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Invested in America

October 28, 2022

By Electronic Submission

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Release No. 34-94499; File No. S7-11-22
Removal of References to Credit Ratings from Regulation M

Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to again have the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed amendments to remove credit rating references from Rules 101 and 102 of Regulation M ("Proposal"),[2] in accordance with Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").[3]

SIFMA previously submitted an in-depth response to the SEC's request for comments on the Proposal (the "Original Comment Letter")[4] in which it expressed a number of significant

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1 SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

2 SEC Release No. 34-94499, 87 FR 18312 (March 30, 2022) (*available at* https://www.govinfo.gov/content/pkg/FR-2022-03-30/pdf/2022-06583.pdf).

3 Section 939A of the DFA requires the SEC to, among other things, remove any references to credit ratings from its regulations and to instead "substitute in such regulations such standard of credit-worthiness" as the SEC determines to be appropriate. The SEC had issued two prior proposals to remove references to credit ratings from the provisions of Regulation M – one in 2008, prior to the DFA, and one in 2011, following the DFA. *See* SEC Release No. 34-58070, 73 FR 40088 (July 11, 2008) (*available at* https://www.sec.gov/rules/proposed/2008/34-58070fr.pdf) and SEC Release No. 34-64352, 76 FR 26550 (May 6, 2011) (*available at* https://www.sec.gov/rules/proposed/2011/34-64352fr.pdf). Neither proposal was adopted.

4 *See* Letter from Joseph Corcoran, Managing Director and Associate General Counsel, SIFMA, to Vanessa Countryman, Secretary, SEC (May 23, 2022) (*available at* https://www.sec.gov/comments/s7-11-22/s71122-20129392-295219.pdf).

concerns regarding the SEC's proposed "probability of default" exception for nonconvertible debt securities and nonconvertible preferred securities. In lieu of an exception based upon the "probability of default" of such nonconvertible securities, SIFMA recommended that the SEC adopt an exception for such securities if they are offered pursuant to an effective registration statement filed on Forms S-3 or F-3, or certain other registration statement forms, as further described in the Original Comment Letter.

SIFMA member firms continue to have significant concerns regarding the proposed "probability of default" standard and believe that a standard based on registration statement use would be preferable. Among other things, a registration statement-based standard would (i) be familiar to issuers and distribution participants alike, (ii) better align with the approach taken under proposed Rule 101(c)(2)(ii) of Regulation M with respect to asset-backed securities (as well as the approach taken under the Securities Act of 1933, as amended ("Securities Act") with respect to the DFA Section 939A-related amendments to the eligibility criteria for certain Securities Act registration statement forms, as discussed in the Original Comment Letter), (iii) afford greater predictability, simplicity and objectivity in connection with the offering process, and (iv) importantly, also further the SEC's objective of encouraging the conduct of offerings on a registered basis. The straightforward nature of such a standard would also obviate the need for any additional broker-dealer recordkeeping requirements and would ease the burden on all involved, including the examination staffs of the SEC and various self-regulatory organizations.[5]

Data in Support of an Exception Based Upon Securities Act Registration

SIFMA is submitting this supplemental comment letter in order to share with the SEC the results of certain data gathered from SIFMA member firms following the submission of the Original Comment Letter. Specifically, SIFMA gathered and analyzed data for all registered nonconvertible debt offerings over a five calendar year period (2017-2021) with a view to determining the nexus between registration under the Securities Act and investment grade status. A table reflecting the total number of registered tranches of nonconvertible debt offered during each calendar year, and the breakdown of such tranches between investment grade and non-investment grade, appears below:

[5] Please see the Original Comment Letter for a more comprehensive discussion of SIFMA's concerns regarding the proposed probability of default standard and its preference and rationale for a more straight-forward and predictable standard akin to the proposed Form SF-3 standard for asset-backed securities.

REGISTERED TRANCHES OF NONCONVERTIBLE DEBT			
Year	Total Number of Registered Tranches of Nonconvertible Debt Offered*	Number (and approximate %) of Investment Grade Tranches	Number (and approximate %) of Non-Investment Grade Tranches
2017	1273	1202 (94.4%)	71 (5.6%)
2018	1036	995 (96%)	41 (4%)
2019	1067	1027 (96.3%)	40 (3.7%)
2020	1528	1447 (94.7%)	81 (5.3%)
2021	1241	1187 (95.6%)	54 (4.4%)
TOTAL	6145	5858 (95.3%)	287 (4.7%)

* This data includes *all* Securities Act registered tranches of nonconvertible debt, including but not limited to those registered on Forms S-3 and F-3. References to "investment grade" means a security or corporate rating by at least one nationally recognized statistical rating organization ("NRSRO") in one of its generic rating categories that signifies investment grade.

The consistently very high percentage of registered nonconvertible debt tranches that were investment grade demonstrates that Securities Act registration alone serves as a reliable proxy for identifying offerings of nonconvertible debt securities that trade primarily based upon their yield and creditworthiness. Indeed, the percentages reflected in the SIFMA data are remarkably consistent with the data proffered in support of the proposed 0.055% probability of default threshold, where the SEC notes that, based upon its sample, the threshold would have captured 2436 investment grade-rated issues and 125 non-investment grade issues in its sample pool[6] (*i.e.*, approximately 95.1% investment grade and 4.9% non-investment grade). In simple terms, it appears that both standards would capture predominantly investment grade issues, along with a nominal percentage of non-investment grade issues; however, SIFMA's proposed approach has the benefit of being simpler and more predictable and also furthers the SEC's goal of promoting Securities Act registration.

In light of this data and SIFMA's previously identified concerns regarding the proposed probability of default exception, SIFMA once again encourages the SEC to replace the proposed probability of default exception for nonconvertible securities with an exception based upon Securities Act registration, as outlined in the Original Comment Letter.

If the SEC Goes Forward With the Proposed Probability of Default Standard

If the SEC is reluctant to replace the current investment grade exception with an exception that does not incorporate embedded, credit-related criteria, SIFMA requests that the SEC:

[6] Proposal, 87 FR at 18330 ("The Commission calibrated the 0.055% threshold in the sample of nonconvertible fixed income securities so as to capture approximately 90% of the investment grade securities in our sample of nonconvertible fixed income securities (2436 investment grade rated issues with probability of default below 0.055% out of 2710 total investment grade rated issues in the sample). This threshold also captures 125 distinct non-investment grade rated issues with probability of default below 0.055%.")

- at a minimum, adopt a modified version of the proposed probability of default exception, as discussed in the Original Comment Letter; and
- concurrently adopt a new and separate additional exception to Rule 101 for distributions involving offerings of nonconvertible debt and nonconvertible preferred securities made pursuant to an effective registration statement and sold solely to qualified institutional buyers, as defined in Securities Act Rule 144A ("QIBs"), or to purchasers that the seller and any person acting on behalf of the seller reasonably believe to be QIBs.[7] To claim the exception, distribution participants would need to ensure that any investor receiving an allocation in the registered distribution satisfies the necessary qualification criteria).[8]

Rationale for an Additional Exception for Registered Nonconvertible Offerings Sold to QIBs

The market for fixed income securities has been and continues to be a predominantly sophisticated, institutional market where the buyers are typically QIBs. The SEC has long recognized that these investors are less in need of the prophylactic protections of Regulation M. Indeed, in the 1996 Regulation M adopting release the SEC noted that it was "appropriate to reduce the scope of Rule 101's prophylactic protections in the case of QIBs, because QIBs have considerable ability to obtain, consider, and analyze market information, and the Commission is not aware of complaints of manipulation in this context."[9] The Commission also noted that QIBs would "continue to be protected by the general anti-manipulation and anti-fraud provisions, including Section 17(a) of the Securities Act, and Sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder."[10] These same policy rationales should equally be applicable in the context of Securities Act registered offerings, especially in light of the data regarding the percentage of registered nonconvertible debt offerings that are investment grade.

While such an exception would admittedly place limitations on the universe of investors to which the distribution participants may allocate the nonconvertible securities, SIFMA member firms believe this is a manageable and acceptable limitation (and would not adversely affect the

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7 SIFMA further notes that, whether pursuant to the same registered offering or a concurrent Regulation S offering, distribution participants should also be able to allocate the nonconvertible securities to non-U.S. persons within the meaning of Regulation S (including non-U.S. persons in the United States), regardless of whether they are QIBs. This would be comparable to the approach the SEC takes under Rules 101(b)(10) and 102(b)(7) with respect to Regulation S offerings of Rule 144A-eligible securities that are conducted concurrently with the private offering of such securities to QIBs. *See also* Letter regarding Regulation S Transactions during Distributions of Foreign Securities to Qualified Institutional Buyers, [1993-1994] Fed. Sec. L. Rep. (CCH) 76,851 (February 22, 1994), as modified by Letter regarding Regulation S Transactions during Distributions of Foreign Securities to Qualified Institutional Buyers (March 9, 1995).

8 A distribution qualifying under the exception would be excepted from the prohibitions of Rule 101 and therefore the subject securities would not be subject to a Rule 101 restricted period. Consistent with certain other parallel exceptions under Rules 101 and 102 (*e.g.,* the "Rule 144A exceptions" in Rules 101(b)(10) and 102(b)(7)), SIFMA encourages the SEC to consider whether it would be appropriate to adopt a comparable exception under Rule 102 for registered distributions of nonconvertible securities.

9 SEC Release No. 34-38067 (December 20, 1996).

10 *Id.* at n.77.

pricing to be achieved by the issuers of the securities), especially given the inherently institutional nature of the fixed income market. As previously noted, such an exception would also further the Commission's objective of promoting Securities Act registration rather than driving issuers (and their distribution participants) to the private Rule 144A market. Although the securities would not be restricted securities (and therefore could be resold in the secondary market to non-QIBs), limiting the universe of investors to which distribution participants may allocate the securities in the registered offering would ensure that QIBs are instrumental in the price discovery function. In short, an exception for distributions involving registered offerings of nonconvertible securities that are sold solely to QIBs (or persons reasonably believed to be QIBs) would further the SEC's goals of promoting the conduct of offerings on a registered basis and encouraging liquid capital markets, while maintaining necessary investor protections.

It is worth noting that, a little more than 26 years ago, SIFMA's predecessor, the Public Securities Association (PSA)[11] stated in its comment letter on proposed Regulation M that "the sophisticated nature of high-yield market participants, improved transparency and surveillance of the high-yield market, increased reliance on relative-yield pricing of high-yield securities, more extensive credit analysis of high-yield securities, and broader dealer participation in the high-yield market all warrant, separately and collectively, a reevaluation of the treatment of high-yield securities under Regulation M."[12] On this basis, and in addition to supporting the investment grade and Rule 144A exceptions to Rule 101, the PSA recommended that the SEC adopt certain additional exceptions directed towards non-investment grade securities. For example, the PSA proposed an exception for distributions (including public offering distributions) in which "[distribution] participants are contractually obligated (*e.g.*, in an underwriting agreement) to sell the securities in lots of $250,000 or more."[13] This is similar in concept to the additional and separate exception SIFMA is currently requesting for distributions involving registered offerings of nonconvertible securities that are sold solely to QIBs (or persons reasonably believed to be QIBs).

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[11] The PSA, which was subsequently renamed the Bond Market Association, merged with the Securities Industry Association in 2006 to form the present day SIFMA.

[12] *See* Letter from Paul Saltzman, Senior Vice President and General Counsel, and Sarah M. Starkweather, Vice President and Associate General Counsel, Public Securities Association, to Jonathan G. Katz, Secretary, SEC (July 17, 1996) (*available at* https://www.sec.gov/rules/proposed/s71196/salzman1.txt).

[13] *Id.* (further noting that "this relatively simple test would assure that an underwriter's trading activity during the period of a distribution is the subject of scrutiny by institutional investors whose 'market sophistication and bargaining power' should provide protection against abusive conduct"). Other prospective exceptions referenced in the PSA's comment letter include exceptions for distributions in which (i) the security is priced at a specified number of basis points above a benchmark Treasury instrument (meaning it is more likely that the security has been priced on the basis of relative yield and is thus largely fungible with other securities); (ii) the issuer's equity securities meet a $1 million ADTV test; (iii) a large amount of the issuer's securities is owned by investors unaffiliated with the issuer; or (iv) the amount of new securities being distributed is large enough to result in a high degree of liquidity. The last three scenarios were intended to "reflect situations where it is reasonable to assume that investors also follow closely the issuer's debt securities." *Id.*

The PSA's 1996 observations regarding the sophistication and maturation of the fixed income markets are even more true today. SIFMA echoes the sentiments previously expressed in the 1996 PSA comment letter and would welcome the opportunity to work with the SEC in revisiting the treatment of fixed income securities (including high-yield securities) under Regulation M more broadly. For immediate purposes, however, and particularly if the SEC intends to move forward with its proposed probability of default standard in lieu of SIFMA's proposed alternative standard, SIFMA requests that the SEC concurrently adopt a separate, additional exception for distributions involving registered offerings of nonconvertible securities that are sold solely to QIBs (or persons reasonably believed to be QIBs), as discussed above. As previously noted, such an exception would further the SEC's goals of promoting the conduct of offerings on a registered basis (rather than driving issuers (and their distribution participants) to the private Rule 144A market) and encouraging liquid capital markets, while maintaining necessary investor protections.

Conclusion

SIFMA appreciates the opportunity to submit this supplemental comment letter on the Commission's proposed amendments to Rules 101 and 102 of Regulation M. We respect the pressure Section 939A of the DFA places upon the SEC and support the Commission's efforts to identify a workable alternative. SIFMA continues to believe that it is essential for the proposed exceptions to be based on a uniform, predictable and straightforward standard that is independently verifiable and not susceptible to different outcomes. Consistent with these objectives, SIFMA reiterates its concerns regarding the proposed "probability of default" standard and its preference for an exception based upon Securities Act registration, as detailed in the Original Comment Letter. Nonetheless, to the extent the SEC feels compelled to move forward with the proposed probability of default standard, SIFMA requests that, at a minimum, the SEC (i) adopt a modified version of the proposed probability of default exception, as discussed in the Original Comment Letter, and (ii) concurrently adopt a new and separate additional exception to Rule 101 for distributions involving offerings of nonconvertible debt and nonconvertible preferred securities made pursuant to an effective registration statement and sold solely to QIBs (or persons reasonably believed to be QIBs), as discussed above.[14]

SIFMA appreciates your consideration of our views and would welcome the opportunity to further discuss our comments with the SEC staff if it would be helpful to do so. If you have

[14] *See also* notes 7 and 8, *supra.*

any questions or require additional information, please do not hesitate to contact us by calling Joe Corcoran at [redacted].

Very truly yours,

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