PROPOSED AMENDMENTS TO SEC RULES AND FORMS REFERRING TO CREDIT RATINGS ISSUED BY NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

On June 25, 2008, the U.S. Securities and Exchange Commission (the "Commission") voted to propose amendments to rules and forms under the Securities Act of 1933 (the "1933 Act"), the Securities Exchange Act of 1934 (the "1934 Act"), the Investment Company Act of 1940 (the "1940 Act") and the Investment Advisers Act of 1940 (the "Advisers Act") that refer to ratings issued by Nationally Recognized Statistical Rating Organizations ("NRSROs"). The Commission published the proposed amendments in three separate releases on July 1, 2008. The three releases address NRSRO ratings related to rules governing (1) securities registration and disclosure surrounding offers of securities; (2) broker-dealer, securities trading and securities markets; and (3) investment companies and investment advisers, together with forms used with certain of those rules.

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I. Background

The Commission relies on NRSRO ratings in a number of its rules and forms. For example, broker-dealers rely on NRSRO ratings in calculating their capital requirements. Under the 1940 Act, NRSRO ratings are used in classifying securities held by investment companies in several contexts, including determination of whether securities are eligible investments for money market funds and treatment of repurchase agreements for diversification purposes, and NRSRO ratings are used in rules under both the 1940 Act and Advisers Act to determine the availability of certain exemptions from the Acts. NRSRO ratings also are used in determining the eligibility of certain securities to be offered in shelf registrations or whether non-convertible securities may be registered primary offerings under the 1933 Act.

In light of recent credit market issues, including much criticism of ratings for structured products, the Commission expressed concern that (1) the extensive use of NRSRO ratings in its rules and forms effectively is placing an "official seal of approval" by the Commission on those ratings, and (2) rather than undertaking quality due diligence and investment analysis, market participants may be relying on these "approved" NRSRO ratings in deciding which securities to purchase. According to the Commission, the proposed amendments are intended to reduce this perceived undue reliance on NRSRO ratings by investors, broker-dealers, registered investment companies and their boards of directors, investment advisers and other market participants by eliminating or limiting the use of these ratings in specified Commission rules and forms. The Commission has generally requested comment on whether there are other alternatives to eliminating ratings from Commission rules and forms.

The Commission's proposed amendments to rules and forms referencing NRSRO ratings is its third NRSRO rulemaking initiative. Proposed rules related to the first two initiatives were published for comment on June 16, 2008.[1] These initiatives are intended, among other things, to (1) reduce conflicts of interest in the ratings process; (2) increase the transparency of the ratings process; and (3) improve investor understanding of the risks associated with structured finance products.

Further, on July 8, 2008, the Commission released the results of a 10-month staff examination of three major NRSROs: Fitch Ratings Ltd., Moody's Investor Services Inc. and Standard & Poor's Ratings Services.[2] The Commission staff concluded that the ratings processes of these NRSROs were deficient in certain material respects. For example, the staff found that the NRSROs lacked written policies and procedures for rating residential mortgage-backed securities ("RMBSs") and collateralized debt obligations ("CDOs"), failed to disclose and document significant aspects of the ratings process, and failed to manage conflicts of interest appropriately. The Commission staff's findings are consistent with the Commission's conclusion in the release proposing changes to the Commission's rules governing NRSRO ratings processes that shortcomings in those processes for RMBSs and CDOs contributed to the current credit crisis.

II. Broker-Dealers, Securities Trading and Alternative Trading Systems[3]

A. *Net Capital (Rule 15c3-1 under the 1934 Act)*

Rule 15c3-1, the broker-dealer Net Capital Rule, requires broker-dealers to maintain a certain level of liquid assets. In computing its net capital, *i.e.*, its net liquid assets, a broker-dealer must deduct certain percentages of the market value of its proprietary securities positions from its net worth. These deductions, called "haircuts," are intended to provide a cushion against losses that might be incurred because of fluctuations in the market prices of, or a lack of liquidity in, a broker-dealer's proprietary securities positions. Certain types of securities held by broker-dealers that have investment grade ratings receive lower haircuts than those without such ratings because the securities with investment grade ratings typically are more liquid and less volatile than securities not so highly rated.

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[1] Proposed Rules for Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 57967 (June 16, 2008).

[2] Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies, http://www.sec.gov/news/studies/2008/craexamination070808.pdf (July 8, 2008).

[3] References to Ratings of Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 58070 (July 1, 2008).

The Commission is proposing to eliminate, with limited exceptions, all references to NRSRO ratings in the Net Capital Rule and replace those ratings with two new subjective standards. With respect to determining haircuts on commercial paper, the minimum NRSRO rating standard would be replaced with a requirement that the security be subject to a minimal amount of credit risk and have sufficient liquidity so that it could be sold at or near its carrying value almost immediately. For purposes of determining haircuts on non-convertible debt securities and preferred stock, the minimum NRSRO rating standard would be replaced with a requirement that the security be subject to no greater than moderate credit risk and have sufficient liquidity so that it could be sold at or near its carrying value within a reasonably short period of time. The proposed method of determining haircuts would apply to both short and long security positions. Broker-dealers would determine internally if their securities meet these standards and would need to be able to explain how securities included in their net capital calculations meet the proposed standards. The proposing release states that NRSRO ratings would be one acceptable means of determining if securities comply with the new standards.

The proposed amendments to the Net Capital Rule also would eliminate NRSRO references in portions of Rule 15c3-1 governing, among other things: (1) how broker-dealers that are part of a consolidated supervised entity subject to Commission supervision on a group-wide basis calculate net capital, and (2) calculation of net capital for a special class of broker-dealers called OTC derivatives dealers. Broker-dealers would solely rely on counterparty credit risk based on internal ratings using Commission-approved methodologies.

In its request for comments, the Commission asks if: (1) broker-dealers have the sophistication and resources necessary to evaluate credit risk internally to determine the appropriate haircuts on their proprietary securities positions; (2) broker-dealers evaluating credit risk internally would have an incentive to downplay credit risk to minimize capital charges; and (3) it should require any policies and procedures with regard to basic determinations of whether a security meets the proposed standards.

B. *Confirmations Issued by Broker-Dealers (Rule 10b-10 under the 1934 Act)*

Rule 10b-10 under the 1934 Act requires broker-dealers to provide a customer with written notification of certain basic terms about a securities transaction, such as the identity, price, and number of shares of the security bought or sold, at or before the completion of such a transaction. Among other things, Rule 10b-10 requires broker-dealers to disclose that certain debt securities are unrated by an NRSRO. The proposed amendment to the Rule would eliminate that disclosure requirement out of concern over undue reliance on NRSRO ratings and confusion about the significance of such ratings. In its discussion of the proposed amendments to Rule 10b-10, the Commission asks if investors have found disclosures about the fact that a debt security is not rated by an NRSRO to be useful.

C. *Anti-Manipulation Rules for Distributions (Rules 101 and 102 of Regulation M under the 1934 Act)*

Rules 101 and 102 of Regulation M prohibit issuers, selling security holders, underwriters, brokers, dealers, other distribution participants, and any of their affiliated purchasers, from directly or indirectly bidding for, purchasing, or attempting to induce another person to bid for or purchase, a covered security until the applicable restricted period has ended. Both rules except investment grade non-convertible and asset-backed securities.

The proposed amendments to Rules 101 and 102 would eliminate references to NRSRO ratings in those rules. The Commission is proposing new exceptions for non-convertible debt securities and non-convertible preferred securities based on the "well-known seasoned issuer" ("WKSI") concept in the 1933 Act, regardless of the method used to attain WKSI status. The WKSI could take advantage of the proposed exception only if it had issued at least $1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the 1933 Act. Asset-backed securities would be excepted if registered on Form S-3.

The Commission solicits comments on a number of aspects of the proposed amendments to Rules 101 and 102. Among other things, the Commission asks if the WKSI requirements are "appropriate for use in a trading (as opposed to disclosure) context" and whether WKSI convertible debt and non-convertible preferred securities excepted in the proposed amendments would be as resistant to manipulation as those subject to investment grade standards. The Commission also solicits comments on whether the WKSI and Form S-3 benchmark standards are adequate proxies for credit quality.

D. *Reserve Requirements (Rule 15c3-3 under the 1934 Act)*

The Commission proposes to amend Rule 15c3-3, the Customer Protection Rule, which includes a formula for calculating the reserve requirement, *i.e.*, the amount of money that a broker-dealer must maintain in a special reserve bank account for the benefit of its customers. A broker-dealer may include as debit items in the formula certain dollar amounts posted as customer margin related to customers' positions in security futures products posted to a registered clearing or derivatives organization if that organization meets certain creditworthiness standards. Such an organization may meet the creditworthiness standards through one of four alternative means, one of which is maintaining the highest investment grade rating issued by an NRSRO. The proposed amendments would delete the NRSRO rating alternative and replace it with an alternative requiring that the clearing or derivatives organization have the highest capacity to meet its financial obligations and be subject to no greater than minimal credit risk. A broker-dealer relying on this alternative would need to be able to explain how the registered clearing or derivatives organization meets the proposed standard. The Commission states that one means of complying with the proposed amendment would be by referring to NRSRO ratings. The Commission asks if broker-dealers have the sophistication and resources necessary to evaluate internally the credit risk associated with registered clearing or derivatives organizations.

E. *Alternative Trading Systems (Rule 3a-1, Regulation ATS, Form ATS-R and Form PILOT under the 1934 Act)*

Rule 3a-1 under the 1934 Act exempts an alternative trading system ("ATS") from registration as an exchange if, among other things, it registers as a broker-dealer and complies with Regulation ATS. The Commission, however, reserves the right to require a "dominant" ATS to register as an exchange and imposes certain volume thresholds for securities traded on an ATS that, if reached, would permit the Commission to require the ATS to register as an exchange. An ATS may reach "dominant" status in eight enumerated classes of securities, including investment grade and non-investment grade corporate debt securities. Investment grade corporate debt is debt that has been rated in one of the four highest rating categories by at least one NRSRO; non-investment grade corporate debt has not received such a rating. The Commission has proposed eliminating investment grade and non-investment grade corporate debt as separate classes of securities under Rule 3a-1 and instead creating a single class of "corporate debt securities" for purposes of assessing whether an ATS is "dominant." A "corporate debt security" would be defined as any security that evidences a liability of the issuer, has a fixed maturity date that would occur at least one year after the date of issuance, and is not an exempted security within the meaning of Section 3(a)(12) of the 1934 Act.

The Commission is proposing similar amendments to Regulation ATS, which imposes specified requirements on an ATS that chooses to register as a broker-dealer rather than as an exchange. Regulation ATS imposes a "fair access" requirement on an ATS that exceeds certain volume thresholds in any class of securities under which the ATS must grant access to trading on its system. The fair access standard applies if an ATS has five percent or more of the average daily trading volume during at least four of the preceding six calendar years in enumerated classes of securities, including investment grade and non-investment grade corporate debt securities. As with Rule 3a-1, the Commission would eliminate investment grade and non-investment grade corporate debt as separate classes of securities and instead create a single class of corporate debt securities for purposes of determining if the five percent threshold was exceeded.

The Commission is proposing conforming amendments to Form ATS-R, which an ATS uses to report specified information about its activities on a quarterly basis. The amendments would eliminate the separate categories contained in the form for investment grade and non-investment grade securities and instead create a single category for corporate debt securities.

Proposed amendments to Form PILOT also would delete references to separate classes of investment grade and non-investment grade securities and create a single corporate debt securities category. Form PILOT is a report that an SRO operating a pilot trading system files with the Commission on a quarterly basis.

The Commission asks if, given the proposed deletion of references to NRSRO ratings in Rule 3a-1 and Regulation ATS, the volume thresholds in those two provisions should be lowered. The Commission also solicits comments on whether the proposals would have any significant impact on investors, market participants, the national market system or the public interest.

III. Investment Companies and Investment Advisers[4]

A. *Money Market Funds (Rule 2a-7 under the 1940 Act)*

Rule 2a-7 under the 1940 Act exempts money market funds from, among other things, standard share price calculations required under the 1940 Act and permits money market funds to maintain a stable net asset value per share subject to compliance with the Rule's requirements relating to maturity, quality, and diversification of its portfolio investments. Specifically, money market funds are generally limited to investments in securities that qualify as "Eligible Securities," as defined by the Rule, and that a fund's board (or its delegate) determines present minimal credit risk. The Rule currently defines "Eligible Securities" by reference to the NRSRO ratings that they possess or their comparability in quality to rated securities. In addition, NRSRO ratings may be one of several factors relating to credit quality considered in determining whether a security presents minimal credit risk. The Rule also delineates between "First Tier" and "Second Tier" securities by reference to NRSRO ratings, which categorizations affect money market fund portfolio diversification requirements.

The proposed amendments to Rule 2a-7 would eliminate all references to NRSRO ratings. Rather than determining whether a security is an Eligible Security based on its NRSRO rating, a fund's board (or its delegate) would be required to determine that the security "presents minimal credit risks." According to the Asset Management Proposing Release, this determination should be based on "factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations."

With respect to categorization of a security as First or Second Tier, the proposed Rule would replace the ratings standard with a determination by a fund's board (or its delegate) as to whether a security's issuer has the "highest capacity to meet its short-term financial obligations." If so, the security could be deemed a First Tier Security. A Second Tier Security would continue to be any Eligible Security that is not a First Tier Security. According to the Commission, the proposed amendments to the categorization standards under Rule 2a-7 as proposed to be amended are intended to retain the level of risk limitations under the current rule.

A new standard of review for monitoring credit risk is also being proposed by the Commission. Rule 2a-7(c)(6) currently requires a money market fund's board (or its delegate) to reassess whether a security continues to present minimal credit risk to the fund upon the security being downgraded by an NRSRO (or, if unrated, being determined to have declined in quality in relation to a rated security). The Rule as proposed to be amended instead would require a fund's board to reassess a security if it becomes aware of "any information about a portfolio security or issuer of a portfolio security that may suggest that the security may not continue to present minimal credit risks." In the Asset Management Proposing Release, the Commission notes that

[4] References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327, Investment Advisers Act Release No. 2751 (July 1, 2008) (hereinafter, "Asset Management Proposing Release").

the intent of the rule is not to require the monitoring of all available sources of information, but rather that a fund's investment adviser should exercise "reasonable diligence" as to information about a fund's portfolio securities.

In addition to the new standards for evaluating and monitoring securities, proposed Rule 2a-7 would establish an explicit requirement for money market fund portfolio liquidity. Under proposed new Rule 2a-7(c)(5), money market funds would be required to "hold securities that are sufficiently liquid to meet reasonably foreseeable redemptions in light of the fund's obligations under section 22(e) of the [1940 Act] and any commitments the fund has made to its shareholders." The proposal codifies the objective standard for money market liquidity set out by the Commission in prior guidance—money market funds must limit investments in illiquid securities to 10 percent of assets at the time of acquisition of an illiquid security.

The Commission has also proposed adding a new reporting requirement to Rule 2a-7 relating to transactions involving "distressed" securities. Proposed Rule 2a-7(c)(7)(iii)(B) would require money market funds to notify the Commission any time an affiliate of the fund, the fund's adviser, or its principal underwriter purchases, in reliance on Rule 17a-9 under the 1940 Act, a security that is no longer an Eligible Security as defined by Rule 2a-7. The Commission, in the Asset Management Proposing Release, cites as the rationale for the new reporting requirement its need for more information on money market funds' holdings in distressed securities.

The Commission seeks comment on the proposed money market fund rule. It asks generally whether there are better standards to replace the NRSRO ratings than those proposed and asks for feedback on the costs to implement the proposals. With respect to the new "minimal credit risk" standard for money market fund Eligible Securities, the Commission asks whether it is a workable standard of review for a fund's board of directors and a fund's investment adviser and whether the proposed standard encourages directors and investment advisers to make independent risk analyses. Regarding the new portfolio security monitoring standard, the Commission asks whether the proposed standard is practicable for investment advisers and whether it would provide for sufficient investor protection. With respect to the express liquidity requirement for money market funds, the Commission asks whether the requirement provides funds and advisers with sufficient flexibility in retaining securities if doing so after they become illiquid is in the best interest of a fund.

B. *Repurchase Agreements (Rule 5b-3 under the 1940 Act)*

Rule 5b-3 allows funds to treat the acquisition of a repurchase agreement as the acquisition of the securities serving as collateral for the agreement if the agreement is "collateralized fully," as defined by the Rule. This determination is important for fund diversification purposes under the 1940 Act as well with respect to the applicability of the prohibition on registered funds acquiring interests in certain financial services companies under Section 12(d)(3) of the Act.

The Rule currently characterizes a repurchase agreement as "collateralized fully" if, among other requirements, the collateral consists of cash, government-issued securities, securities rated in the highest rating category by "Requisite NRSROs," or, for non-rated securities, a determination by

a fund's board of directors or its delegates that the securities are comparable to those in the highest rating category.

The Commission has proposed an alternative standard to the use of NRSRO ratings in determining whether a repurchase agreement is "collateralized fully." The proposal would eliminate the requirement that securities be rated by an NRSRO. Instead, the Commission proposes that all non-government issued securities be subject to a standard similar to that currently used for non-rated securities—that a fund's board of directors (or its delegate) make a determination that the securities present minimal credit risk and are highly liquid. The proposed Rule sets out criteria to be considered in determining a security's credit risk and liquidity: that the security is sufficiently liquid to be sold at or near carrying value within a reasonably short time; that the security is subject to no greater than minimal credit risk; and that the issuer of the security has the highest capacity to meet its financial obligations. In the Asset Management Proposing Release, the Commission anticipated that NRSRO ratings may be used as part of a board's consideration of a security's credit risk and liquidity; however, the ratings no longer would provide a bright-line test for such determinations.

The Rule also contains a provision, under Rule 5b-3(c)(4), that addresses the characterization of refunded securities for diversification purposes under the Rule. Under the current Rule, deposited securities must be accompanied by a certification from an independent accountant that that the deposited securities will satisfy all scheduled payments of principal, interest, and applicable premiums on the refunded securities unless the securities have a certain NRSRO rating. The proposed Rule would eliminate this exception from independent accountant certification.

The Commission seeks comment on the appropriateness of the replacement standard for the NRSRO ratings. Specifically, the Commission asks whether the "minimal credit risk" standard is workable and would encourage independent risk analyses by a fund's board of directors and investment adviser.

C. *Affiliated Underwritings (Rule 10f-3 under the 1940 Act)*

An "eligible municipal security," as defined by Rule 10f-3, may be purchased by a fund affiliated with the security's underwriter during an underwriting despite the general prohibition on such transactions under Section 10(f) of the 1940 Act. The definition of eligible municipal security includes municipal securities that meet certain NRSRO ratings. The proposed Rule would eliminate references to NRSRO ratings in the definition of eligible municipal security, replacing the ratings standards with one based on the liquidity and credit risk of the security. Specifically, a security could be an eligible municipal security under the Rule as proposed to be amended if: (1) it could be sold at or near its carrying value within a reasonably short time and it were subject to no greater than moderate credit risk; or (2) in the case of a security issued by an issuer in continuous operation for less than three years, it were subject to a minimal or low credit risk. The Commission expects that NRSRO ratings would be one of several factors considered by a board in reviewing procedures and transactions under the Rule.

Similar to the questions posed for other proposals in the Asset Management Proposing Release, the Commission seeks comment on the appropriateness of the replacement standard for the NRSRO ratings in Rule 10f-3 and on whether the proposed standard is workable.

D. *Structured Finance Vehicles (Rule 3a-7 under the 1940 Act)*

Currently, under Rule 3a-7, structured finance vehicles that offer their securities to the public are exempt from the definition of "investment company" under the 1940 Act if, among other things, the securities being publicly offered have certain NRSRO ratings. In the Asset Management Proposing Release, the Commission states that most structured finance vehicles rely on the so-called private fund exemptions under Sections 3(c)(1) and 3(c)(7) from the provisions of the 1940 Act. The proposed amendments to Rule 3a-7 would eliminate the availability of the exemption for publicly offered structured finance vehicles and in doing so would remove references to NRSRO ratings from the Rule. Rule 3a-7 as proposed to be amended also would eliminate NRSRO ratings-based criteria for the safekeeping of assets under Rule 3a-7(a)(4) and for acquiring and disposing of certain assets under Rule 3a-7(a)(3)(ii). The NRSRO ratings standard in each case would be replaced with standards based on "full and timely payment" of the obligations on fixed-income securities held or issued by a structured finance company.

The Commission seeks comment on whether it is correct in its assertion that structured finance vehicles generally do not make public offerings. If this is not the case, the Commission seeks comment on what a better standard would be by which to determine eligibility for Rule 3a-7.

E. *Dually Registered Investment Advisers and Broker-Dealers (Rule 206(3)-T under the Advisers Act)*

Rule 206(3)-T provides an exemption for investment advisers who are also registered as broker-dealers from the general prohibition under Section 206(3) of the Advisers Act against principal trades with advisory clients absent transaction-by-transaction consent from the client. The exemption under Rule 206(3)-T is not available to an adviser who controls, or is under common control with, the issuer of the security, except in the case of an issuer of non-convertible investment grade debt securities. "Investment grade debt security" is defined under the Rule with reference to the security's NRSRO rating. The Rule as proposed to be amended would eliminate the rating standard from the definition and replace it with, as is the case in several of the other proposed Rule amendments, one based on the credit risk and liquidity of the security.

For a security to qualify as "investment grade" under the Rule as proposed to be amended, the adviser would be required to determine that the security has no greater than moderate credit risk and is sufficiently liquid so that it can be sold at or near its carrying value within a reasonably short time. The Asset Management Proposing Release also notes that investment advisers must adopt policies and procedures designed to prevent violations of the Advisers Act, and these policies and procedures should be updated to reflect any amendments to this Rule.

In addition to questions on the appropriateness of the proposed standard of review under Rule 206(3)-T, the Commission seeks comment on whether there should be an explicit documentation requirement for investment advisers with respect to transactions in reliance on the Rule.

IV. Securities Registration and Disclosure Provisions[5]

A. *Asset-Backed Securities ("ABS") and Form S-3 Eligibility under the 1933 Act*

Currently, ABS may be eligible for registration on short form Form S-3 and may by offered on a delayed or continuous basis if they are rated investment grade by an NRSRO and meet certain other conditions. The Commission would replace the ratings component of the Form S-3 eligibility requirements for ABS offerings with a minimum denomination requirement for initial and subsequent sales and a requirement that initial sales of classes of securities be made only to qualified institutional buyers. The rationale is that the short form registration statement should be available only if the issuer is selling to sophisticated investors who can undertake their own analyses of the merits and risks of the investment. Thus, issuers offering ABS for cash would be eligible to use Form S-3, provided that (1) initial and subsequent resales are made in minimum denominations of $250,000; (2) initial sales are made only to qualified institutional buyers; (3) delinquent assets do not constitute 20% or more of the asset pool; and (4) with respect to certain leases, the portion of the securitized pool balance attributable to the residual value of the physical property underlying the leases does not constitute 20% or more of the securitized pool balance. In addition to requesting comment on the appropriateness of the proposed amendments, the Commission highlighted issues such as the effect of the proposed rule on liquidity in the market for ABS and the cost of capital for ABS sponsors if sales are limited to qualified institutional buyers.

B. *Mortgage Related Securities (Rule 415 under the 1933 Act)*

Currently, "mortgage related securities" (which are defined by reference to NRSRO ratings) may be offered on a delayed basis even if the offering cannot be registered on Form S-3 because it does not meet the requirements of such Form. Under the proposed amendments, mortgage-backed securities having the same characteristics as "mortgage related securities," regardless of the security rating, could be offered on a delayed basis provided that (1) initial sales and any resales of the securities are made in minimum denominations of $250,000 and (2) initial sales of the securities are made only to qualified institutional buyers. The Commission specifically requested comment on whether mortgage related securities should be treated differently from other ABS for purposes of Rule 415, and asserted that they should not be.

[5] Security Ratings, Securities Act Release No. 8940, Securities Exchange Act Release No. 58071 (July 1, 2008).

C. *Primary Offerings of Non-Convertible Debt Securities (Forms S-3 and Form F-3 under the 1933 Act)*

Currently, an issuer is eligible to use a Form S-3 or Form F-3 registration statement if it meets the Forms' eligibility requirements as to registrants, which generally means a reporting history under the 1934 Act of at least 12 months, and at least one of the form's transaction requirements. One such transaction requirement permits registrants to register primary offerings of non-convertible debt securities if they are rated investment grade by at least one NRSRO. Under the proposed amendments, NRSRO ratings would no longer be a transaction requirement permitting issuers to register primary offerings of non-convertible debt securities for cash. Instead of being eligible based upon ratings, primary offerings of non-convertible debt securities would be eligible under Forms S-3 or F-3 only if the issuer has issued, as of a date 60 days prior to the filing of the registration statement, more than $1 billion in non-convertible securities for cash, other than common equity, through registered primary offerings over the prior three years. With respect to non-convertible debt securities, the Commission specifically requested comment on whether the eligibility based on the amount of prior registered non-convertible debt securities issued would serve as an adequate replacement for the investment grade eligibility condition, as well as highlighted questions about the "market following" of a debt issuer and the appropriateness of applying the same eligibility standards to foreign private issuers. The Commission also asked about the potential impact on competition of the proposed non-convertible debt eligibility requirements.

D. *U.S. GAAP Reconciliation (Form 20-F under the 1933 Act)*

Currently, foreign private issuers of investment grade debt are permitted to comply with less extensive U.S. GAAP reconciliation requirements under Item 17 of Form 20-F instead of under Item 18 of Form 20-F (which requires that a foreign private issuer provide all of the information required by U.S. GAAP and Regulation S-X, in addition to the reconciling information for the line items specified in Item 17). Under the proposed amendments, foreign private issuers would be permitted to comply under Item 17 of Form 20-F in a registration statement or private offering document if the issuer would meet the proposed Form F-3 eligibility requirements (*i.e.*, if the issuer has issued, as of a date 60 days prior to the filing of the registration statement, for cash more than $1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years), regardless of whether the debt is rated investment grade.

E. *Incorporation by Reference (Forms S-4 and F-4 under the 1933 Act and Schedule 14A under the 1934 Act)*

Currently, Forms S-4 and F-4 (which are used to register securities issued in certain business combinations) allow registrants that meet the registrant eligibility requirements of Form S-3 or F-3 and are offering investment grade securities to incorporate by reference certain information. Similarly, Schedule 14A (which sets forth the information required in proxy statements) permits a registrant to incorporate by reference if the Form S-3 registrant requirements are met and the

registrant is offering investment grade securities. Under the proposed amendments, the disclosure options in Forms S-4 and F-4 would have the same standard as in Forms S-3 and F-3 (*i.e.*, a registrant would be eligible to use Forms S-4 and F-4 to register non-convertible debt or preferred securities if the issuer has issued (as of a date 60 days prior to the filing of the registration statement) for cash more than $1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years). The instructions to Schedule 14A would similarly be amended to refer to the requirements of Form S-3 rather than to "investment grade securities."

F. *Certain Communications (Rules 138, 139 and 168 under the 1933 Act)*

Rules 138, 139 and 168 provide that certain communications are deemed not to be an offer for sale or offer to sell a security. Rules 138 and 139 govern a broker's or dealer's publications and distribution of research reports and Rule 168 governs an issuer's regular release and dissemination of communications of factual business information or forward-looking information. These rules would be revised to be consistent with the proposed eligibility requirements of Forms S-3 and F-3, since to rely on these rules the issuer either must satisfy the public float threshold of Form S-3 or F-3, or be issuing non-convertible investment grade securities as defined in the instructions to Form S-3 or F-3.

G. *Tombstone Rule (Rule 134 under the 1933 Act)*

The proposed revision to Rule 134 (which allows the disclosure of security ratings in certain communications (generally, "tombstone" advertisements) deemed not to be a prospectus or free writing prospectus) would permit an issuer to disclose the security rating of any credit rating agency, but require an issuer to provide a statement as to whether the entity issuing the rating is an NRSRO if it elects to include a security rating in a communication under Rule 134.

H. *ABS (Regulation AB under the 1933 Act)*

Item 1100(c) of Regulation AB would be amended to permit incorporation by reference of third-party financial statements if the third party meets the registrant requirements of Form S-3 and the pool assets related to the third party are non-convertible debt securities. Items 1112 and 1114 currently require the disclosure of certain financial information regarding significant obligors of an asset pool and significant credit enhancement providers relating to a class of ABS but allow for exceptions when the assets are of investment grade and are backed by the full faith and credit of a foreign government. Both items would be amended so that exceptions based on investment grade ratings would no longer apply. Instead, certain detailed information relating to the issuer's receipts and expenditures would be required in all situations when the obligations of a significant obligor are backed by the full faith and credit of a foreign government.

I. *SEC Disclosure Policy*

The SEC is not proposing to change its policy on permitting issuers to disclose security ratings assigned by credit rating agencies to classes of debt securities, convertible debt securities and preferred stock, but seeks comment on whether such disclosure should be required.

J. *Consent Requirements (Rule 436(g) under the 1933 Act)*

The SEC is proposing to amend Rule 436(g) and related rules to expand the relief from the consent requirements currently provided to NRSROs to other credit rating agencies that are not NRSROs.

V. Comment Periods

Comments on the proposed amendments in each of the three releases are due on or before September 5, 2008.

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If you have any questions regarding the foregoing or would like additional information, please contact Benjamin Haskin (202-303-1124, bhaskin@willkie.com) or Margery Neale (212-728-8297, mneale@willkie.com) on investment company and investment adviser matters; David Boston (212-728-8625, dboston@willkie.com) on securities registration and disclosure matters; and Larry Bergmann (202-303-1103, lbergmann@willkie.com) on broker-dealer and securities market matters. You may, of course, contact the attorney with whom you regularly work.

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