

SEC Proposes Amendments Affecting Ratings by Credit Rating Agencies

Alert

In response to the recent sub-prime mortgage crisis and resulting credit crunch, the United States Securities and Exchange Commission (SEC) proposed at an Open Meeting held on June 25, 2008, to eliminate references in certain of its rules and forms to credit ratings by Nationally Recognized Statistical Rating Organizations (NRSROs)¹ to reduce reliance by market participants on NRSRO credit ratings and to encourage investors to make independent judgments.

The SEC proposed changes to rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940, including the following:

- Remove references to NRSROs so that market participants have the option to perform their own credit risk analysis in addition to the option of relying on credit ratings by NRSROs.
- Eliminate credit ratings as an issuer eligibility criteria for certain SEC registration statements (such as Form S-3 or Form F-3).
- Enable investments by U.S. money-market funds in short-term debt without regard to credit ratings assigned by NRSROs.

At an Open Meeting held on June 11, 2008, the SEC proposed a detailed set of new conduct rules for NRSROs, including the following:

- Prohibit NRSROs from issuing a rating on a structured product unless information on assets underlying the product is available, or from participating in structuring any product that they rate.
- Prohibit anyone who participates in determining a credit rating from negotiating the fee that the issuer pays for the rating or receiving gifts from issuers of the products they rate.
- Require disclosure by NRSROs of reliance on the due diligence of others, how frequently ratings are reviewed, whether different models are used for ratings surveillance and for determining initial ratings, and any significant out-of-model adjustments.
- Require NRSROs to disclose performance statistics for one, three and ten years within each class of rating category, and to furnish to the SEC a report of the number of credit rating actions (upgrades, downgrades and placements on watch for an upgrade or downgrade) made during a fiscal year.
- Require NRSROs to differentiate ratings on structured products from ratings on bonds.

The Open Meetings held on June 11, 2008 and June 25, 2008 can be viewed via webcast at <http://www.connectlive.com/events/secopenmeetings/>.

SEC proposed rules are posted on the SEC's website <http://www.sec.gov/rules/proposed.shtml>.²

If you have any questions or wish us to comment on your behalf to any of the proposed rules, you may contact David W. Dykhouse at 212.336.2850 (dwdykhouse@pbwt.com), Alexander Shapiro at 212.336.2935 (ashapiro@pbwt.com) or Herman H. Raspé at 212.336.2301 (hhraspe@pbwt.com).

Endnotes

- ¹ SEC currently recognizes 10 credit rating agencies as NRSROs. They are Standard & Poor's Rating Services, Rating and Investment Information, Inc.; Moody's Investors Service, Inc.; Japan Credit Rating Agency, Ltd.; Fitch, Inc.; Egan-Jones Rating Company; DBRS Ltd.; A.M. Best Company, Inc.; LACE Financial Corp.; and Realpoint LLC.
- ² SEC Release No. 34-57967 (June 11, 2008). The SEC Release relating to June 25, 2008 Open Meeting is not available on SEC's website as of the date of this Client Update.

This alert is provided for general informational purposes only and should not be construed as specific legal advice. Please contact any of the attorneys listed above if we can provide assistance regarding the matters discussed herein.

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