additional Information unless the rating criteria will materially affect the investment policies of the Registrant (e.g., if the rating agency establishes criteria for selection of the Registrant's portfolio securities with which the Registrant intends to comply), in which case it should be included in the prospectus.

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By the Commission.

Dated: October 7, 2009.

Elizabeth M. Murphy,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 220

[Release Nos. 33-9071; 34-60798; IC-28943; File No. S7-21-09]

RIN 3235-AK45

Concept Release on Possible Rescission of Rule 436(g) Under The Securities Act of 1933

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: As part of the Commission's review of the role of credit rating agencies in the operation of the securities markets, and in light of disclosure regarding credit ratings that is being proposed in a companion release, the Commission is seeking comment on whether Rule 436(g) under the Securities Act of 1933 should be rescinded. In particular, we would like to understand whether there continues

to be a sufficient basis to exempt nationally recognized statistical rating organizations from Section 7 and 11 of the Securities Act.

DATES: Comments should be received on or before December 14, 2009.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/concept.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-21-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-21-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov/rules/concept.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m.. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Blair F. Petrillo, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: In a companion release,¹ the Commission is proposing amendments to rules under the Securities Exchange Act of 1934² and Regulation S-K,³ and forms under the Securities Act of 1933,⁴ the

¹ See the proposing release considered by the Commission on September 17, 2009 regarding proposed disclosure regarding credit ratings in registration statements.

² 15 U.S.C. 78a *et seq.*

³ 17 CFR 229.10 through 1123.

⁴ 15 U.S.C. 77a *et seq.*

Exchange Act and the Investment Company Act of 1940⁵ to require disclosure by registrants regarding credit ratings in their registration statements under the Securities Act and the Exchange Act, and by closed-end management investment companies in registration statements under the Securities Act and the Investment Company Act, if the registrant uses the rating in connection with a registered offering. In connection with the proposed amendments, we are soliciting comment on whether the Commission should rescind Rule 436(g) under the Securities Act.⁶

I. Introduction

We are considering whether we should propose rescinding Rule 436(g) under the Securities Act. Rule 436(g) provides an exemption for credit ratings provided by nationally recognized statistical rating organizations ("NRSROs") from being considered a part of the registration statement prepared or certified by a person within the meaning of Sections 7⁷ and 11⁸ of the Securities Act. The exemption currently does not apply to credit rating agencies that are not NRSROs. We are concerned that there is no longer a sufficient basis to exempt NRSROs and to distinguish between NRSROs and credit rating agencies that are not NRSROs for purposes of liability under Section 11 of the Securities Act. Rescinding the exemption would cause NRSROs to be included in the liability scheme for experts set forth in Section 11, as is currently the case for credit rating agencies that are not NRSROs.

We solicit comment on what impact removing the rule would have on markets and their participants. Scrutiny of credit ratings and the process of obtaining a credit rating appears to have increased as a result of the turmoil in the credit markets over the past few years. As discussed below and in the companion release proposing to require disclosure regarding credit ratings, as credit ratings have become more significant, we have sought to protect investors while recognizing the role credit ratings play in the offer and sale of securities. In that regard, we are now exploring whether Rule 436(g) is still appropriate in light of the growth and development of the credit rating industry and investors' use of credit ratings. We are mindful of the potential significant impact that rescinding Rule 436(g) could have on registrants,

⁵ 15 U.S.C. 80a-1 *et seq.*

⁶ 17 CFR 220.436(g).

⁷ 15 U.S.C. 77g.

⁸ 15 U.S.C. 77k.

NRSROs and other credit rating agencies, investors and the financial markets in general, and we seek comment on any burdens or benefits that may result. Therefore, we are requesting input on the possible elimination of Rule 436(g) from all market participants and other members of the public.

A. Section 7 and Section 11 of the Securities Act

Section 7 of the Securities Act provides that “[i]f any accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement.”⁹ These persons are referred to as experts for purposes of the securities laws. Registrants are required to file the consents of experts as exhibits to their registration statements.

Section 11 of the Securities Act imposes liability on various parties who are involved in the preparation of registration statements filed under the Securities Act. Section 11 was enacted so that those persons with a direct role in a registered offering would be subject to a rigorous standard of liability to assure that disclosure regarding securities is accurate.¹⁰ It was also designed to give investors additional protection not available under common law due to the barriers to recovery presented by the common law fraud requirements of scienter, reliance and causation. Liability under Section 11 extends to the issuer, officers and directors who sign the registration statement, underwriters, and persons who prepare or certify any part of the registration statement or who are named as having prepared or certified a report or valuation for use in connection with the registration statement.¹¹ Section 11 provides that an expert may be held liable if, when the registration statement became effective, the part of the registration statement purporting to be made on his or her authority contained an untrue statement of material fact or omitted to state a material fact necessary to make the statements therein not

misleading, unless he can establish that he had, after reasonable investigation, reasonable grounds to believe and did believe at the time such part of the registration statement became effective, that the statements in the registration statement were true and that there was no omission to state a material fact necessary to make the statements therein not misleading.¹² Under Section 11, persons other than the issuer may be able to assert as a defense to Section 11 liability that they relied upon an expert that consented to be named in the registration statement (the “experts’ defense”).¹³

B. Background of Rule 436(g)

Securities Act Rule 436(g) provides that a credit rating assigned by an NRSRO to a class of debt securities, a class of convertible debt securities, or a class of preferred stock is not a part of a registration statement prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act. With one limited exception arising in connection with our Multijurisdictional Disclosure System with Canada, there is no similar provision for credit rating agencies that are not NRSROs.¹⁴ As a result, disclosure of credit ratings in a registration statement currently results in different treatment for NRSROs and for credit rating agencies that are not NRSROs. By virtue of Rule 436(g), an NRSRO is not subject to liability under Section 11 even if its rating is disclosed in a registration statement. A registrant is not required to file consent of an NRSRO with its registration statement, and the experts’ defense is not available to other persons involved in the registration statement, regardless of whether they relied on the expertized portion of the registration statement. By contrast, if a credit rating assigned by a credit rating agency that is not an NRSRO is disclosed in a registration statement, the credit rating agency would be subject to potential liability under Section 11. The registrant is

required to file the credit rating agency’s consent with its registration statement, and the experts’ defense may be available.

In 1977, the Commission published a concept release announcing that it was considering a change in policy to permit disclosure of credit ratings in documents filed with the Commission.¹⁵ In that release the Commission solicited comment on whether an NRSRO is the type of person from whom a consent would be required under Section 7 of the Securities Act (thereby also subjecting it to liability under Section 11). That release contained a list of questions regarding the Commission’s then-current policy of discouraging the disclosure of credit ratings and whether the Commission should change that policy or retain it.¹⁶ According to the 1981 release ultimately announcing the Commission’s change in position, commenters on the 1977 release generally were opposed to subjecting NRSROs to liability under Section 11 and argued, among other things, that it would interfere with the substance and timing of the registration process, that it would result in changes to the way credit ratings were issued, and that it would result in increased costs and uncertainty over the scope of liability.¹⁷ The NRSROs in existence in 1977 indicated that they would not provide consents to be named in the registration statement.¹⁸ The 1981 release also indicated that commenters were concerned that requiring consent and subjecting NRSROs to Section 11 liability would affect their independence if they were “participants” in the offering and would lessen the quality of ratings because NRSROs likely would rely only on

¹⁵ See Disclosure of Security Ratings, Release No. 33-5882 (Nov. 9, 1977) [42 FR 58414].

¹⁶ The Commission sought comment on two questions regarding NRSROs and liability under Section 11 of the Securities Act:

A. (5) Is an entity issuing a security rating the type of person referred to in Section 7 of the Securities Act of 1933 whose consent is required to be filed by the issuer of the security? If so, what costs or other burdens may be associated with the issuer obtaining a consent from the rating agency or, in the case of multiple ratings, from all the rating agencies involved? Assuming, arguendo, that such consents may be waived by the Commission under Section 7, should waivers be granted and, if so, under what circumstances?

A. (6) What impact may result, directly or indirectly, from a rating entity being subject to Section 11 under the Securities Act of 1933, with respect to its rating being disclosed in a prospectus?

See the 1977 Release in note 15 above.

¹⁷ See Disclosure of Ratings in Registration Statements, Release No. 33-6336 (Aug. 6, 1981) [46 FR 42024].

¹⁸ *Id.*

¹² See Section 11(b) of the Securities Act [15 U.S.C. 77k(b)].

¹³ See Section 11(b)(3)(C) of the Securities Act [15 U.S.C. 77k(b)(3)(C)].

¹⁴ Rule 436(g) applies to ratings disclosed in Form F-9 [17 CFR 239.39.] registration statements by ratings organizations specified in the Instruction to paragraph (a)(2) of General Instruction I of that form. Form F-9 is the Multijurisdictional Disclosure System (“MJDS”) form used to register investment grade debt or preferred securities under the Securities Act by eligible Canadian issuers. Under Form F-9, securities are deemed to be investment grade if, at the time of sale, at least one NRSRO or Approved Rating Organization, as specified in the above-referenced Instruction, has rated the securities in a category signifying investment grade.

⁹ See Section 7 of the Securities Act in note 7 above.

¹⁰ See William O. Douglas and George E. Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171 (1933); *Herman & Maclean v. Huddleston*, 459 U.S. 375 (1983).

¹¹ See Section 11 of the Securities Act in note 8 above.

objective, quantifiable information.¹⁹ The commenters in favor of subjecting NRSROs to liability under Section 11 cited the incentive that NRSROs would take more care in determining ratings.²⁰

As noted above, in 1981, the Commission announced the shift in policy to permit, but not require, disclosure of credit ratings in registration statements. In addition, the Commission proposed Securities Act Rule 436(g) to provide that a security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock by an NRSRO would not be considered a part of the registration statement prepared or certified by a person within the meaning of Section 7 and Section 11 of the Securities Act.²¹ In proposing Rule 436(g), the Commission noted that if NRSROs refused to provide consents, then disclosure of credit ratings would not be provided even if permitted by the Commission. As a result, the Commission proposed Rule 436(g) in order to make its new policy position on the disclosure of credit ratings meaningful.²² The Commission also cited the fact that NRSROs already were subject to substantial liability under the antifraud provisions of the securities laws and to regulation by the Commission under the Investment Advisers Act of 1940.²³ The Commission then expected that, because of antifraud liability, NRSROs would be required “to adhere to the highest professional standards in determining security ratings.”²⁴ When Rule 436(g) was adopted in 1982, the Commission stated its belief that exempting NRSROs from liability under Section 11 of the Securities Act was appropriate and cited the rationale provided in the proposing release that practical problems would arise in obtaining the consents and that NRSROs were subject to the antifraud provisions of the securities laws.²⁵

In 1986, the Commission proposed to expand the Rule 436(g) exemption to include ratings assigned by NRSROs to

money market funds.²⁶ In proposing the rule, the Commission stated “because money market fund shares are equity securities, a money market fund which has received an NRSRO rating must obtain the consent of the NRSRO or seek a waiver of consent under Rule 437 [17 CFR 230.437] before using the rating in its registration statement.”²⁷ The Commission did not act on this proposal, and Rule 436(g) was not amended.

In 1994, the Commission proposed to require disclosure about credit ratings in registration statements.²⁸ In the 1994 release, the Commission noted that the policy announced in 1981 created a distinction between NRSROs and credit rating agencies that were not NRSROs. The Commission noted that the distinction was most significant in the context of Rule 436(g). While an NRSRO would not be required to provide a consent if its rating was disclosed in a registration statement pursuant to Rule 436(g), “[a]ny non-NRSRO rating organization must furnish a consent and take on expert liability under the Securities Act if its rating is included in the registration statement and prospectus.”²⁹

The 1994 release did not propose any change to Rule 436(g), but it did solicit comment on whether there should continue to be a distinction between NRSROs and credit rating agencies that are not NRSROs for purposes of Rule 436(g). The release also sought comment on whether Rule 436(g) should be expanded to include credit rating agencies that are not NRSROs or whether the rule should be rescinded. Commenters generally were opposed to subjecting NRSROs and other credit rating agencies to liability under Section 11 of the Securities Act. In particular, one commenter provided several arguments as to why Section 11 liability was not appropriate for NRSROs.³⁰ Among other things, the commenter argued that: Ratings published by NRSROs “are expressions of opinion about risk, not statements,” and even if the security defaults in an individual case, it would not necessarily be an indication that the opinion was wrong;³¹ Section 11 liability would

violate the NRSROs’ First Amendment rights;³² and Section 11 liability could eliminate the disclosure of security ratings in prospectuses.³³ The Commission did not act on the proposals in the 1994 release.

In July 2008, the Commission proposed to amend Rule 436(g) to extend the exemption to ratings provided by any “credit rating agency,” as defined in 15 U.S.C. 78c(a)(61),³⁴ rather than only to ratings provided by NRSROs. The Commission cited its belief that, among other things, amending Rule 436(g) would foster competition between credit rating agencies. Only three commenters addressed the proposed amendment to Rule 436(g). One commenter opposed it because credit rating agencies that are not NRSROs are not subject to Commission oversight.³⁵ Another commenter supported extending the exemption in Rule 436(g) to credit rating agencies that are not NRSROs.³⁶ That commenter did not believe references to ratings should be considered “expertized.” The commenter also cited the costs that registrants have to incur absent the amendment of Rule 436(g) to obtain a consent from a credit rating agency that was not an NRSRO. In addition, the commenter discussed the possibility that a rating obtained from a credit rating agency that was not an NRSRO would be omitted, thus offering investors an incomplete view of the ratings for a particular security. A third commenter objected to requiring disclosure of credit rating agency information without the consent of the relevant credit rating agency but did not cite any concerns about liability.³⁷ The Commission did not adopt the proposal.

³² NRSROs have taken the position that they “publish” their ratings and that their ratings are protected under the First Amendment. Cases in which NRSROs have asserted this position include: *Compuware Corp. v. Moody’s Inv. Servs., Inc.*, 499 F.3d 520 (6th Cir. 2007); *Jefferson County Sch. Dist. No. R-1 v. Moody’s Inv. Servs., Inc.*, 175 F.3d 848 (10th Cir. 1999); *First Equity Corp. v. Standard & Poor’s Corp.*, 690 F.Supp. 256 (S.D.N.Y. 1988); and *Abu Dhabi Commer. Bank v. Morgan Stanley & Co. et al.*, 2009 U.S. Dist. Lexis 79607 (S.D.N.Y. 2009).

³³ See note 30 above.

³⁴ See *Security Ratings* Release No. 33–8940 (July 1, 2008) [73 FR 40106].

³⁵ See letter regarding File No. S7–17–08 of American Securitization Forum (Sept. 5, 2008), at <http://www.sec.gov/comments/s7-18-08/s71808.shtml>.

³⁶ See letter regarding File No. S7–17–08 of the American Bar Association (Oct. 10, 2008), at <http://www.sec.gov/comments/s7-18-08/s71808.shtml>.

³⁷ See letter regarding File No. S7–17–08 of Realpoint LLC (Sept. 8, 2008), at <http://www.sec.gov/comments/s7-18-08/s71808.shtml>. The commenter appears to be concerned with the potential negative ramifications for subscriber-paid credit rating agencies whose ratings are disclosed publicly in a registration statement.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ 15 U.S.C. 80b–1 *et seq.* At the time Rule 436(g) was proposed, NRSROs generally were required to register as investment advisers. Congress provided an exclusion from the Advisers Act for NRSROs when it passed the Credit Rating Agency Reform Act of 2006, Public Law. 109–291, 120 Stat. 1327 (Sept. 29, 2006). See Section 202(a)(11)(F) of the Advisers Act [15 U.S.C. 80b–202(a)(11)(F)].

²⁴ See *Disclosure of Ratings in Registration Statements* in note 17 above.

²⁵ See *Adoption of Integrated Disclosure System*, Release No. 33–6383 (Mar. 3, 1982) [47 FR 11380].

²⁶ See *Disclosure of Security Ratings by Money Market Funds*, Release No. 33–6630 (March 21, 1986) [51 FR 9838].

²⁷ *Id.*

²⁸ See *Disclosure of Security Ratings*, Release No. 33–7086 (Aug. 31, 1994) [59 FR 46304].

²⁹ *Id.*

³⁰ See letter regarding File No. S7–24–94 of Moody’s Investor Service, Inc. (Dec. 5, 1994). See also letter regarding File No. S7–24–94 of Fitch Investors Service Inc. (Dec. 6, 1994).

³¹ *Id.*

In April 2009, the Commission hosted a roundtable regarding the oversight of credit rating agencies. In connection with the roundtable, the Commission also solicited comment on the topics to be covered at the roundtable, including the appropriate oversight and liability for NRSROs and credit rating agencies that are not NRSROs.³⁸ One commenter suggested that the Commission reconsider the exemption from liability for NRSROs.³⁹ That commenter also expressed skepticism regarding the First Amendment arguments asserted by NRSROs against being held liable for their credit ratings because credit rating agencies have become involved in the structuring of complex securities and no longer rate most or all securities, regardless of whether or not they have been hired to do so.⁴⁰ In addition, another commenter commissioned a white paper in connection with the roundtable discussion.⁴¹ The paper argues that in order to make NRSROs more accountable, they must be subject to a credible threat of liability. Some commenters expressed concern regarding any liability that would allow for second-guessing of judgments made by credit rating agencies.⁴²

II. Solicitation of Comment on Rescinding Rule 436(g)

In light of market developments and our proposal to require disclosure of credit ratings and information about credit ratings, we are considering proposing to rescind Rule 436(g) under the Securities Act, and we solicit comment on what impact removing the rule would have on market participants. If we were to rescind Rule 436(g), then NRSROs and credit rating agencies that are not NRSROs would be treated in the same manner for purposes of liability under Section 11 of the Securities Act if their credit ratings are disclosed in registration statements. If we adopt the amendments to require certain disclosure regarding credit ratings in registration statements, and if we were

to rescind Rule 436(g), then a registrant who uses a credit rating assigned by an NRSRO or a credit rating agency that is not an NRSRO in connection with a registered offering would be required to file the consent of the rating agency as an exhibit to its registration statement. As a result, both NRSROs and credit rating agencies that are not NRSROs would be subject to potential liability under Section 11 of the Securities Act.

We believe that it may be appropriate to rescind Rule 436(g) for four primary reasons. First, we believe that the original reasons supporting adoption of Rule 436(g) may no longer provide a sufficient basis to continue to provide the exemption to NRSROs. If this is the case, then we believe it is appropriate to reconsider whether NRSROs should continue to be insulated from liability under Section 11. In the nearly 30 years that Rule 436(g) has been in place, the credit ratings industry has grown dramatically in terms of the number of ratings issued and the types of securities being rated.⁴³ We believe that it is now appropriate to revisit the purposes underlying the adoption of Rule 436(g), particularly in light of the disclosure regarding credit ratings that we are proposing in a companion release. The Commission, in proposing Rule 436(g), stated that the rule was necessary to make its policy of permitting voluntary disclosure about security ratings meaningful. Without the exemption provided by Rule 436(g), the Commission was concerned that registrants would not voluntarily disclose security ratings in their registration statements because of the liability concerns of the NRSROs who provided the ratings. If we adopt the proposal to require disclosure regarding credit ratings if they are used in connection with a registered offering of securities, then we believe the rationale cited by the Commission in 1981 is no longer applicable because we would no longer need to provide a means to encourage disclosure about credit ratings. Registrants would be required to provide such disclosure if they use a

credit rating in connection with a registered offering. In addition, when Rule 436(g) was adopted, the Commission believed that the liability that was already applicable to NRSROs was sufficient for the protection of investors.⁴⁴ At the time, the Commission noted that NRSROs were subject to liability under both Section 10(b) of the Exchange Act and the Investment Advisers Act.⁴⁵ As noted above, NRSROs are no longer required to register under the Investment Advisers Act.⁴⁶ NRSROs remain subject to liability under Section 10(b) of the Exchange Act, but they are held liable infrequently.⁴⁷ In addition, questions could be raised about whether NRSROs' performance has "adhere[d] to the highest professional standards in determining security ratings" that the Commission expected when Rule 436(g) was adopted.⁴⁸

Second, we believe that when credit ratings are used to sell securities, investors rely on NRSROs and other credit rating agencies as experts and that it may be appropriate for our liability scheme for experts to apply to them. In our view, NRSROs represent themselves to registrants and investors as experts at analyzing credit and risk.⁴⁹ Investors rely on the information provided by credit rating agencies for a key part of their investment decision. NRSROs describe the credit ratings that they provide as opinions with respect to the registrant or security of the registrant, and the Commission notes that other professionals provide opinions upon which investors rely, such as legal opinions, valuation opinions, fairness opinions and audit reports, and we treat these opinions as subject to the Securities Act's provisions for experts, including our requirements that registrants include the consents of such professionals if their reports are referenced in registration statements. It appears to us that NRSROs and other credit rating agencies are experts similar to other parties subject to liability under Section 11 and that it may no longer be

³⁸ See Roundtable on Oversight of Credit Rating Agencies, Release No. 34-59753 (Apr. 13, 2009) [74 FR 17698].

³⁹ See Statement regarding File No. S7-04-09 of Investment Company Institute (Apr. 15, 2009), at <http://www.sec.gov/comments/4-579/4-579.shtml>.

⁴⁰ *Id.*

⁴¹ See Frank Partnoy, *Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective*, April 2009, at <http://www.cii.org/UserFiles/file/CRAWhitePaper04-14-09.pdf> (white paper commissioned by Council of Institutional Investors).

⁴² See e.g. statement regarding File No. S7-04-09 of Standard & Poor's (Apr. 15, 2009) at <http://www.sec.gov/comments/4-579/4-579.shtml> (noting that some percentage of securities will default and that such a default does not automatically mean the credit rating was inappropriate).

⁴³ See Roger Lowenstein, *Triple-A Failure*, N.Y. Times Magazine, Apr. 27, 2008 (discussing the dramatic growth in revenues of NRSROs). See also *Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies* (July 2008), at <http://www.sec.gov/news/studies/2008/craexamination070808.pdf> (noting that some rating agencies struggled with the substantial growth of the number of deals to be rated beginning in 2002); Marco Pagano and Paolo Volpin, *Credit Ratings Failures: Causes and Policy Options*, Working Paper (Feb. 9, 2009), at http://www.italianacademy.columbia.edu/publications/working_papers/2008_2009/pagano_volpin_seminar_IA.pdf (discussing the role of credit rating agencies in the growth of the market for structured products).

⁴⁴ See note 17 above.

⁴⁵ See note 23 above.

⁴⁶ *Id.*

⁴⁷ See e.g. Partnoy in note 41 above (noting that credit rating agencies "have been sued relatively infrequently, and rarely have been held liable").

⁴⁸ See note 24 above and the related discussion.

⁴⁹ We are aware that NRSROs generally do not consider themselves as experts because they believe they are providing opinions on risk. See letter of Moody's Investor Service, Inc. in note 30 above. We do not at this time believe, however, that the nature of the credit rating provided by a credit rating agency, including an NRSRO, is in and of itself so distinct from the parts of registration statements provided by other experts that they should be subject to a different standard of liability.

consistent with investor protection to exempt NRSROs from the provisions of the Securities Act applicable to experts.⁵⁰

Third, we believe that rescinding Rule 436(g), and therefore potentially increasing the risk of liability under the federal securities laws, could significantly improve investor protection. Enhancing the accountability of NRSROs may help to address concerns about the quality of credit ratings. In light of the proposal to require mandatory disclosure of information about credit ratings, rescinding Rule 436(g) could encourage both NRSROs and credit rating agencies that are not NRSROs to improve the quality of their ratings and analysis in order to reduce the risk of liability under Section 11. An improvement in the quality of credit ratings should, consistent with the goals of the federal securities laws, better protect investors. Of course, we are mindful of the possibility that a risk of greater NRSRO liability as a result of subjecting NRSROs to Section 11 may undermine competition if credit rating agencies decide that they are unable to bear the risk of liability and thus exit the ratings business. Similarly, firms considering entering the ratings business may reconsider in the face of an increased risk of legal liability. The threat of liability may particularly affect smaller, less-established rating agencies that may find it more difficult to negotiate for indemnification or bear the risk of additional liability. It also is possible that, in response to the rescission of Rule 436(g), registrants would begin to take greater advantage of private placements instead of public offerings.

Finally, we believe that the distinction in Rule 436(g) between NRSROs and credit rating agencies that are not NRSROs may contribute to competitive disadvantages. We understand that investors rely on credit ratings issued by NRSROs as much as, if not more than, credit ratings issued by credit rating agencies that are not NRSROs, particularly because the NRSROs dominate the credit rating

market.⁵¹ Distinguishing between NRSROs and credit rating agencies that are not NRSROs may create a competitive barrier for those credit rating agencies because they are subject to a higher standard of liability under the securities laws than NRSROs. For credit ratings disclosed in registration statements, it may be more time consuming or costly for a credit rating agency that is not an NRSRO to provide a credit rating to a registrant than it would be for an NRSRO to provide a credit rating because of the potential for liability under Section 11 for the credit rating agency that is not an NRSRO. As discussed above, in 2008 we proposed to amend Rule 436(g) to extend the exemption to cover ratings issued by credit rating agencies that are not NRSROs in order to foster competition in the credit rating agency industry. We did not at that time, however, propose to require disclosure regarding credit ratings. In light of the proposal to require disclosure regarding credit ratings used in connection with registered offerings, we believe that the rationale for extending the exemption to credit rating agencies that are not NRSROs may be achieved by eliminating Rule 436(g) and subjecting both NRSROs and credit rating agencies that are not NRSROs to potential liability under Section 11 of the Securities Act. We now believe this approach to fostering competition may be preferable in order to protect investors by including the proposed disclosure of the credit rating within the liability scheme of Section 11 of the Securities Act to which similar disclosure is subject. At the same time, we are mindful that the increased risk of legal liability could undercut competition if certain NRSROs are unable to bear the risk of increased liability.

We are aware that rescinding Rule 436(g) may have significant impact on the market and on market participants. We want to be cognizant of all the implications of our proposed amendments to require disclosure regarding credit ratings as well as a possible future proposal to rescind Rule 436(g). Therefore we are soliciting comments on all of the potential implications that a rescission of Rule 436(g) might have.

We solicit comment below on whether rescinding Rule 436(g) might increase reliance on credit ratings. Preliminarily, we do not believe that requiring registrants to obtain consents from NRSROs and treating NRSROs as experts under the federal securities laws should increase reliance on credit ratings. Rescinding Rule 436(g) would not change the fundamental nature of what a credit rating is. The information credit rating agencies provide is already being relied upon by investors. Rescinding Rule 436(g) would require that, before such information can be used in connection with a registered offering, the registrant would have to obtain the NRSROs' consent to take responsibility for it (in addition to any liability that would be applicable pursuant to Section 10(b) of the Exchange Act).⁵²

While we believe that elimination of Rule 436(g) may have important benefits, as discussed above, we also recognize that NRSROs have in the past expressed an unwillingness to be subject to Section 11 liability. However, we are also aware that providing credit ratings for registrants is the key component of revenues for NRSROs. As a result, we seek comment on how NRSROs would adapt if Rule 436(g) were rescinded and whether they would, in fact, stop issuing credit ratings permanently.

If we were to propose the elimination of Rule 436(g) and require disclosure regarding credit ratings as proposed, we recognize that obtaining and filing consents of all credit rating agencies may raise some practical and timing concerns. Assuming NRSROs are willing to grant consents, we do not wish to create a process that is unduly costly and burdensome or that unnecessarily delays completion of offerings. We have outlined below a potential approach to the question of when consents would be required to be filed and when a new consent would be required to be obtained. We solicit comment on whether this approach would be workable, whether there is a better approach and what other changes to our rules may have to be made in order for this process to work.⁵³

⁵² In the companion release proposing to require disclosure regarding credit ratings, we are proposing to require disclosure of preliminary ratings under certain circumstances. At this stage, we preliminarily believe we should not require consents regarding disclosure of preliminary ratings or unused final ratings. The preliminary rating may be based on preliminary information and may not have been subject to all of the credit rating agency's internal processes for determining credit ratings.

⁵³ As noted in the companion release proposing to require disclosure regarding credit ratings, the proposed disclosure requirement regarding credit

⁵⁰ In the merger context, for example, if the fairness opinion provided by the investment banker is disclosed in the registration statement, then the party preparing the opinion must consent to be named as an expert in the registration statement. We note that fairness opinions generally include language that the financial advisor relied upon information provided by the parties to the business combination. In this regard, see *In re Global Crossing, Ltd. Sec. Litig.*, 313 F.Supp. 2d 189 (S.D.N.Y. 2003) and *In re AOL Time Warner, Inc. Sec. and ERISA Litig.*, 381 F.Supp. 2d 192 (S.D.N.Y. 2004). See also *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991).

⁵¹ For "corporate issuers" in 2007, for example, Standard and Poor's, Moody's, and Fitch issued 39%, 33%, and 21% of outstanding credit ratings, respectively, for a total of 93% of outstanding credit ratings. See Annual Report on Nationally Recognized Statistical Rating Organizations (2008), at <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0608.pdf>.

The question of when consents need to be filed may turn, in part, on what the credit rating relates to and what form is being used to register the offering. We believe an offering registered on Form S-1, for example, would require a consent for the offering, and the consent would need to be filed prior to the effectiveness of the registration statement. In the context of registered offerings made on a delayed or continuous basis in reliance on Rule 415 under the Securities Act,⁵⁴ prospectus supplements are used rather than stand-alone registration statements. As a result, the following different types of ratings may result in different consent filing requirements: (1) A credit rating that is applicable to the issuer and does not necessarily change with each offering; (2) a credit rating that applies to a specific program or type of security, such as a credit rating assigned to a medium-term note program or one for long-term debt and one for short-term debt; and (3) credit ratings that are specific to each issuance of a security. In the first instance, we believe the rating would be disclosed in the prospectus that is part of a registration statement, and the consent would need to be filed prior to the time the registration statement is declared effective.

Rule 430B⁵⁵ and Rule 430C⁵⁶ under the Securities Act deem information contained in prospectus supplements to be part of and included in the registration statement. The prospectus supplement filing does not create a new effective date for experts, and we believe it would not require the filing of a consent, unless the prospectus supplement (including incorporated Exchange Act reports such as current reports on Form 8-K) includes a new report or opinion of an expert. Thus, in the case of an issuer rating or a rating on a class of securities such as a medium-term note facility, we believe only a new or changed rating issued after the date of the last consent by the rating agency or change in any other information as to which the rating agency is an expert would require a new consent. We believe a new consent would always be required in the case of

ratings would not be triggered if the only disclosure of a credit rating in a filing with the Commission is related to changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings, and the credit rating is not otherwise used in connection with a registered offering. We preliminarily believe that a consent would not be required for such disclosure.

⁵⁴ 17 CFR 230.415.

⁵⁵ 17 CFR 230.430B.

⁵⁶ 17 CFR 230.430C.

a credit rating that is specific to each issuance of a security.⁵⁷

Request for Comments

We request comment below on specific aspects of a possible proposal to rescind Rule 436(g). While we have grouped comments by how any such proposal might affect a group of market participants, we encourage all market participants to comment on all aspects of this concept release.

Impact on Registrants and Access to Capital

- If we were to subject all credit rating agencies to Sections 7 and 11 of the Securities Act by rescinding Rule 436(g), would registrants be able to obtain the consent required to use ratings in connection with registered offerings of rated securities? What effects would rescinding Rule 436(g) have on the practice of offering securities? In particular, would doing so affect the use of credit ratings in registered offerings, affect investor reliance on credit ratings, affect the cost of obtaining a credit rating, or affect the decisions of registrants and investors regarding whether to raise capital in registered or unregistered offerings?
 - Would access to capital be disrupted if Rule 436(g) were rescinded, or would market participants adjust their practices to accommodate the change? How long would it take market participants to adjust their practices? Would a long phase-in period help to mitigate any disruptions in access to capital? Why or why not? Would a phase-in period of 12 months be sufficient? How long would the phase-in period need to be?
 - Would registrants be able to obtain the consent if the rating is not available until after the registration statement goes effective? Are there circumstances where the rating would be available prior to effectiveness?
 - Would smaller companies be able to afford any increased costs to obtain a credit rating? What alternatives would

⁵⁷ In the event a new consent is required, we anticipate that the consent could be filed by a post-effective amendment to the registration statement or by filing an Exchange Act report, such as an annual report on Form 10-K or a report on Form 8-K or Form 6-K, which is incorporated by reference into the registration statement. The consent would need to be filed prior to the filing of a prospectus under Rule 424 of the Securities Act. Rule 424 requires a prospectus to be filed not later than the second business day following the earlier of the date of the determination of the offering price or the date the prospectus is first used after effectiveness in connection with a public offering or sale of securities. We also anticipate that a new consent would be required for an update pursuant to Section 10(a)(3) of the Securities Act. See 15 U.S.C. 77j(a)(3).

these companies have for raising capital? What could we do to help limit any such impact?

- If we propose to rescind Rule 436(g), should we distinguish among issuers of corporate debt, issuers of structured products and closed-end management investment company securities? Are there differences among the markets for corporate debt, structured products and closed-end management investment companies that justify treating the same NRSRO as an expert for purposes of Sections 7 and 11 of the Securities Act for ratings issued on some kinds of securities but not others?

- If the proposal to require disclosure regarding credit ratings is adopted, and we do not eliminate Rule 436(g), officers, directors and underwriters will not be able to rely on NRSROs as experts with respect to the disclosure of credit ratings. Is this appropriate? Why or why not?

- Are there circumstances where a credit rating agency issuing a preliminary rating should be treated as an expert?

- Practically speaking, how would the filing of a consent work in the context of a shelf offering if we propose to rescind Rule 436(g)? Would the approach outlined above work? What other changes to our rules would be necessary?

- Do rating agencies view the issuance of each security issued by a company they rate, including each issuance within a class of securities, as the issuance of a new rating? Do investors or registrants view the issuance of each security by a company as the issuance of a new rating by the rating agency? For instance, does each issuance under a medium-term note facility constitute the issuance of a new rating that should require a consent?

- In the context of an issuer rating, are there concerns for the rating agencies with not having to provide a consent each time the registrant issues a new security?

- We believe investors would view a credit rating as current when it is used in connection with an offering of securities off a shelf registration statement. If that is the case, should we require a new consent for each take-down regardless of the type of rating or type of security? If issuing a new consent each time would be too burdensome, should we propose a rule that would deem the consent filed each time a take-down is made?

- Should a new consent be required if the company has been put on a watch list or the company has been given a positive outlook or negative outlook

designation, or there has been some change other than an actual change in the rating?

- If the proposal to require disclosure regarding credit ratings is adopted, regardless of whether we rescind Rule 436(g), would market practices develop in the context of a take-down from a shelf registration statement where underwriters or other parties would require the credit rating agency to re-affirm its rating?

- In the context of asset-backed securities, if Rule 436(g) is eliminated, should we retain our requirement to disclose whether an issuance is conditioned on the assignment of that rating and the minimum rating that must be assigned? Should we require a consent related to the expected rating⁵⁸ and then require a subsequent consent for the final rating only if that rating changes? Should we instead treat the consent similar to pricing information under 430A⁵⁹ so that it may be filed as part of a pricing supplement but would relate back to the effective date?

- Form F-9 is the MJDS form used by eligible Canadian issuers to register investment grade debt or preferred securities. Under the MJDS, Canadian MJDS filers are largely permitted to use their Canadian provincial disclosure documents when registering their securities with the Commission, although the liability provisions under the Securities Act apply whether or not the registration statement is filed under the MJDS. If we eliminate Rule 436(g) in its entirety, a Form F-9 filer would need to obtain the consent of an NRSRO or Approved Rating Organization in the same circumstances as a similarly situated U.S. issuer, notwithstanding that the Canadian filer may not be required to do so under Canadian provincial law or regulation. How would the elimination of Rule 436(g) affect Form F-9 filers, and why? Should the Rule 436(g) exemption be retained in connection with an NRSRO or Approved Rating Organization rating disclosed in a Form F-9 to maintain consistency of consent requirements with Canadian provincial law or regulation? Should the exemption be retained for an Approved Rating Organization rating only, and eliminated for an NRSRO rating, disclosed in a Form F-9 registration statement? Or, insofar as Rule 436(g) concerns the allocation of liability for portions of a registrations statement, and liability under the Securities Act applies without regard to whether a registration statement is filed pursuant

to the MJDS, should we eliminate completely the Rule 436(g) exemption for ratings disclosed in a Form F-9?

Impact on NRSROs and Credit Rating Agencies

- Are there reasons to continue to distinguish between NRSROs and credit rating agencies that are not NRSROs for purposes of Section 11 liability? Is the fact that NRSROs are subject to Commission oversight, a reasonable basis upon which to distinguish between NRSROs and credit rating agencies that are not NRSROs for this purpose?

- How would the financial markets be affected if NRSROs and other credit rating agencies temporarily or permanently stopped issuing credit ratings in registered offerings?

- As noted above, NRSROs have previously indicated that they would not provide consent. However, because we are proposing to require disclosure regarding credit ratings in registration statements, we are seeking to understand the practical implications that requiring a consent would have on NRSROs. Would NRSROs and other credit rating agencies initially or permanently refuse to provide consent? Would they initially or permanently stop issuing credit ratings in registered offerings? How would NRSROs adapt if Rule 436(g) were rescinded? How long is it likely such adaptation would take? Are NRSROs likely to adapt in different ways?

- Would rescinding Rule 436(g) reduce or eliminate the incentive for a credit rating agency to become an NRSRO?

- How would rescission of Rule 436(g) affect the process of issuing a credit rating? Would the process take longer? Would the NRSROs and credit rating agencies that are not NRSROs change their procedures? If so, how? Would credit rating agencies seek more, less or different information from registrants in order to provide a credit rating? How would requiring consents from both NRSROs and credit rating agencies that are not NRSROs affect their interactions with registrants and underwriters? Would there be any inflation or deflation of ratings? Why or why not?

- Would rescinding Rule 436(g) affect the types of products that credit rating agencies are willing to rate? How? Would they be less likely to rate lower grade products or products issued by smaller or less well-established registrants?

- Would any additional disclosure be necessary in order for the rating and other statements regarding the rating not

to contain an untrue statement of a material fact or fail to state a material fact required to be stated in order to make the statements therein not misleading? What other information would be necessary to make the disclosure not misleading? Should we revise the proposed disclosure in the companion release to include additional items?

- What costs would potential liability under Section 11 impose on NRSROs and other credit rating agencies? Would those costs be passed on to registrants or, ultimately, to investors? What steps would NRSROs and other credit rating agencies take to protect themselves from potential liability under Section 11?

- If we propose to rescind Rule 436(g), should we specify that the credit rating itself would be considered prepared or certified by a person, or a report or valuation prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act? Should it include more than just the actual rating? Are there other parts of the registration statement that would be considered prepared or certified by the credit rating agency? How would determining which portions of the registration statement would be considered prepared or certified by a person, or a report or valuation prepared or certified by a person impact other potential defendants who might rely on that portion as a defense to liability?

- Are there issues related to the liability of other experts, such as lawyers, investment bankers and accountants, that we should consider in deciding whether to rescind Rule 436(g)? Are credit rating agencies different from other types of experts from whom we require consent? If so, how? What steps could we take to account for those differences? How would the elimination of Rule 436(g) change the standard of liability to which NRSROs are currently subject for the use of credit ratings in connection with a registered offering? Is there any reason to believe the liability standards applicable to other experts may be applied differently to NRSROs and credit rating agencies that are not NRSROs?

- Is Section 11 liability appropriate for NRSROs and credit rating agencies that are not NRSROs? What is the expected standard of liability for a credit rating to be actionable under Section 11, and how does it compare to the standard of liability under Section 10(b) of the Exchange Act? If Section 11 were applicable, what is the practical impact of the different pleading standards under Section 10(b) of the Exchange Act and Section 11 of the

⁵⁸ See Item 1120 of Regulation AB.

⁵⁹ 17 CFR 220.430A.

Securities Act? How would any claims of First Amendment protection applicable to NRSROs be impacted by potential Section 11 liability?

- To reduce the risk of legal liability, would NRSROs issue more “defensive” ratings than are warranted? If so, how would this affect the cost of capital for registrants?

Impact on Investors

- Would eliminating the exemption in Rule 436(g) so that NRSROs are subject to potential liability under Section 11 be beneficial to investors? What effects would there be for investors if we eliminate the exemption for NRSROs in Rule 436(g)? Would the protections afforded by potential Section 11 liability for NRSROs be offset by any changes in the credit rating process, such as possible increases in the use of unregistered offerings or potential disruptions to registrants’ access to capital?

- To what extent do the concerns expressed regarding possible undue reliance by investors on credit ratings suggest that investors actually do consider NRSROs to be persons whose profession gives authority to statements they make, as contemplated by Sections 7 and 11 of the Securities Act?

- How would the elimination of Rule 436(g) affect the quality of credit ratings? Would potential liability under Section 11 provide an incentive for NRSROs to provide higher-quality ratings? Would quality decline? Why?

- If credit rating agencies, including NRSROs, initially refuse to provide consent or stop issuing credit ratings, how would investors be affected?⁶⁰

⁶⁰ Should NRSROs refuse to issue ratings, money market funds subject to Rule 2a-7 [17 CFR 270.2a-

Would investors with guidelines that require them to invest in rated securities be able to continue to invest? Would such investors change their investing guidelines? How long would it take for any such changes to be implemented?

- What effect would rescinding Rule 436(g) have on investors’ reliance on credit ratings? Would any investors rely more or less on credit ratings? Would investors view credit ratings as more reliable?

Impact on Competition

- How would rescinding Rule 436(g) affect competition among credit rating agencies? Would treating NRSROs and credit rating agencies that are not NRSROs the same for purposes of liability under Section 11 of the Securities Act lower competitive barriers for credit rating agencies that are not NRSROs? Would it have any impact on the number of companies seeking to be an NRSRO?

- If NRSROs are unable to absorb the litigation costs and risks of Section 11 liability, and competition is reduced as a result, what impact, if any, would that

7] under the Investment Company Act may, for example, be affected to the extent the rule requires certain securities in which they invest to be rated by an NRSRO. See Rule 2a-7(a)(10)(ii)(A) (long-term security with a remaining maturity of less than 397 days that does not have a short-term rating is not an “eligible security” unless it has at least one long-term rating from an NRSRO); Rule 2a-7(a)(10)(ii) (asset backed security must be rated by an NRSRO to be an “eligible security”); and Rules 2a-7(c)(3)(iii) and (a)(10)(iii)(A) (together permitting funds to substitute the credit quality of a guarantor for the credit quality of the issuer only if the guarantee (or guarantor) is rated by an NRSRO). The Commission has requested comment on whether use of these ratings requirements ought to be removed from Rule 2a-7. See Money Market Fund Reform, Release No. IC-28807 (June 30, 2009) [74 FR 32688].

reduced competition have on investor protection?

- Would rescinding Rule 436(g) have negative consequences for smaller NRSROs? Would it increase their costs of doing business? Would it make registrants more likely to seek ratings from the larger NRSROs? Would it make smaller NRSROs unable to issue ratings in connection with registered offerings? Would smaller NRSROs be able to adapt to the changes that might occur? Are there ways to mitigate negative competitive consequences if Rule 436(g) were eliminated?

III. General Request for Comments

We request and encourage any interested person to submit comments regarding:

- The concepts that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the concepts contained in this release.

We request comment from the point of view of companies, investors, and other market participants, including NRSROs and other credit rating agencies. With regard to any comments, we note that such comments are of greater assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments.

By the Commission.

Dated: October 7, 2009.

Elizabeth M. Murphy,
Secretary.

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