Corporate & Securities Law Blog
Up-to-date Information on Corporate & Securities Law
Presented By SheppardMullin

SEC Rulemaking: Guide to Newly Effective Eligibility Criteria to Replace Credit Ratings in Public Offerings

September 26, 2011

On July 26, 2011, the U.S. Securities and Exchange Commission adopted new rules to phase-out and eventually eliminate credit ratings from the transaction eligibility requirements of Forms S-3 and F-3, the short forms that eligible issuers can use to register securities under the Securities Act of 1933 (the "Securities Act"). These forms enable eligible issuers to rapidly access the public capital markets in the United States. The SEC also adopted corresponding amendments to modify other SEC rules that reference credit ratings. The new rules were adopted in light of Section 939A of the Dodd-Frank Act ("Dodd-Frank"), requiring the SEC to amend its regulations to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness." Following is background and a guide to the new short-form eligibility criteria for transactions.

Attached as Appendix A are a precise redline showing those portions of the eligibility criteria and related rules marked to show changes.

Background

As previously discussed in our February 17, 2011 blog posting "New SEC Proposal to Modify Short Form Registration Statement Eligibility Requirements And Repeal Credit Rating-Based Eligibility For Public Offerings Of Non-Convertible Debt Securities," eligibility to use Form S-3 or F-3 requires that an issuer meet at least one of the "transaction requirements" in addition to the "issuer requirements." One of the permitted transaction types has historically been primary offerings of non-convertible securities if at least one nationally recognized statistical rating organization ("NRSRO") rated the

securities "investment grade." This particular eligibility requirement is important to issuers of indebtedness and guarantors that are subsidiaries of publicly-traded companies.

In response to Dodd-Frank, the SEC proposed to replace the transaction eligibility on Form S-3 and F-3 for primary offerings of non-convertible debt from an NRSRO investment grade rating to an issuer-focused requirement – primary offerings of non-convertible debt could be registered on Form S-3 or F-3 if the issuer has issued, as of a date within 60 days prior to filing the registration statement, at least $1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash (excluding exchange offerings) registered under the Securities Act, over the prior three years.

The SEC sought comments to determine if the proposed standard would reduce the number of issuers eligible to use Forms S-3 and F-3. After receiving comments, the SEC expanded the eligibility rules to include three additional means of eligibility. These are discussed below.

What are the new eligibility criteria for public offerings?

The SEC's final rulemaking removed credit ratings from a broad range of eligibility criteria for the public offering process. In addition to amending Forms S-3 and F-3, the new rules modify Forms S-4 and F-4 and Schedule 14A to the extent that they incorporate by reference the amended contents of Forms S-3 and F-3. The SEC also adopted conforming amendments to various communications safe harbor provisions that reference Form S-3 or F-3 eligibility-- Rules 138, 139 and 168. Finally, the SEC rescinded Form F-9 and also removed the reference to credit ratings as an expressly allowed part of a safe harbor communication under Rule 134.

Forms S-3 and F-3

The newly adopted rules will allow an issuer to satisfy the transaction requirement if it meets one of the following four criteria:

1. The issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least $1 billion in non-convertible securities other than common equity, in primary offerings for cash (not exchange), registered under

the Securities Act over the prior three years (the same as in the proposing release);

2. The issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of non-convertible securities other than common equity, issued in primary offerings for cash (not exchange), registered under the Securities Act;

3. The issuer is a wholly-owned subsidiary of a well-known seasoned issuer as defined under the Securities Act; and

4. The issuer is a majority-owned operating partnership of a real estate investment trust that qualifies as a well-known seasoned issuer.

The new rules also include a transitional provision that allows an issuer to use Form S-3 or F-3 for a period of three years following the effective date of the amendments if the issuer believes that it met the previously available eligibility criteria based on an investment-grade credit rating and discloses that belief and the basis for that belief in the Form S-3 or F-3 (including presumably in a final prospectus under such registration statement). The transitional provisions are designed to allow issuers that access the capital markets time to adjust to the new standards.

Keep in mind that these new rules relate to only one of the transaction eligibility criteria; albeit an important one for debt that is issued or guaranteed by a subsidiary of a publicly-traded company. An issuer or guarantor of non-convertible debt securities may qualify for other transaction eligibility standards, such as transactions by issuers having outstanding voting securities held by non-affiliates with a market value of $75 million or more and transactions involving secondary offerings.

Forms S-4 and F-4 and Schedule 14A

In addition to the changes to Forms S-3 and F-3, conforming amendments were made to Forms S-4 and F-4, used to register securities issued in business combination transactions or exchange offers, and Schedule 14A proxy statements. The amended Form S-4, Form F-4 and Schedule 14A delete references to NRSROs and replace standards for incorporation of information by reference that depended upon Form S-3 or F-3 eligibility with appropriate references to the revised eligibility standard.

Rule 134(a)(17)

Securities Act Rule 134 is a safe harbor for certain limited communications (e.g., short announcement press releases and tombstone advertisements) issued after the filing of a registration statement that might otherwise be deemed a “prospectus” or “free writing prospectus.” As amended, the new rule eliminates from this safe harbor disclosure of a security's rating or expected rating by an NRSRO. This change should have only minimal impact on the information available to investors because issuers will (as is common now) be able to disclose a credit rating in a free writing prospectus. The removal of the safe harbor for the credit rating reference does not necessarily result in a communication that includes rating information to be deemed to be a prospectus or a free writing prospectus; rather, the issuer will now have to make the determination based on all of the facts and circumstances. While this statement is helpful, we nonetheless expect that credit rating information will likely be removed from Rule 134 notices

Rules 138, 139 and 168

Rules 138, 139 and 168 of the Securities Act provide a safe harbor for communications that might otherwise be deemed an offer for sale or an offer to sell a security under the Securities Act when these communications concern an offering of non-convertible investment grade securities. As amended, references to investment grade securities in these rules have been removed and they have been amended to reflect the new eligibility requirements of Forms S-3 and F-3.

Form F-9

The new rules also rescind Form F-9, the form used by Canadian registrants to register non-convertible investment grade debt.

When are the rules effective?

With the exception of the rescission of Form F-9, which will be effective on December 31, 2012, the rule changes became effective on September 2, 2011.

What is the expected impact of the rules?

The SEC estimates that most issuers that were previously eligibility to use Forms S-3 or F-3 will not lose eligibility under the new rules. In fact, the SEC designed the final rules

to limit the number of issuers that would lose such eligibility. The transitional provisions discussed above will allow most issuers to retain their short-form registration eligibility for a period of three years. However, once the transitional period has expired, issuers that do not satisfy the new requirement will need to review transaction eligibility with each new Form S-3 of F-3 filing and with each successive Form 10-K filing (which is deemed a post-effective amendment to any outstanding Form S-3).

The new rules may also expand short-form registration eligibility to a number of large subsidiary issuers and guarantors of non-investment grade debt securities that did not previously qualify for short-form registration but are now able to satisfy one of the new transaction eligibility criteria.

In regard to Rules 138 and 139, brokers or dealers that previously relied on the investment grade rating of securities to be offered for a safe harbor in connection with publication of research reports must now perform the issuer-related tests as of the appropriate filing or post-effective amendment date of the Form S-3 or F-3, which will be more complicated than simply checking the credit rating of an issue.

What if you have questions?

For any questions or more information on these or any related matters, please contact Louis Lehot, John Tishler or any attorney in the firm's corporate and securities practice group.

Disclaimer

Appendix A WHAT CHANGED? The guide to newly effective eligibility criteria to replace credit ratings in public offerings

Following are links to precise redlines showing only those portions of the eligibility criteria and related rules that were impacted by the SEC's rulemaking:

- Form S-3
- Form F-3
- Form S-4
- Form F-4
- Schedule 14A
- Rule 134
- Rule 138
- Rule 139
- Rule 168