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

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

Attention: Elizabeth M. Murphy,
Secretary, Securities and Exchange Commission

Re: Comments on Proposed Amendments to Rules Relating to Credit Ratings Disclosure, File No. S7-24-09, and Concept Release on Possible Rescission of Rule 436(g) Under the Securities Act of 1933, File No. S7-25-09

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Securities Regulation of the New York City Bar in response to (i) the Securities and Exchange Commission's proposed rule amendments to require disclosure of credit ratings and related information in connection with a registered offering of securities (the "Proposed Rules")[1] and (ii) the Commission's concept release relating to rescission of Rule 436(g) of the Securities Act of 1933[2], which presently exempts the use of credit ratings provided by nationally recognized statistical rating organizations ("NRSROs") from the expert consent and liability provisions of Sections 7 and 11 of the Securities Act (the "Concept Release").

1 Release No. 33-9070 (as amended by 33-9070A); IC-28942; File No. S7-24-09 (Oct. 7, 2009).

2 Release No. 33-9071 (as amended by 33-9071A); IC-28943; File No. S7-25- 09 (Oct. 7, 2009).

Our Committee is composed of lawyers with diverse perspectives on securities issues, including members of law firms, counsel to corporations, investment banks, investors, and academics. Please note that Mr. Jeffrey T. Kern, a member of the Staff of the Financial Industry Regulatory Authority ("FINRA"), who is a member of our Committee, did not participate in the preparation of this letter or the decision by our Committee to submit this letter to the Commission.

INTRODUCTION

The Committee welcomes the opportunity to comment on the Commission's proposed rulemaking regarding credit ratings disclosure and its concept release regarding the possible rescission of Rule 436(g) under the Securities Act. In recent years, credit ratings agencies have been the focus of enormous attention, in Congress and the press as well as from the Commission. We have seen a lively policy debate, raising myriad issues, which promises to continue. Our purpose in writing is not to join in that general debate, but rather to provide specific comments, from the perspective of capital markets participants, on the impact we would expect from implementation of the proposed and contemplated rule changes. We have some serious concerns about those potential impacts, particularly as applied to the market for corporate fixed income securities.

Many of the issues and concerns around the use of credit ratings have involved practices found largely or exclusively in the markets for asset-backed and mortgage-backed securities and other "structured products." The nature and purpose of those securities, and the role that credit ratings play in those markets, make them wholly distinguishable from corporate debt securities. In addition, we understand that in 2010 the Commission plans to conduct a broad review of the rules governing asset-backed securities offerings and disclosure requirements, including the use of credit ratings. The focus of this letter is therefore on the use of credit ratings in offerings of corporate fixed income securities.

As set forth below, we have a variety of specific comments on both the Proposed Rules and the Concept Release. We have combined these comments in a single letter because we think it is critical that these matters be considered together. The specific disclosure requirements of the Proposed Rules would take on a very different significance if Rule 436 was amended to rescind the Rule 436(g) exemption for NRSROs, as contemplated by the Concept Release. Sound rulemaking therefore requires that these matters be considered in a unified and holistic manner, rather than in piecemeal fashion, and we urge the Commission to take that approach. The following discussion begins with an overview of the portions of the two proposals that we will focus on. The remaining two sections address specific aspects of each proposal.

OVERVIEW OF THE PROPOSALS

The Proposed Rules would amend Item 202 of Regulation S-K to add a new paragraph (g) requiring disclosure of certain information in connection with the use of credit ratings. If a credit rating is "used" in connection with a registered offering by any selling security holder, underwriter, or member of a selling group, the issuer would be required to disclose in the prospectus the credit rating, its scope and material limitations, potential conflicts of interest with respect to the credit rating agency (who paid for the rating and whether other services were provided), and indicia of ratings-shopping. Such "use" would include the oral and written selling efforts of the registrant and other members of the selling group. A credit rating would also be deemed to have been "used" in a so-called Exxon Capital exchange offer (an exchange, following a private placement, for substantially identical registered securities) if it was used in the initial private placement. Although the proposed disclosure requirements would theoretically not apply (so long as the credit rating is not otherwise "used" in connection with a registered offering) to unsolicited ratings or to references to a credit rating in the context of liquidity, covenant or similar disclosures, we believe that as a practical matter issuers would have to comply with the disclosure requirements whenever a solicited rating exists, because there will be no practicable way to determine that no distribution participant has made some reference to it.

The Concept Release seeks comment on whether the Commission should rescind Securities Act Rule 436(g), which currently exempts from the expert consent and liability provisions of Sections 7 and 11 of the Securities Act any rating issued by an NRSRO with respect to a class of debt securities, convertible debt securities, or preferred stock. Under Rule 436(g), such ratings are not considered part of the registration statement prepared or certified by an expert for the purposes of Sections 7 and 11, and NRSROs are therefore not liable for material misstatements or omissions with respect to NRSRO credit ratings in a registration statement. The amendment would require the issuer to obtain and file the consent of an NRSRO, as an expert, when its credit ratings are included in a registration statement, and impose on the NRSRO civil liability for such use under Section 11.

PROPOSED RESCISSION OF RULE 436(G)

The Committee believes that imposing expert liability upon NRSROs for credit ratings of fixed income securities would not be an effective or appropriate way to increase the quality of ratings. More important, the Committee believes that if ratings are required to be included in registration statements and Rule 436(g) is rescinded, it is quite possible that no NRSRO viewed by the investment community as a leading rating agency would agree to consent to the inclusion of its ratings in any prospectus for corporate debt securities. We therefore believe this change could result in serious disruption to the debt capital markets, possibly including a migration of capital raising from registered offerings to Rule 144A and other exempt offerings that are not subject to Securities Act disclosure and liability standards. The Committee therefore would not support a proposal to rescind Rule 436(g).

Rescinding Rule 436(g) Could Result in Market Disruption, with Significantly More Offerings Being Executed on an Unregistered Basis

The Committee believes that if ratings are required to be included in registration statements and Rule 436(g) is rescinded, it is quite possible that the principal NRSROs would elect not to assume Securities Act liability, at least in respect of corporate fixed income securities. As noted above, we believe that if adopted the Proposed Rules would, as a practical matter, compel issuers to include disclosure of a solicited credit rating in the prospectus whenever such a rating exists. We also believe that credit ratings have a great practical significance and utility in the marketing of corporate fixed income securities. Many institutional investors are subject to legal investment requirements and investment guidelines that rely heavily on credit ratings. We anticipate that issuers would therefore continue to obtain and use credit ratings. If NRSROs refuse to consent, these issuers would be forced to increase their use of Rule 144A and other exemptions from

Securities Act registration in order to access the capital markets. These offerings would not be subject to the Securities Act's disclosure or liability standards. In addition, retail investors would generally not be eligible to participate in these exempt offerings, and thus would be precluded from these investment opportunities. Moreover, at least over the short term, there may be limits on the capacity of the Rule 144A market to absorb substantially greater volumes of primary offerings in an efficient manner, resulting in higher borrowing costs for issuers. Many institutional investors have limits on the amount of unregistered securities that they may hold. If the primary offering market for corporate debt securities were to shift substantially to the 144A market it is possible that the institutional investors would be unable to purchase all of these securities. The result would be a significant restriction on capital formation in the debt capital markets. We submit that these results would negatively affect investors and issuers, without providing benefits sufficient to justify these costs, and would thus represent a very poor outcome, from a Securities Act policy perspective, and from a capital formation and liquidity perspective.

Rescinding Rule 436(g) Would Not Be Consistent With the Policies Underlying the Liability Provisions of the Federal Securities Laws.

The Committee believes that rescission of Rule 436(g) would raise serious conceptual concerns. The theory underlying the liability provisions of the Federal securities laws is that participants in capital formation transactions are best situated to monitor the accuracy and adequacy of the issuer's disclosure. The financial statements, which are prepared by the issuer, are reviewed by the auditors subject to expert liability. Reserve reports prepared by the issuer may be subject to review by an engineer also subject to expert liability. Underwriters serve as an additional check on the entire body of disclosures, with respect to the issuers' business and results, prepared by the issuer. In each case, the expert or underwriter is reviewing and checking a body of information prepared by and relating to the issuer. By contrast, the issuer does not prepare the credit rating, nor is it issuer information in the same way as in the other examples. Rather, the credit rating is a professional opinion of the rating agency with respect to the credit quality of the issuer, taking into account information provided by the issuer, but fundamentally reflecting the analysis and views of the agency.

In addition, the liability provisions of the Federal securities laws are based on the principle of materiality -- isolated errors in disclosure do not necessarily create liability unless, individually or in the aggregate, they are material. In addition, under Generally Accepted Auditing Standards, financial statements are audited based on a "fairly present" standard, which is analogous to the materiality standard governing the issuer's non-financial disclosures. In comparison, it is difficult to see how the concept of materiality could be applied to a credit rating, which is an opinion expressed in a letter symbol. A credit rating lacks the multiplicity of statements that, when considered together, give meaning to the concept of materiality. Thus, it would appear that imposing Federal securities law liability upon credit ratings would instead serve to create something approaching guarantor liability on the rating agencies should the issuer's credit subsequently decline. It is difficult to see how a rating agency could defend the material accuracy and adequacy of its rating. In a similar vein, we do not understand how underwriters or directors would meaningfully conduct "due diligence" in respect of a credit rating. We submit that Congress intended the Securities Act liability provisions to protect investors by requiring materially accurate disclosure rather than by in effect insuring the value of investments.

THE COMMISSION SHOULD NOT MANDATE THE DISCLOSURE OF CREDIT RATINGS

Turning to the Proposed Rules, we do not believe that experience with credit ratings applicable to corporate fixed income securities requires or even suggests a need for mandatory disclosure of such ratings. We recognize the issues the Commission has considered and addressed since at least 1994 with respect to asset-backed and other structured products, but do not believe that these problems have afflicted ratings of corporate securities. Developments in the availability of information in the global marketplace, increased disclosure requirements on NRSROs recently imposed and proposed by the Commission, and changes in the disclosure delivery mechanisms of the Securities Act and Securities Exchange Act of 1934, would make such disclosure unnecessary and duplicative. The Proposed Rules would also expand liability of a corporate issuer for disclosure of a third-party process long valued by the investment community as a very useful tool to the investment community and would likely result in production of non-informative disclosures, delivered too late to be useful, and could result in changes to the ratings process itself in adverse ways.

Information material to investors about an issuer, its business, prospects and outlook, and the risks and challenges confronting the issuer with respect to its stakeholders, clearly should be available to investors at appropriate times and in the proper context. However, we believe that required inclusion of ratings information in a Securities Act prospectus, subjecting issuers and their officers and directors to liability for such disclosure, is not appropriate. The framework of the Securities Act effectively requires an issuer to present to the public information about its business, its financial condition and results of operations and its operating environment sufficient to permit reasonable investors to make an investment decision with respect to that issuer. A rating provided by a rating agency is a third party's professional opinion on the creditworthiness of the issuer and the class of securities rated, compared to others in its industry, and is based on both public information and on confidential information provided by and discussed with the issuer over what is frequently a long period of time. The use of credit ratings has evolved over time and been incorporated into covenants and investment criteria, and results in a comparable universe used to price new offerings and measure performance of industry peers and peer issuers in other industries. Imposing liability on an issuer for an independent agency's opinions serves no useful purpose when procedures are in place to make sure those opinions are independent and based on proper criteria.

There is no practical reason why, from an information perspective, this third party opinion need be included in an issuer's disclosure documents in any case, since the information it conveys is widely available otherwise. Financial media broadly disseminate credit ratings information on a timely basis, and the ratings agencies' websites disclose sufficient generic information on their ratings systems, particularly as changes to those disclosure requirements are being implemented at the Commission's initiative. The rating agencies' disclosure sites are the proper place for the agencies to disclose the rationale behind their ratings, or the limitations or special information considered by them, and for investors to look for that additional information. Such disclosure is regularly presented by the rating agencies in press releases when ratings are issued or confirmed or changed. The system is working for corporate issuers and has worked.

Practical considerations also affect the utility of requiring mandatory disclosure of ratings. If an issuer uses a preliminary prospectus, a rating will not usually have been obtained by the time the preliminary prospectus is used. Inclusion of a rating in a final prospectus would result in limited distribution, given that Rule 172 has generally obviated delivery of a final prospectus, and even if delivered, it would in fact follow long after the rating has appeared on financial websites. Much of the information required by the Proposed Rules would, in practice, consist of frequently used, boilerplate disclosure; issuers (and their counsel) could be expected to track closely the rating agencies' own generally available disclosure whenever possible. We also note that given the nature of disclosure in offerings of well known issuers, where most information is incorporated by reference, the ratings disclosure could constitute almost the entire document, giving it undue weight, but with little or no significant value. The Commission's stated purpose for requiring issuer disclosure, as opposed to a reference to the agency's website—to allow an investor to look in one place for relevant information on a specific issuer—is inconsistent with the theory of integrated disclosure in the internet age, which recognizes that interested investors get information from many sources, and must therefore take some steps to aggregate useful data. Perhaps of greatest concern, some of the required disclosures could, particularly in the case of the most frequent issuers, represent a serious timing constraint –a"speed bump"–that would impede ready access to the market for offerings under shelf registration statements. For example, a requirement to disclose non-ratings services provided by the rating agency and its affiliates, and fees paid for those services by the registrant and its affiliates, could be very difficult for frequent issuers to update in the context of a takedown.

We believe that a more desirable approach would be to adopt minor revisions to Item 10 (c) of Regulation S-K. If a rating is used by or on behalf of an issuer in connection with an offering of securities, an issuer could reasonably be expected to disclose to investors material information regarding interactions with ratings agencies outside the normal course of business. Subject to the "speed bump" concern noted above, these could include ratings shopping (i.e., disclosure of any preliminary rating obtained by or on behalf of the issuer from a credit rating agency other than the agency (or agencies) that provided the ratings being disclosed), payment for services not related to a rating, services by a rating agency that do not lead to a rating by that agency and any unusual corporate conduct that may have affected the ultimate rating.[3] This could also include, as proposed by the Commission, disclosure of the identity of the party who is paying the rating agency's fee.

One way to address the "speed bump" concern, which will be most acute in the context of shelf offerings, might be to require or permit disclosure of much of this information in the Exchange Act filings of seasoned issuers, subject to periodic updating. For example, even if the <u>fact</u> that fees have been paid is a required prospectus disclosure, the <u>amount</u> of fees paid could be disclosed on a quarterly basis. After all, this information is of interest to the secondary markets as well as to investors in primary offerings.

[3] Alternatively, the Committee would support interpretive or similar guidance from the Commission in lieu of formal rulemaking to the effect that disclosure regarding the topics enumerated in the text above is presumptively material and thus should be disclosed pursuant to Rule 408 under the Securities Act, unless the issuer affirmatively concludes that the materiality threshold is not met. Such an approach may be a useful means by which to convey to practitioners the views of the Commission as to the significance of this information to investors without further expanding the line item disclosure requirements under Regulation S-K and the various forms.

It is important to note that in each area where the Committee endorses the Commission's proposal to expand disclosures, the information in question would be available to the issuer, and the issuer would take liability for the accuracy and adequacy thereof under the Securities Act and the Securities Exchange Act. The Committee does not believe it would be necessary to treat this information any differently from other information contained in a filing by imposing liability on rating agencies for the accuracy and adequacy thereof.

It is our experience that rating agencies perform a valuable service to the market for corporate issuers, whose whole operating and balance sheet strategy is often geared to having their securities rated within a target category. The agencies therefore provide an important check on assuring that issuers within categories meet uniform criteria for their industry peers and that non-industry comparables share investment characteristics. These intangibles are understood in the market and are not susceptible to meaningful prospectus discussion. Mandatory disclosure of ratings would lead either to the absence of individualized disclosure or, equally troubling, the evolution of liability-limiting practices in the ratings process, such as giving ratings within a range, creation of lists of conditions and assumptions which render a rating practically useless, or agreements which inhibit the flow of information between an issuer and the rating agencies.

If the Commission nonetheless were to require mandatory disclosure of credit ratings for corporate issuers, we believe several specific changes to the proposals should be made. First, the triggering event for disclosure should not automatically include use of a rating by a selling securityholder, an underwriter or any member of a selling group. An issuer has limited or no control over such entities and its disclosure requirements and liability should not be based on their actions. Any entity actually using the rating will presumably be subject to Section 12(a)(2) and Rule 10b-5 liability for such use; we do not believe it is necessary, from an investor protection perspective, to add issuer liability to this mix on a blanket basis. If use of a credit rating in an offering were to constitute a triggering event for prospectus disclosure, it should be such use by an issuer or authorized use by another party in the offering process.

We also do not believe that the Commission should attempt in any way to impose requirements relating to use of credit ratings in the context of the Rule 144A market. The disclosures appropriate in that marketplace have developed over many years, taking into account the nature and sophistication of the investors permitted to buy in that market. For the Commission to require disclosure and consent as a condition to use of an Exxon Capital exchange offer or for effectiveness of a resale registration statement, based on use of a credit rating in a Rule 144A offering memorandum, would seriously undercut the participants' current total flexibility on appropriate disclosure in such circumstances and would be an unwarranted expansion of the Commission's control over those offerings.

We do not have any major concern about a requirement to disclose in a Form 8-K the receipt by an issuer of a notice from a rating agency that a previously disclosed rating has been changed or withdrawn. We do agree with those who in comments to this proposal in 2002 indicated that such a requirement is not necessary. It also would operate unevenly, depending solely on whether disclosure of the rating had been made in the first place. Changes in ratings are widely reported by the rating agencies, financial media and financial analysts, and always in less time than Form 8-K would allow. In addition, as has been widely recognized, the actual downgrade of an issuer's securities often follows a long period of time in which the events leading to the downgrade are widely reported and the actual event has little significance.

While one could argue that there is little harm from requiring disclosure that is not difficult to produce, we believe the Commission should have an affirmative rationale for any further expansion of the Form 8-K requirements. Adding yet another requirement for information that is produced and triggered by a third party without any involvement by an issuer seems to serve no practical purpose. We believe that the current requirements in the Exchange Act for reporting events with a material effect on an issuer, including in Form 8-K disclosure of acceleration of financial obligations as a result of a ratings downgrade, are sufficient.

CONCLUSION

We support the Commission's efforts to review the role of credit rating agencies in the operation of the securities markets. To that end, we believe that limited expansion of the disclosure obligations relating to the issuer's relationship with ratings agencies, as described above, is warranted. However, we do not believe that rescinding Rule 436(g) would enhance investor protection or otherwise achieve the results the Commission seeks to achieve. NRSROs are currently regulated under the Credit Agency Reform Act of 2006. In giving the Commission statutory authority to oversee credit rating agencies registered with the Commission as NRSROs, Congress found that this type of Commission oversight would protect investors by encouraging transparency, competition and accountability in the industry. We respectfully submit that any issues with the performance of rating agencies would be better addressed by means of legislation or regulations directly focused on NRSROs (or ratings agencies generally), rather than by tinkering with long-standing and finely calibrated liability provisions relating to registered offerings. For the reasons described above, we respectfully submit that rescinding Rule 436(g) would raise fundamental policy issues, without necessarily addressing any concerns with respect to the performance by ratings agencies in the recent market downturn.

Members of the Committee would be pleased to answer any questions you may have concerning our comments.

Respectfully Submitted,

/s/Robert E. Buckholz, Jr.

Committee on Securities Regulation

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