

# Removing Credit-Rating References from Regulation M



The Securities and Exchange Commission proposed amendments to remove references to credit ratings currently included in Regulation M. Under the proposed changes, the measure of credit-worthiness of nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities included in the exception to Rule 101 of Regulation M would be replaced with new standards. The exception to Rule 102 of Regulation M would be eliminated.

Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Commission to review its rules that use credit ratings as an assessment of credit-worthiness, remove those references, and substitute them with other appropriate standards.

## Background and Current Exception

Regulation M is a set of rules designed to preserve the pricing integrity of the securities trading markets by prohibiting issuers, selling security holders, distribution participants, and any of their affiliated purchasers from engaging in activities that could artificially influence the market for an offered security. Rule 101 applies to distribution participants and their affiliated purchasers, and Rule 102 applies to issuers, selling security holders, and their affiliated purchasers. Rule 101(c)(2) and Rule 102(d)(2) currently except nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities that are rated investment grade by at least one nationally recognized statistical rating organization. The Commission has previously proposed two alternatives with respect to removing credit-rating references from these exceptions for certain investment grade securities, once in 2008 and once in 2011. The Commission did not adopt any rules based on those proposals.

---

## Proposed Amendments to Regulation M

The Commission proposed to remove the requirement that nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities be rated investment grade by at least one nationally recognized statistical rating organization. In place of that requirement, under Rule 101, the Commission proposed to except (1) nonconvertible debt securities and nonconvertible preferred securities of issuers having a probability of default of less than 0.055%, as measured over certain period of time and as determined and documented using a “structural credit risk model,” as defined in the rule, and (2) asset-backed securities that are offered pursuant to an effective shelf registration statement filed on the Commission’s Form SF-3. The Commission proposed to eliminate from Rule 102

the existing exception for investment grade nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities.

---

## **Recordkeeping Requirement**

To aid the Commission in its examination and oversight of broker-dealers who are distribution participants or affiliated purchasers and rely on the proposed exception in Rule 101 for certain nonconvertible debt securities and nonconvertible preferred securities, new paragraph (b)(17) of Rule 17a-4 would require those broker-dealers to retain the written probability of default determination supporting their reliance on the exception. Rule 17a-4(b)(17) would require broker-dealers relying on Rule 101's exception for certain nonconvertible debt securities and nonconvertible preferred securities to preserve, for a period of not less than three years, the first two years in an easily accessible place, the written probability of default determination.

---

### ***Additional Information:***

The public comment period will remain open for 60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.