Site Requirements

"SEC Proposes Alternatives to Credit Ratings as Criteria for Short-Form Registration Statement Eligibility"
Fulbright Briefing
Manuel G. Rivera and Harva R. Dockery
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Background

In the aftermath of the 2008 financial crisis, regulatory bodies worldwide have observed that over-reliance on credit ratings contributes to financial instability, and have recommended that financial regulations be amended to reduce reliance on these ratings. Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, adopted last year, requires federal agencies, including the Securities and Exchange Commission (SEC), to review and modify their regulations so that provisions that require the use of an assessment of the credit-worthiness of a security or money market instrument, or that refer to or set forth requirements regarding credit ratings, are replaced with provisions containing alternative regulatory standards.

Proposed Rule Amendments

On February 9, 2011, the SEC proposed the first of several expected rule amendments to replace the credit rating criteria currently included in SEC forms and rules with alternative regulatory criteria. The rule amendments are similar to amendments previously proposed in 2008, and focus most notably on the discontinuation of the use of an "investment grade securities" standard for determining a U.S. reporting company's eligibility to use Form S-3 or a foreign private issuer's eligibility to use Form F-3 to register a primary offering of non-convertible securities (i.e., debt or preferred stock) under the Securities Act. The rule amendments would also eliminate an investment grade securities standard in Forms S-4 and F-4 and references to investment grade securities in several Securities Act rules.

The SEC's current rules permit registration on Form S-3 or Form F-3 if the issuer meets the registrant requirements of the form and the transaction being registered is an offering of non-convertible securities which are rated investment grade by at least one nationally recognized statistical rating organization. Under the proposed rule amendments, this investment grade ratings eligibility standard would be replaced by a standard similar to the one used to determine whether the registrant is a "well-known seasoned issuer," or "WKSI." The issuer would be required to have issued at least $1 billion of non-convertible securities, other than equity securities, for cash in transactions registered under the Securities Act during the previous three years. This three-year period would be measured from a date within 60 days of the filing of the registration statement.

The proposed rule amendments would not change other bases for registering a transaction on Form S-3 or F-3. For example, even if a registrant does not meet the new requirement of having issued $1 billion of non-convertible securities for cash during the past three years, it could still register a primary offering of debt under Form S-3 or F-3 if it satisfies the existing transaction requirement which enables primary offerings of securities for cash by registrants that have a public float of at least $75 million of common equity held by non-affiliates. Consequently, the proposed rule amendments would deny Form S-3 or Form F-3 eligibility principally to issuers of investment grade debt who cannot meet the $75 million public float test or the requirement of having issued $1 billion or more of non-convertible securities in the past three years.

Significance of Amendments to Forms S-3 and F-3

Forms S-3 and F-3 are referred to as "short-form" registration statements because they enable the registrant to incorporate its Exchange Act periodic reports by reference into the registration statement and related prospectus. In addition, Forms S-3 and F-3 provide eligible issuers the flexibility to file a "shelf registration statement" and subsequently conduct primary offerings, or "shelf takedowns," when windows of opportunity present themselves in the securities markets. The proposed amendments to Forms S-3 and F-3 are significant because these forms have evolved to accommodate the capital raising needs of issuers with the greatest market following, and the SEC wishes to continue to make the benefits of these forms available to these prominent issuers. The SEC acknowledges that when originally proposed in 2008, the proposed rule amendments encountered considerable resistance, but views the requirement that the issuer have previously issued a significant dollar amount of non-convertible securities as an appropriate

substitute for an investment grade rating because both criteria are designed to identify issuers that have a wide market following and, if other form eligibility requirements are met, should be eligible to register primary offerings on Form S-3 or F-3.

The SEC has encouraged the submission of comments on the proposed rule changes, particularly concerning the extent to which the change in eligibility standard would cause issuers to lose eligibility to use Forms S-3 and F-3, and as to other alternative eligibility criteria that could function as appropriate substitutes for the investment grade securities standard. Comments are due on March 28, 2011.

This article was prepared by Manny Rivera (mgrivera@fulbright.com or 212 318 3296) and Harva R. Dockery (hdockery@fulbright.com or 214 855 8369) from Fulbright's Securities Practice Group. If you have any questions about this Fulbright Briefing, please do not hesitate to contact the authors.