

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 239, 240, 249 and 274

[Release Nos. 33–9070; 34–60797; IC–28942; File No. S7–20–09]

RIN 3235–AK41

Credit Ratings Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to our rules to require disclosure of information regarding credit ratings used by registrants, including closed-end management investment companies, in connection with a registered offering of securities so that investors will better understand the credit rating and its limitations. The amendments we are proposing today also would require additional disclosure that would inform investors about potential conflicts of interest that could affect the credit rating. In addition, we are proposing amendments to require disclosure of preliminary credit ratings in certain circumstances so that investors have enhanced information about the credit ratings process that may bear on the quality or reliability of the rating. The proposed amendments would be applicable to registration statements filed under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940, and Forms 8–K and 20–F.

DATES: Comments should be received on or before December 14, 2009.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7–20–09 on the subject line; or

Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments

Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–20–09. This file number should be included on the subject line

if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

Blair F. Petrillo, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551–3430, or with respect to questions regarding investment companies, Devin F. Sullivan, Staff Attorney in the Office of Disclosure Regulation, Division of Investment Management, at (202) 551–6784, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing amendments to Regulation S–K,¹ and forms under the Securities Act of 1933,² the Securities Exchange Act of 1934³ and the Investment Company Act of 1940.⁴ In Regulation S–K, the Commission is proposing to amend Items 10⁵ and 202.⁶ Under the Securities Act, the Commission is proposing to amend Form S–3⁷ and Form S–4.⁸ Under the Exchange Act, the Commission is proposing to amend Rule 13a–11⁹ and Rule 15d–11,¹⁰ as well as Form 8–K¹¹ and Form 20–F.¹² The Commission is also proposing amendments to Form N–2¹³ under the Securities Act and the Investment Company Act.

I. Proposed Amendments

A. Introduction

The disclosure requirements we are proposing today are intended to enhance credit rating disclosure so that investors will better understand credit ratings and their limitations. These

proposals reflect our concerns that even though credit ratings appear to be a major factor in the investment decision for investors and play a key role in marketing and pricing of the securities,¹⁴ investors may not have access to sufficient information about credit ratings. We believe our proposed rules would improve investor protection by providing information about credit ratings that will place the credit rating in an appropriate context.

We have four principal areas of concern. First, we are concerned that investors may not be provided with sufficient information to understand the scope or meaning of ratings being used to market various securities. Historically, credit ratings were intended to be a measure of the registrant's ability to repay its corporate debt.¹⁵ As the types of investment products expand and become more complex, however, the returns (including the prospect of repayment) on these securities often are dependent on factors other than the creditworthiness of the registrant.¹⁶ As a result, the information conveyed by ratings has become increasingly less comparable across types of securities.¹⁷ Investors, however, may not be aware of the differences underlying two

¹⁴ See Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, January 2003, at <http://www.sec.gov/news/studies/creditingreport0103.pdf> (noting that issuers use credit ratings in part “to improve the marketability or pricing of their financial obligations.”). See also Bo Becker and Todd Milbourn, *Reputation and Competition: Evidence from the Credit Rating Industry*, Working Paper, (June 2009) at <http://www.hbs.edu/research/pdf/09-051.pdf>.

¹⁵ See *Disclosure of Ratings in Registration Statements*, Release No. 33–6336 (Aug. 6, 1981) [46 FR 42024].

¹⁶ See *Disclosure of Security Ratings*, Release No. 33–7086 (Aug. 31, 1994) [59 FR 46304] (“1994 Ratings Release”) (noting that “[b]ecause of these non-credit payment risks, there is substantially greater uncertainty relating to yield and total return than for traditional debt obligations of comparable credit rating”). See also Joseph Mason and Joshua Rosner, *Where Did the Risk Go? How Misapplied Bond Ratings Cause Mortgage Backed Securities and Collateralized Debt Obligation Market Disruptions*, Working Paper, (May 2007), at <http://ssrn.com/abstract=1027475>.

¹⁷ As we noted in 1994:

Today, a traditional corporate debt instrument with fixed principal and interest obligations, a structured note whose principal and interest is tied, for example, to an index of securities, an “interest-only” strip, a collateralized mortgage obligation security, a residual interest in a CMO offering, and a cash flow (or “kitchen-sink”) bond all can be designated “triple-a,” notwithstanding that investment returns on most of these instruments are largely dependent on factors in addition to the issuer's creditworthiness and that the scope of the rating differs among the securities.

See 1994 Ratings Release in note 16 above. See also Alan Blinder, *Six Fingers of Blame in the Mortgage Mess*, N.Y. Times, Sept. 30, 2007.

¹ 17 CFR 229.10 through 1123.

² 15 U.S.C. 77a *et seq.*

³ 15 U.S.C. 78a *et seq.*

⁴ 15 U.S.C. 80a–1 *et seq.*

⁵ 17 CFR 229.10.

⁶ 17 CFR 229.202.

⁷ 17 CFR 239.13.

⁸ 17 CFR 239.25.

⁹ 17 CFR 240.13a–11.

¹⁰ 17 CFR 240.15d–11.

¹¹ 17 CFR 249.308.

¹² 17 CFR 249.220f.

¹³ 17 CFR 239.14; 17 CFR 274.11a–1.

securities with the same credit rating even if the securities were issued by the same registrant. The recent turmoil in the credit markets has raised serious concerns that investors may not have fully understood what credit ratings mean, or the limits inherent in them.¹⁸ Even when securities are highly rated, investors can suffer significant losses, as was evident during the recent market crisis.¹⁹ For example, the value of AAA-rated mortgage-backed securities fell 70 percent from January 2007 to January 2008.²⁰ As a result, we believe that investors should be provided with additional disclosure regarding credit ratings so that investors can choose how much weight to place on a credit rating when making an investment decision.

Second, we are concerned that investors may not have access to information allowing them to appreciate fully the potential conflicts of interest faced by credit rating agencies and how these conflicts may impact ratings. For example, most credit rating agencies are paid by the registrants who receive the credit ratings.²¹ This situation creates the potential for a rating to be inflated by a credit rating agency as a result of the credit rating agency's desire to keep the registrant's business for future ratings.²² Credit rating agencies also may provide additional services to registrants, which can be an important

source of revenue for the credit rating agency.²³

Third, there has been significant discussion of the possibility that "ratings shopping" may lead to inflated ratings.²⁴ Ratings shopping occurs when a registrant, or someone acting on its behalf, seeks the highest credit rating available from multiple credit rating agencies. We are concerned that investors have not been informed about this practice, which we believe could color their assessment of the reliability of the credit ratings ultimately obtained.

Finally, even though credit ratings appear to be a key part of investment decisions and are used to market securities, disclosure about ratings is not required in prospectuses currently. As a result, we are concerned that investors may not be receiving even basic information about a potentially key element of their investment decisions.

To address these concerns, we are proposing several enhancements to our disclosure rules. As a threshold matter, we are proposing to require disclosure by registrants regarding credit ratings in their registration statements under the Securities Act and the Exchange Act, and by closed-end management investment companies ("closed-end funds") in registration statements under the Securities Act and the Investment Company Act, if the registrant uses the rating in connection with a registered offering. The disclosure requirements are intended to address the concerns noted above. To keep investors apprised of developments relating to credit ratings for their investments, we are also proposing amendments to Exchange Act reports to require registrants to disclose changes to credit ratings. We are not proposing to require registrants to obtain credit ratings; instead, we are proposing to require disclosure about credit ratings used by registrants and other offering participants in connection with a registered offering in order to place the credit rating in its proper context for investors.

In a companion concept release,²⁵ we seek comment on whether we should propose to repeal the exemption for credit ratings provided by NRSROs from being considered a part of the registration statement prepared or certified by a person within the meaning of Sections 7²⁶ and 11²⁷ of the Securities Act currently contained in Rule 436(g) under the Securities Act.²⁸ If Rule 436(g) were eliminated, there would no longer be a distinction between NRSROs and credit rating agencies that are not NRSROs for purposes of liability under Section 11 of the Securities Act.

As we noted, we continue to have concerns about the appropriate use of credit ratings by investors, but we recognize the reality that credit ratings are important to investors. Therefore, we seek to improve investor protection through enhanced disclosure about credit ratings. In addition to proposing the rule amendments set forth in this release, the Commission today is also adopting certain amendments to its existing rules regulating NRSROs, as well as proposing additional amendments and a new rule.²⁹ We believe that today's proposals could help reduce undue reliance on credit ratings by providing investors with information about what a credit rating is, and what it is not, and other information bearing on the reliability of ratings to place the credit rating in its proper context. In light of the importance of credit ratings to investors and their use by registrants in marketing securities, we believe it is appropriate to require that this information be included in a registrant's prospectus so that all investors receive this information.

B. Background

In 1981, the Commission issued a statement of policy regarding its view of disclosure of credit ratings in registration statements under the Securities Act.³⁰ This statement marked a clear shift from the Commission's historic practice of discouraging the

¹⁸ See e.g. Recommendations of the Securities Industry and Financial Markets Association Credit Rating Agency Task Force (July 2008), at http://www.sifma.org/capital_markets/docs/SIFMA-CRA-Recommendations.pdf (recommending that investor education regarding the nature and limitations of the credit rating process is necessary to prevent over-reliance on credit ratings). See also Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience (Apr. 7, 2008), at http://www.financialstabilityboard.org/publications/r_0804.pdf.

¹⁹ For a more detailed discussion of the role of nationally recognized statistical rating organizations ("NRSROs") in determining ratings for structured products, particularly subprime residential mortgage backed securities and collateralized debt obligations, in the time period leading up to the credit crisis, see *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, Release No. 34-57967 (June 16, 2008) [73 FR 36212].

²⁰ See e.g., Marco Pagano and Paolo Volpin, *Credit Ratings Failures: Causes and Policy Options*, Working Paper, (Feb. 9, 2009), at http://www.italianacademy.columbia.edu/publications/working_papers/2008_2009/pagano_volpin_seminar_1A.pdf.

²¹ See Briefing Paper: Roundtable to Examine Oversight of Credit Rating Agencies (Apr. 2009), at <http://www.sec.gov/spotlight/cra-oversight-roundtable/briefing-paper.htm> (noting that seven of the ten NRSROs registered with the Commission operate under the issuer-pay model and that the issuer-pay NRSROs have determined 98% of the currently outstanding credit ratings issued by NRSROs).

²² See Pagano and Volpin in note 20 above.

²³ As discussed below, Exchange Act Section 15E(h) and (i) and Exchange Act Rule 17g-5 [17 CFR 240.17g-5] identify a series of conflicts arising from the business of determining credit ratings. Under the rule, some of these conflicts must be disclosed and managed, while others are prohibited outright.

²⁴ See e.g. Vasiliki Skreta and Laura Veldkamp, *Ratings Shopping and Asset Complexity: A Theory of Ratings Inflation*, working paper, (Feb. 2009), at <http://pages.stern.nyu.edu/~Elveldkamp/pdfs/ratings.pdf>; Patrick Bolton, Xavier Freixas and Joel Shapiro, *The Credit Ratings Game*, Working Paper, (Feb. 2009), at <http://www.nber.org/papers/w14712>; Becker and Milbourn in note 14 above.

²⁵ See the companion concept release considered by the Commission on September 17, 2009 regarding Rule 436(g) under the Securities Act.

²⁶ 15 U.S.C. 77g.

²⁷ 15 U.S.C. 77k.

²⁸ 17 CFR 220.436(g).

²⁹ See the releases considered by the Commission on September 17, 2009 regarding (i) amendments to Rule 17g-2 under the Exchange Act; (ii) amendments to Rule 17g-5 under the Exchange Act; (iii) amendments to Regulation FD; (iv) proposed amendments to Rule 17g-3 under the Exchange Act; (v) proposed amendments to the Instructions to Exhibit 6 of Form NRSRO; and (vi) proposed new Rule 17g-7 under the Exchange Act.

³⁰ See *Disclosure of Ratings in Registration Statements*, in note 15 above.

disclosure of credit ratings in these filings and reflected the Commission's then-developing acknowledgement of the growing importance of credit ratings in the securities markets and in the regulation of those markets.³¹ Soon thereafter, the Commission amended Regulation S-K to reflect its new policy of permitting the voluntary disclosure of credit ratings in registration statements along with clear disclosure explaining the rating.³² The Commission also adopted rules to permit the voluntary disclosure of credit ratings in tombstone advertisements,³³ and provided that a credit rating by an NRSRO generally is not part of a registration statement or report prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act.³⁴

³¹ See Release No. 33-6336 in note 15 above. The Commission announced "that, contrary to prior general staff positions on this matter, it will now permit the disclosure of security ratings assigned by rating organizations in registration statements." In support of this shift in policy, the Commission cited "the general usefulness" of credit ratings to investors and the "importance that the Commission and other regulatory entities have attached to the issuance" of a credit rating. *Id.*

³² See *Adoption of Integrated Disclosure System*, Release No. 33-6383 (Mar. 3, 1982) [47 FR 11380] ("Integrated Disclosure Release"). See also *Registration Form for Closed-End Management Investment Companies*, Release No. 33-6967 (November 20, 1992) [57 FR 56826] (adopting amendment to Form N-2 regarding voluntary disclosure of credit ratings for closed-end funds).

³³ See Integrated Disclosure Release in note 32 above (adopting amendments to Rule 134(a) under the Securities Act to provide that certain communications containing a security rating or ratings of a class of debt securities, convertible debt securities and preferred stock and the name(s) of the rating organization would not be deemed to be a prospectus under Section 2(10) of the Securities Act).

³⁴ Concurrent with the adoption of these rules and guidance, the Commission adopted Securities Act Form S-3, the short-form Securities Act registration statement for eligible domestic issuers [17 CFR 239.13]. Form S-3 provides that a primary offering of non-convertible debt securities may be eligible for registration on the form if rated investment grade. A non-convertible security is an "investment grade security" for purposes of form eligibility if at the time of sale, at least one NRSRO has rated the security in one of its generic rating categories which signifies investment grade, typically one of the four highest rating categories. In adopting this requirement, the Commission specifically noted that commenters believed that the component relating to investment grade ratings was appropriate because non-convertible debt securities generally are purchased on the basis of interest rates and credit ratings. See Section III.A.1 of the Integrated Disclosure Release in note 32 above. Later, in 1992, the Commission expanded the eligibility requirement to delete references to debt or preferred securities and to provide Form S-3 eligibility for other investment grade securities (such as foreign currency or other cash settled derivative securities). See *Simplification of Registration Procedures for Securities Offerings*, Release No. 33-6964 (Oct. 22, 1992) [57 FR 48970]. Consistent with Form S-3, the Commission adopted a provision in Form F-3 [17 CFR 239.33] providing for the eligibility of a primary offering of investment grade non-convertible debt securities by eligible

At various times since the policy statement and the adoption of these rules and form eligibility requirements, the Commission has reviewed and reconsidered its approach to the disclosure of credit ratings in filings and the reliance on ratings in the Commission's form eligibility requirements. For example, in 1994, the Commission published a proposing release that would have mandated disclosure in Securities Act prospectuses of a credit rating given by an NRSRO whenever a credit rating with respect to the securities being offered is "obtained by or on behalf of an issuer."³⁵ The proposals would have required disclosure of specified information with respect to credit ratings, whether or not disclosed voluntarily or mandated by the then-proposed rules. In addition, the release sought comment on various areas relating to the disclosure of credit ratings. The release also proposed to require disclosure on a Form 8-K of any material change in the credit rating assigned to the registrant's securities by an NRSRO.³⁶ The Commission received wide-ranging comments on those proposals. Commenters' views on whether registrants should be required to provide disclosure regarding credit ratings of their securities in a final prospectus reflected a wide variety of opinions. Commenters who were against the mandatory disclosure of credit ratings argued, among other things, that: NRSROs have incentives to provide quality ratings; information about credit ratings is widely available and understood; requiring disclosure would be costly and burdensome; and requiring disclosure of ratings may increase investors' reliance on them.³⁷ Commenters who supported mandatory disclosure regarding credit ratings argued, among other things, that: credit ratings have the potential to confuse and mislead investors; investors do not receive sufficient information about the credit rating; and investors expect to know the credit rating when buying a security, so the proposed required disclosure would comport with investor expectations.³⁸ The Commission did not act on the proposals.

foreign private issuers. Shelf registration requirements for asset-backed securities, originally adopted in 1992, also depend on a credit ratings component. See General Instruction I.B.5 of Form S-3.

³⁵ See the 1994 Ratings Release in note 16 above.

³⁶ See the 1994 Ratings Release in note 16 above.

³⁷ See e.g. letter regarding File No. S7-24-94 of Moody's Investor Service, Inc. (Dec. 5, 1994); and letter regarding File No. S7-24-94 of Fitch Investors Service Inc. (Dec. 6, 1994).

³⁸ See e.g. letter regarding File No. S7-24-94 of Savings & Community Bankers of America; and

In 2002, as part of the broader changes to the Form 8-K current reporting requirements, the Commission again proposed to require a registrant to file a Form 8-K current report when it received a notice or other communication from any rating agency regarding, for example, a change or withdrawal of a particular rating.³⁹ Comments were mixed on whether changes to a credit rating should be reported on a Form 8-K.⁴⁰ Commenters against the requirement generally believed it was unnecessary because the information was publicly available.⁴¹ Commenters who supported the requirement generally believed it should be limited to ratings provided by NRSROs.⁴² The new Form 8-K filing regime adopted in 2004 did not include this requirement.⁴³ In declining to adopt a Form 8-K reporting requirement for credit rating changes, the Commission noted that it was continuing to consider the appropriate regulatory approach for rating agencies.⁴⁴

In 2003, the Commission issued a concept release requesting comment on whether it should cease using the NRSRO designation and, as an alternative to the ratings criteria, provide for Form S-3 eligibility where investor sophistication or large size denomination criteria are met.⁴⁵ In 2008, the Commission proposed changes to certain of its forms and rules that would have removed references to credit ratings and would have amended Securities Act Rule 436(g), which exempts NRSROs from liability under Section 11 of the Securities Act, so that

letter regarding file No. S7-24-94 of A.G. Edwards & Sons, Inc.

³⁹ See *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, Release No. 33-8106 (June 17, 2002) [67 FR 42914].

⁴⁰ See also the discussion of Form 8-K in Section I.D. below.

⁴¹ See e.g. letter regarding File No. S7-22-02 of CIGNA Corporation (Aug. 26, 2002), at <http://www.sec.gov/rules/proposed/s72202.shtml>.

⁴² See e.g. letter regarding File No. S7-22-02 of Investment Counsel Association of America (Aug. 26, 2002), at <http://www.sec.gov/rules/proposed/s72202.shtml>.

⁴³ See *Additional Form 8-K Filing Requirements and Acceleration of Filing Date*, Release No. 33-8400 (Mar. 16, 2004) [69 FR 15594], amended by *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Dates; Correction*, Release No. 33-8400A (Aug. 4, 2004) [69 FR 48370].

⁴⁴ *Id.*

⁴⁵ See *Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws*, Release No. 33-8236 (June 4, 2003) [68 FR 35258] ("2003 Concept Release"). Most of the commenters that addressed the issue supported retaining the requirement to use NRSRO ratings for purposes of Form S-3 eligibility. Comments on the concept release are available at <http://www.sec.gov/rules/concept/s71203.shtml>. See also the extensive discussion of market developments in Release No. 34-57967 in note 19.

the exemption would apply to all credit rating agencies, including those that are not NRSROs.⁴⁶

In April 2009, the Commission held a roundtable to examine the oversight of credit rating agencies.⁴⁷ Topics addressed by the panels at the roundtable included current actions being taken by NRSROs, competition within the industry and how to improve oversight of the industry. Participants and the public were invited to submit comments regarding the issues addressed at the roundtable. Commenters addressed a wide range of issues.

The Commission's history in considering the possibility of mandating disclosure of credit ratings reflects the complexity of the issues raised by investors' reliance on them. Our rules under the Securities Act and the Exchange Act require that investors be provided material information in order to evaluate investment opportunities. We understand that investors will continue to use credit ratings in making investment decisions; therefore, we are proposing disclosure requirements we believe will provide investors with additional meaningful information that they can use to make those decisions. We acknowledge the risk that requiring disclosure of credit ratings could emphasize their significance and draw attention away from other, more important information about the registrant and its securities. However, we believe the recent market crisis and questions about the use of credit ratings suggest that investors may not have sufficient information to understand credit ratings fully. In light of the concerns discussed above, we believe all investors would benefit from the proposed revisions to our disclosure rules to require specific disclosures about ratings.

C. Mandatory Disclosure of Credit Ratings

As noted above, the Commission's policy on credit ratings currently is set forth in Item 10(c) of Regulation S-K. Specifically, the policy permits registrants to voluntarily disclose ratings assigned by credit rating agencies to classes of debt securities, convertible debt securities and preferred stock in registration statements and periodic reports.⁴⁸ Item 10(c) also

provides the Commission's views on important matters registrants should consider in disclosing credit ratings in Securities Act and Exchange Act filings. So that all investors are provided with appropriate information about credit ratings, the amendments we propose today would mandate much of the disclosure permitted under Item 10(c) when a registrant uses a credit rating in connection with a registered offering and would remove the policy statement and recommended disclosure from that Item.

Specifically, we are proposing a new paragraph in Item 202 of Regulation S-K that would require much of the specific disclosure currently permitted under Item 10(c).⁴⁹ As more fully described below, proposed Item 202(g) would require disclosure of all material scope limitations of the credit rating and any related published designation, such as non-credit payment risks, assigned by the rating organization with respect to the security.⁵⁰ In addition, in order to highlight potential conflicts of interest, the proposed rule would require disclosure of the source of payment for the credit rating; and if any additional non-rating services have been provided by the credit rating agency or its affiliates to the registrant or its affiliates over a specified period of time, disclosure of the services and the fees paid for those services would be required. Disclosure required pursuant to proposed Item 202(g) of Regulation S-K would be required in Securities Act and Exchange Act registration statements. We are proposing to amend Item 9 of Form S-3 and Item 4(a)(3) of Form S-4 so that disclosure regarding credit ratings is provided in all registration statements on that form when the trigger for disclosure is met. We also are proposing to require, in certain circumstances, disclosure of preliminary ratings, as well as final ratings not used by a registrant, so that investors will be informed when a registrant may have engaged in ratings shopping. Finally, we are proposing to amend Exchange Act reports to require reporting of changes in credit ratings in certain circumstances.

We are proposing to apply similar mandatory disclosure requirements regarding credit ratings of senior securities issued by closed-end funds registered under the Investment Company Act. Like other companies, closed-end funds sometimes issue

senior securities that are rated by one or more credit rating agency and currently are permitted to voluntarily disclose these credit ratings in their registration statements.⁵¹ We are proposing to amend Form N-2 to require that closed-end funds include credit ratings disclosure in their registration statements under the Securities Act and the Investment Company Act. We are also proposing to amend Exchange Act Rules 13a-11 and 15d-11 to require reporting by closed-end funds of changes in credit ratings in certain circumstances.

We believe that the proposed amendments to require disclosure of certain information regarding credit ratings, rather than permitting voluntary disclosure, would provide investors with the information they need about credit ratings to put the rating in the appropriate context. The proposed amendments also may benefit companies that in the past may have hesitated to provide disclosure voluntarily by leveling the playing field so that all companies using credit ratings in connection with a registered offering of securities would be required to provide disclosure.

1. Trigger for Required Disclosure

We believe that it is appropriate for registrants to provide the proposed disclosure when they use a credit rating in connection with a registered offering of their securities. As discussed above, investors rely on credit ratings in making investment decisions. We believe requiring disclosure when a registrant uses the credit rating to offer or sell securities would provide investors with the information they need about the credit rating to put the credit rating in its appropriate context. Specifically, we are proposing to amend Item 202 of Regulation S-K,⁵² Item 12 of Form 20-F,⁵³ and Item 10.6 of Form

⁵¹ Section 18(f) of the Investment Company Act [15 U.S.C. 80a-18(f)] generally prohibits a registered open-end management investment company (*i.e.*, mutual fund) from issuing senior securities.

⁵² See proposed new paragraph (g) to Item 202 of Regulation S-K.

⁵³ Form 20-F is the combined registration statement and annual report form for foreign private issuers under the Exchange Act. It also sets forth disclosure requirements for registration statements filed by foreign private issuers under the Securities Act. "Foreign private issuer" is defined in Securities Act Rule 405 [17 CFR 230.405] and Exchange Act Rule 12b-2 [17 CFR 240.12b-2]. We are proposing to amend Item 12 of Form 20-F, which pertains to securities other than equity securities, to elicit the same disclosure that would be required by proposed Item 202(g) of Regulation S-K. We also propose to amend Item 10 of Form 20-F to require the same disclosure under proposed Regulation S-K Item 202(g) for a class of preferred securities, including non-participatory preferred

Continued

⁴⁶ See *Security Ratings*, Release No. 33-8940 (Jul. 1, 2008) [73 FR 40106].

⁴⁷ See generally <http://www.sec.gov/spotlight/cra-oversight-roundtable.htm>.

⁴⁸ We understand that only a small number of registrants include disclosure regarding credit ratings in their prospectuses. Generally, if ratings are disclosed, they are disclosed in free writing

prospectuses filed pursuant to Rule 433 [17 CFR 230.433].

⁴⁹ See proposed new paragraph (g) to Item 202 of Regulation S-K.

⁵⁰ See note 67 below.

N-2⁵⁴ to require registrants to provide detailed disclosure regarding credit ratings if the registrant, any selling security holder, any underwriter, or any member of a selling group uses a credit rating⁵⁵ from a credit rating agency⁵⁶ with respect to the registrant or a class of securities issued by the registrant, in connection with a registered offering. The proposed rule would not require that registrants obtain a credit rating on any security; however, if a registrant uses a credit rating in connection with a registered offering, then disclosure would be required.

We have proposed to require disclosure regarding credit ratings if the registrant, a selling security holder, underwriter or any member of a selling group uses a credit rating in connection with a registered offering. We included selling security holders, underwriters and other members of the selling group in the proposed trigger for disclosure so that registrants would not be able to structure their selling efforts in a manner that would avoid triggering disclosure under the proposed rule. In addition, there are circumstances where the underwriter obtains the credit rating on behalf of the registrant, and if the underwriter uses that rating, we believe disclosure should be required.

A credit rating may be “used” in a variety of ways. For example, in addition to oral and written selling efforts of the registrant and other members of the selling group, we would consider a credit rating to be used in connection with a registered offering of securities when it is disclosed in a prospectus or a term sheet filed pursuant to Rule 433 or Rule 497⁵⁷ under the Securities Act.

Furthermore, as proposed, a credit rating also would be considered to be used in connection with a registered offering of securities if it is used in connection with a private offering of

securities that is made in reliance on an exemption from registration under the Securities Act when the privately offered securities are exchanged shortly thereafter for substantially identical registered securities.⁵⁸ Disclosure would be required even if the rating was not disclosed in the registered exchange offer.⁵⁹ As a result, registrants would not be able to avoid the proposed disclosure requirements regarding credit ratings by disclosing a credit rating to investors in a private offering but not using it in connection with the registered exchange offer to those same investors of substantially identical securities.

We intend for the proposed rule to apply to both oral and written selling efforts. Thus, for example, disclosure would be required when a credit rating is disclosed to potential purchasers by the registrant, any selling security holder, any underwriter or any member of a selling group in response to an inquiry from an investor. A registrant would not be able to avoid providing the proposed disclosure by using a rating only in oral selling efforts and not including it in written communications related to an offering, by not “volunteering” the information about the credit rating except upon request or by referring an investor to a Web site that discloses the credit rating. We believe that if a credit rating is used in connection with a registered offering, then investors should have the benefit of all of the disclosure required by our proposed amendments.

We have not proposed to require that a registrant provide disclosure when it has not sought or otherwise solicited the

credit rating unless the rating is used in connection with a registered offering of its securities, as we believe that such a requirement may create an undue burden for registrants to follow and provide disclosure on all of the ratings outstanding on their securities. In this regard, we note that regulatory changes could increase the number of unsolicited ratings being provided.⁶⁰ If we were to require disclosure of unsolicited ratings not used in connection with a registered offering of a security, a registrant would have to monitor all of the credit rating agencies to determine not only whether a credit rating had been issued with respect to a security, but also whether the rating has been changed or withdrawn.

We are aware that some registrants discuss their credit rating in other contexts in their periodic reports or Securities Act registration statements. As proposed, the disclosure requirement regarding credit ratings would not be triggered if the only disclosure of a credit rating in a filing with the Commission is related to changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings, and the credit rating is not otherwise used in connection with a registered offering. For instance, some registrants note their ratings in the context of a risk factor discussion regarding the risk of failure to maintain a certain rating and the potential impact a change in credit rating would have on the registrant. A registrant also may refer to its rating in the context of its liquidity discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”). Registrants may need to discuss ratings when they describe debt covenants, interest or dividends that are tied to credit ratings or potential support to variable interest entities. We have proposed to exclude these references to credit ratings from the trigger that would require additional disclosure regarding credit ratings because we believe that the additional information is not necessary in that setting. We believe that the material information to be conveyed in that setting relates to the fact that a credit rating has the potential to have a material impact on the registrant. We believe additional information about

stock as that term is used under 17 CFR 230.902(a)(1).

⁵⁴ Form N-2 is the registration form used by closed-end funds to register under the Investment Company Act and to offer their securities under the Securities Act. We are proposing to amend Item 10.6 of Form N-2 to elicit the same disclosure that would be required by proposed Item 202(g) of Regulation S-K.

⁵⁵ As proposed, a “credit rating” would have the same meaning as the definition in Section 3(a)(60) of the Securities Exchange Act [15 U.S.C. 78c(a)(60)].

⁵⁶ As proposed, a “credit rating agency” would have the same meaning as the definition in Section 3(a)(61) of the Securities Exchange Act [15 U.S.C. 78c(a)(61)].

⁵⁷ 17 CFR 230.497. This would include closed-end fund advertisements that, under Rule 497(i) [17 CFR 230.497(i)], are considered to be filed with the Commission upon filing with a national securities association registered under Section 15A of the Exchange Act [15 U.S.C. 78o].

⁵⁸ See proposed Instruction 3 to Item 202(g).

⁵⁹ These transactions are sometimes referred to as Exxon Capital exchange offers based on a series of no-action letters issued by the staff beginning in May 1988 that outline the staff's interpretive positions regarding such exchange offers. In a typical Exxon Capital exchange offer, an issuer sells debt securities to a broker-dealer in reliance on the exemption in Section 4(2) of the Securities Act [15 U.S.C. 77d(2)]. The broker-dealer then immediately resells those securities to qualified institutional buyers in reliance on Rule 144A under the Securities Act. [17 CFR 230.144A]. The issuer then files a registration statement on Form S-4 to register the exchange of the securities for substantially identical securities. Upon effectiveness of the S-4 registration statement, the qualified institutional buyers exchange restricted securities for registered securities, and therefore, may resell the securities they receive in the exchange offer without further registration or prospectus delivery. See Exxon Capital Holdings Corporation, SEC No-Action Letter (pub. avail. May 13, 1988); Morgan Stanley & Co., Inc., SEC No-Action Letter (pub. avail. June 5, 1991); Mary Kay Cosmetics, Inc., SEC No-Action Letter (pub. avail. June 5, 1991); K-III Communications Corp., SEC No-Action Letter (pub. avail. May 14, 1993); Shearman & Sterling, SEC No-Action Letter (pub. avail. July 2, 1993); Brown & Wood LLP, SEC No-Action Letter (pub. avail. Feb. 5, 1997).

⁶⁰ The Commission is adopting today various changes to Exchange Act Rule 17g-5 [17 CFR 240.17g-5] that would provide the opportunity for other credit rating agencies to use the information provided to NRSROs by the registrant to develop “unsolicited ratings” for certain rated asset-backed securities. See the adopting release considered by the Commission on September 17, 2009.

scope limitations, conflicts of interest, preliminary ratings and other matters does not appear to be necessary to understand that disclosure.

We are proposing to amend Item 9 of Form S-3 and Item 4(a)(3) of Form S-4 so that disclosure regarding credit ratings is included in all registration statements where appropriate. Currently, Item 9 requires registrants to include the disclosure required by Item 202 of Regulation S-K in a registration statement on Form S-3 unless capital stock is to be registered and securities of the same class are registered pursuant to Section 12 of the Exchange Act.⁶¹ Item 4(a)(3) of Form S-4 requires registrants to include the disclosure required by Item 202 of Regulation S-K unless the registrant would meet the requirements for use of Form S-3 and capital stock is to be registered, securities of the same class are registered pursuant to Section 12 of the Exchange Act, and the security is listed on a national securities exchange. We are proposing to amend these items so that the disclosure required by proposed Item 202(g) of Regulation S-K would be included in a registration statement on Form S-3 or Form S-4 even if securities of the same class are registered under Section 12 of the Exchange Act so long as the trigger for disclosure under proposed Item 202(g) has been met. We believe these amendments are appropriate so that investors would receive information about credit ratings in circumstances where securities of the same class have been previously registered because securities of the same class that are issued at different times may have different ratings.

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- As proposed, we would require disclosure of credit ratings if the registrant, any selling securityholder, underwriter or member of a selling group uses a credit rating in connection with a registered offering. Are there any other persons that should be included as persons who could cause the disclosure requirement to be triggered? Are there reasons to exclude any of the persons or entities currently included in the proposal?

- Should the proposed rule mandate disclosure of a credit rating obtained by a registrant regardless of whether the rating is used in connection with a registered offering? For example, should we require disclosure whenever a

registrant discloses a rating? Do the triggers in the requirement encourage the use and related disclosure of only favorable ratings? Are there other circumstances that should trigger the proposed disclosure?

- Would the rule, as proposed, have an effect on the frequency with which registrants seek credit ratings? Why or why not?

- As proposed, we would consider a credit rating to be used in connection with a registered offering of securities if it is disclosed upon request of an investor. We believe this approach should reduce the risk that practices might develop that would undermine the purpose of our proposal, such as a registrant or member of a selling group not offering the information about a credit rating unless asked. Is this approach necessary or appropriate? Should registrants be excluded from the proposed requirement to provide disclosure regarding credit ratings if they and the offering participants decide not to use the rating in selling efforts, but disclose the rating in response to an investor who specifically asks about the rating?

- Would registrants and other members of a selling group be able to circumvent the rule as proposed? How would they be able to do that? How could we modify the rule proposal to avoid circumvention? Could the proposed trigger for disclosure lead to procedural modifications to the practice of assigning credit ratings so that registrants could avoid the disclosure requirement even though the credit rating is used in connection with a registered offering? If so, how could we modify the proposal to avoid such modifications?

- As proposed, a credit rating would be considered used for purposes of the proposed disclosure trigger if it is used in connection with a private offering even if not used in a subsequent registered exchange offering for substantially identical securities made to the purchasers in the private placement. Is this trigger for disclosure appropriate in light of the unique structure of these transactions? Should we expand the instruction to include a credit rating obtained in connection with a private offering if those securities are subsequently registered for resale?

- Is the instruction, as proposed, that a credit rating would be considered used if it is used in connection with a private offering but not used in a subsequent registered exchange offering

for substantially identical securities, appropriate for closed-end funds?

- As proposed, a registrant would not be required to make disclosure with regard to solicited or unsolicited ratings unless the rating is used in connection with the registered offering of a security. Is there a difference between solicited and unsolicited ratings such that they should be treated differently for purposes of this proposal? Would requiring disclosure of all unsolicited ratings regardless of whether they are used in connection with a registered offering be too burdensome for registrants? Should disclosure be triggered only if the registrant, or someone acting on its behalf, obtains the credit rating (*i.e.*, a solicited rating) and uses the rating in connection with a registered offering? If we were to require disclosure of unsolicited ratings regardless of whether they are used in connection with a registered offering of securities, should we impose limitations on how many ratings, or which credit rating agencies' ratings, should be required to be disclosed? For example, should we require disclosure for unsolicited ratings issued by NRSROs only? Would such disclosure impose an undue burden on the registrant?

- Should the proposed mandatory disclosure of credit ratings apply to closed-end funds?

- Investment companies, including both closed-end funds and mutual funds, sometimes represent that they invest only in securities that have a specified credit rating, such as investment grade, or disclose the percentage of their portfolios comprised of securities with specified ratings. As noted above, investors may not have access to sufficient information in order to understand fully what credit ratings mean, or the limits inherent in them. Do current investment company disclosure requirements adequately address the meaning and limitations of credit ratings of portfolio securities? If not, how could investment company disclosure requirements be changed to better promote investor understanding of credit ratings of portfolio securities?

- The proposed amendments apply to the disclosure of credit ratings. Mutual funds sometimes obtain other non-credit ratings and use such ratings in connection with the offer or sale of their securities. For example, rating agencies issue credit quality ratings to fixed-income funds, which examine credit

⁶¹ 15 U.S.C. 78l.

risk in the fund's underlying portfolio.⁶² Ratings agencies may also issue volatility ratings, which are designed to identify the potential volatility of the market value of a fund's shares.⁶³ In addition, at least one rating agency issues principal stability ratings that are designed to identify a money market fund's capacity to maintain stable principal or a stable net asset value.⁶⁴ Should we require the mandatory disclosure of these additional fund ratings as part of a fund's prospectus or statement of additional information if the ratings are used in connection with the offer or sale of an investment company's securities? If so, what disclosures should we require?

- The proposed disclosure item includes an instruction that provides that a registrant would not trigger the disclosure requirement regarding credit ratings if the credit rating is not otherwise used in connection with a registered offering, and the only disclosure of a credit rating in a filing with the Commission is related to changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings. Is this approach appropriate? Are there other disclosures about credit ratings of a similar nature that should be added to this instruction? Would registrants avoid such references because of concerns that it might trigger the proposed additional disclosure requirements? Would this instruction be used to circumvent the disclosure requirement?

- We are proposing to amend Item 9 of Form S-3 and Item 4(a)(3) of Form S-4 so that disclosure regarding credit ratings would be included (if applicable) in registration statements for offerings of capital stock even if securities of the same class have previously been registered pursuant to Section 12 of the Exchange Act. Are there any other circumstances where we need to amend forms so that information regarding credit ratings is

provided to investors when a credit rating is used in connection with a registered offering?

- Schedule B under the Securities Act provides the disclosure requirements for foreign governments or political subdivisions thereof that register their securities for public offering in the United States. The disclosure requirements for those issuers are located directly in the Securities Act, and there are no corresponding disclosure regulations or forms under Schedule B applicable to foreign governments⁶⁵ or their political subdivisions.⁶⁶ However, through market practice and investor expectation, registration statements prepared under Schedule B generally contain disclosure beyond the requirements of the statute, and may include, for example, credit rating information relating to the sovereign issuer's debt. Should we extend the proposals for the disclosure of credit ratings to foreign government issuers? Or should we continue to permit foreign governments to disclose credit ratings on a voluntary basis? Should a foreign government be required to disclose credit ratings in Schedule B registration statements under the Securities Act and in Exchange Act documents, including the annual report on Form 18-K and the registration statement on Form 18, if it uses the credit rating in connection with a registered offering of its debt securities? If we extend the credit rating disclosure requirements to foreign governments, are there some forms or documents that in whole or in part should be exempt from these requirements? Would disclosure of credit ratings be appropriate for foreign government issuers? If so, why? If not, why should they be exempt? If mandatory credit ratings disclosure in filings under the Securities Act or the Exchange Act is appropriate for foreign government issuers, should they be subject to requirements analogous to those proposed for other issuers or are there different factors that should be considered in any amendments that may

be adopted for foreign government issuers? What are those considerations?

2. Required Disclosure

Under the proposed amendments, a registrant would be required to disclose the information for each credit rating that triggers disclosure. The proposed disclosure seeks to provide investors with a specific description of the ratings and to make clear to investors:

- The elements of the securities that the credit rating addresses;
- The material limitations or qualifications on the credit rating; and
- Any related published designation, such as non-credit payment risks, assigned by the credit rating agency with respect to the security.

The disclosure would be required in registration statements under the Securities Act and the Exchange Act, including Form 10 and Form 20-F, and in registration statements filed by closed-end funds on Form N-2 under the Securities Act and the Investment Company Act.

(a) General Information Including Scope and Limitations

As proposed, our amendments would require disclosure of certain general information regarding credit ratings, including the scope of the rating and any limitations on the scope of the rating. In this regard, our proposed rules would require:

- The identity of the credit rating agency assigning the rating and whether such organization is an NRSRO;
- The credit rating assigned by the credit rating agency;
- The date the credit rating was assigned;
- The relative rank of the credit rating within the credit rating agency's classification system;
- A credit rating agency's definition or description of the category in which the credit rating agency rated the class of securities;
- All material scope limitations of the credit rating;⁶⁷
- How any contingencies related to the securities are or are not reflected in the credit rating;
- Any published designation reflecting the results of any other evaluation done by the credit rating agency in connection with the rating, along with an explanation of the designation's meaning and the relative rank of the designation;

⁶⁷ A limited scope rating is a rating that assesses less than the promised or expected return on a security. We are proposing disclosure of any material scope limitations in order to mitigate the potential risk that investors may not understand the limited scope of the rating. See the 1994 Release in note 15 above.

⁶² See, e.g., Fitch's Fund and Asset Manager Ratings, at <http://www.fitchratings.com/jsp/sector/Sector.faces?selectedTab=Overview&Ne=11%2b4293330821> (last visited on Aug. 11, 2009) ("Fitch's Fund and Asset Manager Ratings"); Moody's Ratings Definitions, Money Market and Bond Fund Ratings, at <http://v3.moody.com/ratings-process/Money-Market-and-Bond-Fund-Ratings/002001018> (last visited Aug. 11, 2009) ("Moody's Ratings Definitions"); Standard & Poor's Ratings Definitions, Ratings Direct, (Apr. 30, 2009), available at http://www2.standardandpoors.com/spf/pdf/fixedincome/Ratings_Definitions_Update.pdf ("Standard & Poor's Ratings Definitions").

⁶³ See, e.g., Fitch's Fund and Asset Manager Ratings; Standard & Poor's Ratings Definitions.

⁶⁴ See, e.g., Standard & Poor's Ratings Definitions.

⁶⁵ "Foreign government" refers to any issuer that is eligible to register securities under Schedule B of the Securities Act, including political subdivisions and some quasi-governmental entities.

⁶⁶ Unlike other issuers, foreign government issuers that register securities under Schedule B of the Securities Act are not subject to reporting obligations under Section 15(d) of the Exchange Act [15 U.S.C. 78o(d)]. However, foreign government securities listed on a U.S. exchange must be registered under Section 12(b) of the Exchange Act [15 U.S.C. 78j(b)], as is the case with the securities of other issuers. Foreign governments that have securities registered under Section 12(b) file annual reports with the Commission on Form 18.

- Any material differences between the terms of the securities as assumed or considered by the credit rating agency in rating the securities and (i) the minimum obligations of the security as specified in the governing instruments of the security; and (ii) the terms of the securities as used in any marketing or selling efforts; and

- A statement informing investors that a credit rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific class of securities to which it applies; and that investors should perform their own evaluation as to whether an investment in the security is appropriate.⁶⁸

A preliminary prospectus would include information about any credit rating that is used in connection with a registered offering of securities. For example, a registrant would disclose the initial rating (if any) assigned by the credit rating agency in the preliminary prospectus when a final rating is not assigned until after the effectiveness of a registration statement. If a disclosed rating is changed or if a different rating becomes available before effectiveness, the registrant would be required to convey the rating change to the purchaser. The registrant would be required to update the final prospectus to reflect the final rating assigned and all related disclosure. In connection with delayed shelf offerings, the final rating would be disclosed in a prospectus supplement.⁶⁹

We are proposing to require disclosure of the relative rank of the credit rating within the credit rating agency's classification system and the credit rating agency's definition or description of the category in which the credit rating agency rated the class of securities. We believe this disclosure will help put the credit rating in its appropriate context and provide investors with important information about the credit rating agency's assessment of the degree of risk presented by the security.

Under the proposed amendments, a registrant would be required to disclose any material limitations on the scope of

the credit rating and how any contingencies related to the securities are or are not reflected in the credit rating. For example, a registrant would be required to disclose if the credit rating takes into account less than the promised return on a security. A residual security, for example, typically represents a beneficial interest in whatever cash flows remain in a pool of financial assets after obligations to pay all other outstanding classes have been satisfied. Sometimes, because of the highly speculative nature of these cash flows, a residual security incorporates a fixed promise to pay a nominal amount of principal to the residual holder in the early months of the securities' existence. The amount of the nominal fixed obligation may have no relationship to the amount paid for the residual security, nor to the anticipated residual cash flow. The credit rating for the residual interest represents only an evaluation of the likelihood that the nominal fixed obligation would be paid. It does not evaluate whether there will be any residual cash flow. Under the proposed rule, such a limitation would be required to be disclosed. We believe this type of disclosure would help investors understand what the rating is intended to cover, and, just as importantly, the limitations on the rating issued. In addition, if the security is subject to contingent payment obligations, registrants would be required to disclose how those contingencies are reflected in the credit rating. We believe these requirements will provide investors with better information so that they can make important distinctions about the nature of risks presented by securities with the same or similar ratings.

If the credit rating includes a related published designation, such as non-credit payment risk assessments, volatility assessments or other analyses performed by the credit rating agency that do not solely reflect credit risk, the proposed amendments would require a description of the additional analysis, so that investors relying on the designation are not left unaware of the related evaluation. For example, the related evaluations covered by such designation could include an analysis of prepayment speeds, effects of interest rates or other market based factors, or volatility assessments done in connection with a credit rating.⁷⁰ We

believe disclosure of these published designations together with a description of the analysis would provide meaningful additional information to investors regarding the information taken into consideration by the credit rating agency. We also believe disclosure of these related designations would signal to investors that significant differences may exist between a security with a credit rating that includes a published designation indicating that an evaluation of additional risk was done by the credit rating agency and a security with a similar credit rating without such a designation. In addition, we believe disclosure of published designations would help investors understand the limitations on comparing credit ratings across different types of securities.

Under the proposed amendments, registrants would be required to disclose any material differences between the terms of the security as considered or assumed by the credit rating agency for purposes of determining the rating, the terms in the governing documents of the securities and the terms of the securities as marketed to investors. We believe this disclosure may allow investors to better evaluate the credit rating and the security to which it applies because they would understand if the credit rating was based on assumptions or terms different from the information provided to investors. For example, this item would require disclosure if the security was rated using a yield assumption which differs from the expected yield being disclosed to investors.

We have also proposed to require that registrants include a statement informing investors that a credit rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific class of securities to which it applies; and that investors should perform their own evaluation as to whether an investment in the security is appropriate. We believe this statement will alert investors to some of the limitations inherent in a credit rating so that the credit rating is placed in an appropriate context.

Under the proposed amendments, a closed-end fund would be required to

⁶⁸ See proposed amendments to Item 202(g) of Regulation S-K, Item 12 of Form 20-F, and Item 10.6 of Form N-2.

⁶⁹ The registrant could also disclose the credit rating in a free writing prospectus, such as a term sheet, as long as it was also included in the registration statement (including through disclosure in a prospectus supplement that becomes a part of the registration statement in accordance with Rule 430B).

⁷⁰ See e.g., Moody's Global Credit Policy, Rating Methodology, Updated Report on V Scores and Parameter Sensitivities for Structured Finance Securities (Dec. 2008), at <http://www.moodys.com> indicating that the evaluations are intended to address the degree of uncertainty underlying the assumptions made in determining ratings and how

sensitive the ratings are to changes in those assumptions); Fitch Ratings Structured Finance Global Criteria Report, Criteria for Structured Finance Loss Severity Ratings (Feb. 2009), at <http://www.fitchratings.com> indicating that a Loss Severity Rating is intended to indicate the relative risk that a security will incur a severe loss in the event of default).

include the disclosure concerning credit ratings in its prospectus, unless the prospectus relates to securities other than senior securities that have been rated by a credit rating agency, in which case such disclosure may be provided in the statement of additional information unless the rating criteria will materially affect the registrant's investment policies.⁷¹

For closed-end funds, current Item 10.6 of Form N-2 requires that, if a registrant discloses a rating assigned by an NRSRO in its prospectus, the registrant must briefly discuss the significance of the rating, the basis upon which ratings are issued, any conditions or guidelines imposed by the NRSRO for the registrant to maintain the rating, and whether or not the registrant intends, or has any contractual obligation, to comply with these conditions or guidelines. Current Item 10.6 also requires disclosure of the material terms of any agreement between the registrant or its affiliates and the NRSRO under which the NRSRO provides the rating. The proposed amendments would, if adopted, replace those requirements with the same disclosure requirements contained in proposed Item 202(g) of Regulation S-K, which, in some cases, are substantially similar to the current requirements and, in other cases, provide information that is intended to allow investors to more easily put the credit rating in its appropriate context than the disclosure requirements of current Item 10.6 of Form N-2.⁷² We are also proposing technical amendments to remove the current instructions to Item 10.6.⁷³

⁷¹ See proposed Instruction 4 to Item 10.6 of Form N-2. Cf. Item 10.6 of Form N-2 (similar current provision regarding inclusion of disclosure in statement of additional information).

⁷² Proposed Item 10.6 of Form N-2 is substantially similar to current Item 10.6 in that a registrant would be required to disclose the relative rank of the credit rating within the rating agency's overall classification system, the rating agency's definition or description of the category in which the rating agency rated the class of securities, all material scope limitations, how any contingencies related to the securities are or are not reflected in the credit rating, and any material differences between the terms of the securities as assumed or considered by the rating agency and (i) the minimum obligations of the security as specified in its governing instruments and (ii) the terms of the security as used in any marketing or selling efforts. Rather than require disclosure of the material terms of any agreement between the registrant or its affiliates and the NRSRO under which the NRSRO provides the rating as set forth in current Item 10.6, proposed Item 10.6 would require disclosure of the identity of the person compensating the rating agency for providing the rating and a description of any other non-rating services provided by the rating agency to the registrant or its affiliates and any fees paid for such non-rating services.

⁷³ The current instructions to Item 10.6 define NRSRO, cross-reference Rule 436(g)(1) under the

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- We have proposed to require disclosure similar to the disclosure recommended in Item 10(c) of Regulation S-K. Is there a better model for providing disclosure about credit ratings? Should we adopt a general rule that all material elements of a credit rating be disclosed and give examples of the types of information that should be disclosed? Does our proposed approach capture the information that investors would need to make informed investment decisions?

- Does the proposed disclosure requirement add too much weight to the credit rating?

- Non-investment company registrants would be required to make the Item 202(g) disclosures in their Securities Act and Exchange Act registration statements, and closed-end funds would be required to make similar disclosures in their Securities Act and Investment Company Act registration statements. Is disclosure about a registrant's credit ratings appropriate disclosure for such filings? Are there alternative or additional filings in which the disclosure should be made? Should we also require that similar disclosure be provided in any written selling materials that disclose the rating? Should this disclosure be recommended rather than required?

- Is there another means that could be used to provide investors with this information, and the information described below, when a credit rating is used in connection with a registered offering?

- Is the proposed disclosure regarding credit ratings adequate to provide investors with sufficient information to be able to understand the ratings assigned by a credit rating agency and to understand the limitations associated with a rating? Is there other information that would be useful?

- As proposed, Item 202(g) and Item 10.6 of Form N-2 include a list of specific items that must be disclosed about the credit rating. Is this approach appropriate? Should we also include a "catch-all" provision that would require any other information necessary to understand the credit rating? Would including a catch-all help to assure that our rules will be flexible enough to elicit material information about credit ratings, as securities and credit ratings change in response to innovations and market developments? Would Rule 408 under the Securities Act be sufficient to

capture any additional material information?⁷⁴

- Should our proposed disclosure distinguish between corporate debt and structured finance products? Is there different information that would be relevant for ratings of corporate debt and structured finance products? Should we require disclosure of the differences in risk characteristics between corporate debt and structured finance products? Is this information already available to investors in all cases?

- Would investors benefit from the disclosure of the relative rank of the credit rating within the credit rating agency's classification system and the credit rating agency's definition or description of the category in which the credit rating agency rated the class of securities? Is there other or additional information that would assist investors in placing the credit rating in context?

- In addition to requiring the disclosure about a credit rating that currently is recommended in Item 10(c) of Regulation S-K, proposed Item 202(g) of Regulation S-K, Item 12 of Form 20-F and Item 10.6 of Form N-2 would require disclosure of all material scope limitations of the rating, how any contingencies are or are not reflected in the credit rating and any related designation (or other published evaluation) of non-credit payment risks assigned by the rating agency with respect to the security. Would this additional disclosure assist investors in better understanding the credit rating and assessing the risks of an investment in the security? What additional disclosure would be helpful to investors in making these assessments?

- As noted above, under proposed Item 12 to Form 20-F, foreign private issuers would be required to provide the same disclosure that would be required by proposed Item 202(g) of Regulation S-K for domestic issuers. Is this type of ratings information disclosed by foreign private issuers in their home jurisdictions? Should foreign private issuers be required to provide this type of information? Is there a basis on which to distinguish between foreign private issuers and other registrants for this purpose? If so, please explain. Is there any other type of credit ratings information that foreign private issuers should disclose?

Securities Act, and cross-reference Item 10(c) of Regulation S-K.

⁷⁴ 17 CFR 230.408. Rule 408 provides that, in addition to the information expressly required to be included in a registration statement, the registrant is required to include any additional material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

- As proposed, a registrant would be required to disclose additional information about any published designation that reflects the results of any other evaluation done by a credit rating agency. Should we require disclosure for any evaluation by a credit rating agency that is communicated to the registrant, regardless of whether it is published? Do credit rating agencies communicate information of this type to the registrant? If so, what types of information would this cover?

- We are proposing to require registrants to disclose any material differences between the terms of the security as assumed or considered by the credit rating agency in rating the security and (i) the minimum obligations of the security as specified in the governing instruments, and (ii) the terms of the security as marketed to investors. Would this disclosure be helpful to investors in making an investment decision?

- Does the proposed requirement that registrants include a statement informing investors that a credit rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific class of securities to which it applies; and that investors should perform their own evaluation as to whether an investment in the security is appropriate provide meaningful information to investors? Would this statement help to place the credit rating in an appropriate context? Why or why not?

- Are the proposed disclosure requirements appropriate for closed-end funds or should they be modified? Should we instead, or in addition, require all or any of the disclosures that are enumerated in current Item 10.6 of Form N-2? For example, should we expressly require disclosure of the basis upon which ratings are issued by the credit rating agency or disclosure of any conditions or guidelines imposed by a credit rating agency for the registrant to maintain a credit rating? Is it appropriate, as proposed, to permit closed-end funds to include the proposed disclosure in the statement of additional information, rather than the prospectus, if the prospectus relates to securities other than senior securities of the registrant that have been rated by a credit rating agency unless the rating criteria will materially affect the registrant's investment policies?

(b) Potential Conflicts of Interest

We also are proposing to require disclosure regarding credit ratings that

would address potential conflicts of interest.⁷⁵ Specifically, our proposed rules would require disclosure of the identity of the party who is compensating the credit rating agency for providing the credit rating. In addition, if during the registrant's last completed fiscal year and any subsequent interim period up to the date of the filing, the credit rating agency or its affiliates has provided non-rating services to the registrant or its affiliates, the proposed rules would require a description of the other non-rating services and separate disclosure of the fee paid for the credit rating required to be disclosed and the aggregate fees paid for any other non-rating services provided during such period.

We believe that the proposed disclosure regarding fees and services would alert investors to potential conflicts of interest that may have influenced the rating decision of the credit rating agency. We believe investors should know who paid for the rating since that may influence their assessment of the impartiality of the credit rating agency in assigning the rating. For example, many of the NRSROs are paid by the registrants for whom they are providing the credit

⁷⁵ There are rules applicable to NRSROs currently in place that are designed to address certain conflicts of interest of NRSROs. Pursuant to Exchange Act Rule 17g-5 [17 CFR 240.17g-5], an NRSRO must disclose and manage certain conflicts of interest, while certain other conflicts are prohibited outright. Paragraph (b) of Rule 17g-5 identifies nine types of conflicts to be disclosed and managed by an NRSRO, including a new type of conflict being adopted today by the Commission in a companion adopting release: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument. Paragraph (c) of Rule 17g-5 identifies seven conflicts of interest that are prohibited outright, including three added by the Commission in February 2009: issuing or maintaining a credit rating with respect to an obligor or security where the NRSRO or a person associated with the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security; issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining or approving credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models; and issuing or maintaining a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value greater than \$25.

rating. This business model can create a conflict of interest because the NRSRO providing the credit rating may be concerned that if it issues a lower rating than the registrant expects, the registrant would no longer seek credit ratings from that NRSRO. As a result, an NRSRO that is paid by a registrant may have an incentive to give a higher credit rating than it would have if no potential conflict of interest existed. In addition, we believe that the disclosure we are proposing to require regarding non-rating services and related fees paid to the credit rating agency should help investors gauge whether the credit rating agency's decision may have been influenced by a desire to gain or retain other business from the registrant.⁷⁶

We are not proposing to require disclosure of the fee paid for the credit rating unless disclosure of other non-rating services is required as described above. We preliminarily believe that when no such other non-rating services are provided, disclosure of the source of the payment for the rating as proposed would sufficiently convey the potential conflict of interest. We are requesting comment, however, on whether we should require the amount of the fee to be disclosed in all cases.⁷⁷

Request for Comments

- We have proposed to require disclosure of information related to the party paying for the rating, as well as any additional non-rating services provided by the credit rating agency or its affiliates to the registrant or its affiliates. Would the proposed disclosure provide helpful information for investors in order for them to judge whether potential conflicts of interest may have impacted the rating? Is the provision of other services indicative of

⁷⁶ See note 21 above.

⁷⁷ In a companion proposing release, the Commission is also today proposing a new rule that would require an NRSRO, on an annual basis, to make publicly available on its Internet Web site a consolidated report that shows three items of information with respect to each person that paid an NRSRO to issue or maintain a credit rating; specifically, (1) the percent of the net revenue attributable to the person that was earned by the NRSRO for that fiscal year from providing services and products other than credit rating services; (2) the relative standing (top 10%, top 25%, top 50%, bottom 50%, and bottom 25%) of the person in terms of the person's contribution to the total net revenue of the NRSRO for the fiscal year as compared with other persons who provided the NRSRO with revenue; and (3) all outstanding credit ratings paid for by the person. The proposed rule also would provide that the NRSRO must include a generic disclosure statement each time the NRSRO publishes a credit rating or credit ratings indicating where on its Internet Web site the consolidated report is located. See the proposing release considered by the Commission on September 17, 2009 related to proposed new Rule 17g-7 under the Exchange Act.

potential conflicts of interest? Would requiring disclosure regarding other services decrease the other services being provided? Would that have an effect on the quality of ratings? If so, how? Is there other disclosure that would provide additional or better information regarding potential conflicts of interest? If so, what information would provide investors the ability to assess potential conflicts of interest?

- Is the information that we have proposed to require meaningful? Should we require additional context such as the percentage of revenue that the NRSRO or other credit rating agency earns from the registrant so that an investor would be aware of when a registrant accounts for a significant percentage of the NRSRO's revenue? Would requiring disclosure only if non-rating services are provided place too much emphasis on the mix of revenue that the registrant provides to the credit rating agency, rather than the total revenue earned from the registrant? In proposed Exchange Act Rule 17g-7, the Commission is proposing to require that NRSROs publish a report on an annual basis with respect to each person that paid an NRSRO to issue or maintain a rating disclosing (1) the percent of the net revenue attributable to the person that was earned by the NRSRO for that fiscal year from providing services and products other than credit rating services; (2) the relative standing (top 10%, top 25%, top 50%, bottom 50%, and bottom 25%) of the person in terms of the person's contribution to the total net revenue of the NRSRO for the fiscal year as compared with other persons who provided the NRSRO with revenue; and (3) all outstanding credit ratings paid for by the person. Should registrants be required to disclose the aggregate fees paid by the registrant to the credit rating agency for ratings and non-rating services, regardless of whether non-rating services have been provided, and the relative standing of the registrant in terms of the registrant's contribution to the total net revenue of the credit rating agency in registration statements? If we were to require this disclosure, should it be updated to the date of the registration statement instead of being provided as of the end of the last fiscal year? Would registrants have access to this information? If not, could they negotiate with the credit rating agency so that this information could be obtained from the credit rating agency, such as through the contract for services? What would the costs of providing such disclosure be? Would requiring this disclosure affect a registrant's ability to obtain a rating or

to raise capital? Would investors benefit from having this information in the registration statement?

- Our proposed disclosure requirements relate only to fees paid to the credit rating agency. We are aware that there are other relationships that could present potential conflicts of interest. Item 509 of Regulation S-K⁷⁸ currently requires disclosure by a credit rating agency that is not an NRSRO when it (i) is paid on a contingent basis, (ii) has a substantial direct or indirect interest in the registrant, or (iii) has a connection to the registrant as a promoter, underwriter, officer, director or employee or voting trustee. Is this disclosure sufficient, or should there be a more specific disclosure requirement? For example, Exchange Act Rule 17g-5(a) and (b) provides that certain conflicts are permitted if they are disclosed and managed by the NRSRO. Such permitted conflicts include: Conflicts related to being paid by issuers for rating and non-rating services; conflicts related to subscription based services; conflicts related to ownership interests in entities being rated by the NRSRO; conflicts related to business relationships with issuers being rated by the NRSRO; conflicts related to the NRSRO having a broker or dealer associated with it; and any other conflict that would be material to the NRSRO. Should registrants be required to disclose conflicts: Conflicts related to being paid by a registrant for rating and non-rating services, regardless of whether non-rating services are being provided, paying the credit rating agency for subscription-based services, any ownership interest by the credit rating agency in the registrants or its affiliates, any business relationships between the credit rating agency and the registrant and its affiliates, any interest the credit rating agency has in a broker or dealer associated with it and any other material conflicts? Would all of the information be relevant to investors? Would registrants have access to this information? If not, could they negotiate with the credit rating agency so that this information could be obtained from the credit rating agency, such as through the contract for services? Rule 17g-5 currently requires annual reporting by NRSROs of these conflicts. If registrants were also required to disclose these types of conflicts, should we require the disclosure to be updated to the date of the registration statement? What would the costs of providing such disclosure be? Would requiring this disclosure affect a registrant's ability to obtain a rating or to raise capital? Would

investors benefit from having this disclosure in the registration statement?

- Exchange Act Rule 17g-5(c) provides a category of conflicts that an NRSRO is prohibited from having with respect to a credit rating. These prohibited conflicts include: Providing a rating to an entity that accounted for 10% or more of the NRSRO's net revenue; direct ownership interests by the NRSRO or an analyst preparing the rating in the issuer; issuing or maintaining a rating on a person associated with the NRSRO; issuing or maintaining a rating where a person determining or approving the rating is an officer or director of the issuer; issuing or maintaining a rating where the NRSRO made recommendations with respect to the structure of the rating; issuing or maintaining a rating where the fee for such rating was discussed or negotiated by a person at the NRSRO with responsibility for determining or approving the rating; and issuing or maintaining a rating where a person determining or approving the rating received gifts in excess of \$25. These prohibitions are only applicable to NRSROs. To the extent not otherwise required to be disclosed by Item 509 of Regulation S-K, should we require disclosure of the conflicts described above if credit rating agencies that are not NRSROs provide a rating to a registrant and if these conflicts exist or have existed during the registrant's previous two fiscal years through the date of the registration statement so that investors would be aware of such conflicts? Would registrants have this information? If not, could they negotiate with the credit rating agency so that this information could be obtained from the credit rating agency, such as through the contract for services? What would the costs of providing such disclosure be? Would requiring this disclosure affect a registrant's ability to obtain a rating or to raise capital? Would investors benefit from having this disclosure in the registration statement?

- Are there competitive or proprietary concerns that the proposed disclosed requirements should account for? If so, how? For example, will disclosing fees have any effect on the ability to negotiate for services?

- If non-rating services have been provided to the registrant or any of its affiliates by the credit rating agency or any of its affiliates, we have proposed to require a description of the other non-rating services and separate disclosure of the fee paid for the credit rating and the aggregate fees paid for any other non-rating services provided by the credit rating agency or its affiliates

⁷⁸ 17 CFR 229.509.

during the registrant's last completed fiscal year and any subsequent interim periods up to the filing date. Should we require disclosure for fees paid over a longer period such as two or five years? Should we require disclosure of fees for non-rating services that have been contracted and paid for but not yet delivered? Should we require disclosure for services that have been proposed or solicited but not yet finalized?

- Should we require disclosure of fees paid by the underwriter or its affiliates to the credit rating agency or its affiliates for non-rating services if the underwriter is the party paying for the rating? Should we require disclosure about services provided by the credit rating agency to the underwriter if the underwriter is paying for the rating? Should the underwriter be treated as acting on behalf of the issuer in such circumstances? Would the registrant be able to obtain this information? If not, should we consider initiating rulemaking to provide that underwriters shall make this information available to issuers upon reasonable request? Is there any additional information regarding credit rating agency fees that would be important to investors? Should we require disclosure of any current or anticipated arrangements or agreements regarding future services? If so, should we require an estimate of the fees to be paid for such services?

- Under our proposal, disclosure of fees would not be triggered if the services in addition to the credit rating are other credit rating services, such as fees to rate another security of the registrant. Is this approach appropriate? Do fees for other credit rating services raise conflict of interest issues similar to fees for non-rating services? Is the distinction between a credit rating service and a non-credit rating service sufficiently clear? Should we provide further guidance on this point? Should we reference the categories in Form NRSRO in this regard?

- Should we require disclosure of the fee paid for the credit rating regardless of whether additional services have been provided? Would this disclosure provide information that is important in evaluating potential conflicts of interest inherent in the issuer-paid ratings model? Is the information useful without additional context, such as the significance of the fee to the credit rating agency? If context is necessary to make the disclosure of fees meaningful, should we require disclosure of the significance of the fee to the credit rating agency? For example, should we require a registrant to disclose the percentage of revenue derived from the

fee?⁷⁹ Would registrants have access to this information? Is there other information that would convey the significance of the fee to the credit rating agency? Should we require registrants to disclose the total amount of rating-related fees paid to the credit rating agency during the most recent fiscal year completed and any interim periods? During the two most recent fiscal years (or longer?) completed and any interim periods?

- Would disclosure of fees paid to credit rating agencies affect the amount of fees charged, or otherwise affect the competitive landscape for credit rating agencies?

- We note that there may be other factors that could influence the independence of the credit rating agency, such as a reliance on underwriters that refer business to the credit rating agency or the general importance of a particular registrant to the credit rating agency. Should we require disclosure of these sorts of relationships?

(c) Ratings Shopping

Reports that registrants, or persons acting on behalf of registrants, may engage in "ratings shopping" raise serious issues about the integrity of the credit ratings process.⁸⁰ We believe investors should be made aware of when a registrant (or a person acting on a registrant's behalf) may have engaged in ratings shopping.⁸¹ It is our understanding that ratings shopping occurs because registrants, among others, can solicit preliminary credit ratings from a rating agency. If the registrant believes the preliminary rating is too low, the registrant can seek a different credit rating from another credit rating agency.⁸² When a registrant can choose which ratings to disclose, including which final ratings to disclose, we believe the registrant will most likely choose the most favorable rating. If less favorable ratings are not

disclosed, then investors may not have access to potentially important information that may suggest that the credit rating that is disclosed may be inflated.⁸³ Similarly, when the credit rating agency knows that the registrant will likely choose to use the credit rating agency that provides the most favorable rating, there may be an incentive for ratings to be inflated by the credit rating agency in order to keep the business of the registrant. Currently, our rules do not require disclosure of any credit ratings, whether preliminary or not. As a result, investors are not aware of when registrants seek a preliminary rating or when registrants obtain additional credit ratings but choose not to use them, and investors are not aware of any differences between the preliminary rating and the final rating.

We are proposing that if a registrant has obtained a credit rating and is required to disclose that credit rating, then all preliminary ratings of the same class of securities as the final rating that are obtained from credit rating agencies other than the credit rating agency providing the final rating must also be disclosed. In addition, we are proposing that if a rating is disclosed pursuant to the trigger described above, then any credit rating obtained by the registrant but not used must also be disclosed. We believe this disclosure requirement would provide investors with important information to assess whether any ratings shopping may have occurred, and whether any rating inflation may have occurred between the preliminary rating and the final rating obtained by a registrant as a result of the ratings shopping, or whether the registrant has other credit ratings that it has not used in connection with the offering.

We have not proposed to require disclosure of preliminary ratings obtained by a registrant from the credit rating agency that issues the final rating. We are concerned that such a disclosure requirement may impede useful communications between credit rating agencies and registrants as the credit rating agencies determine their initial ratings and perform continuing work related to monitoring the rating. In addition, there are rules applicable to NRSROs that are intended to prevent some of the problematic practices in this area. For example, Rule 17g-5 under the Exchange Act prohibits an NRSRO from issuing or maintaining a rating where it made recommendations with respect to the structure of the security.

When disclosure of any preliminary rating or unused final rating is required,

⁷⁹ See note 77 above.

⁸⁰ See note 24 above.

⁸¹ In this regard, we note that three of the largest NRSROs entered into an agreement with the Attorney General for the State of New York in June 2008 that provides for certain disclosure regarding preliminary ratings. See Press Release, Office of the Attorney General, "Attorney General Cuomo Announces Landmark Reform Agreements with the Nation's Three Principal Credit Rating Agencies," (June 5, 2008), at http://www.oag.state.ny.us/media_center/2008/jun/june5a_08.html. Our proposed rule, however, would apply to all credit rating agencies. In addition, because our proposed rules apply to registrants, investors would be able to find disclosure regarding preliminary ratings on a registrant-by-registrant and offering-by-offering basis instead of having to search the disclosure of the NRSROs.

⁸² See Roger Lowenstein, *Triple-A Failure*, N.Y. Times Magazine, April 27, 2008.

⁸³ See Skreta and Veldkamp and Bolton, Freixas and Shapiro in note 24 above.

we are proposing to require similar disclosure as is proposed to be required for a final rating. Because preliminary ratings may vary in their form and level of detail, it is possible that all of the information required to be disclosed about a particular rating would not be available to the registrant. In preparing this disclosure, registrants would be able to rely on Securities Act Rule 409⁸⁴ if the information otherwise required to be disclosed cannot be obtained without unreasonable effort or expense.

We believe disclosure of preliminary ratings as described above would provide important information for investors about potential ratings shopping. We believe registrants could identify any preliminary ratings required to be disclosed in the registration statement in a manner that would avoid confusion for investors. For example, registrants could disclose any preliminary ratings under a separate sub-heading, or the registrant could include written disclosure as to the limitations of preliminary ratings.

For purposes of this proposed disclosure requirement, a credit rating, including a preliminary credit rating, generally would be obtained from a credit rating agency if it is solicited by or on behalf of a registrant from a credit rating agency. For these purposes, we would view an underwriter and others involved in structuring a deal, such as a sponsor or depositor, who obtains a credit rating, including a preliminary credit rating, for a deal structure to be acting on behalf of the registrant.

We intend for the phrase “preliminary credit rating” to be read broadly and to include any rating that is not published, any range of ratings, any oral or other indications of a potential rating or range of ratings and all other preliminary indications of a rating. We believe that a broad reading would better facilitate the purpose of the proposed disclosure in order to alert investors if the registrant has obtained indications of a rating from one credit rating agency but chooses to use a credit rating from another. We are not proposing to limit the required disclosure of preliminary ratings to ratings specific to the registrant. For example, a preliminary rating would include ratings on a particular structure of a security even if not tied to a specific registrant or pool of assets.⁸⁵ As proposed, disclosure of a

preliminary rating would be required even if there have been changes to the security for which a final rating is disclosed. We believe this disclosure would place the information about ratings in context.

Request for Comments

- Should we require disclosure of preliminary ratings, as proposed? Is there any other information regarding preliminary ratings that should be required to be disclosed? Would the rule as proposed capture all potential ratings shopping practices? As an alternative, should the rule require disclosure of contacts between the registrant and the credit rating agency as a means of disclosing preliminary ratings and negotiations between the registrant and the credit rating agency?⁸⁶ Would the rule reduce the number of preliminary ratings sought?

- We have expressed our concerns about ratings shopping by registrants and the potential for credit rating agencies to use less conservative rating methodologies in order to gain or retain business, presumably lessening the value of the ratings. As proposed, a registrant would only be required to provide disclosure of a preliminary rating if it is of the same class of securities as a final rating otherwise required to be disclosed by the rule and is received from a credit rating agency other than the credit rating agency providing the final rating. Are these limitations appropriate? Are there circumstances where disclosure of preliminary ratings would be important even if a final rating was never obtained? Should we require disclosure of all preliminary ratings obtained by a registrant, including from the credit rating agency that issues the final rating?

- We have proposed to require disclosure of unused final credit ratings obtained by a registrant if a credit rating is otherwise disclosed pursuant to the proposed rules so that investors would be aware of any potential ratings shopping by the registrant in choosing which credit rating to use. Would this provide important information for investors? Do registrants ever obtain

the assets, although certain criteria for the assets could be outlined. The preliminary rating that is assigned to the structure would need to be disclosed under our proposal if a rating is used in connection with a registered offering of securities by the underwriter with that structure.

⁸⁶ For example, in the context of roll-up transactions, Item 911(a)(5) of Regulation S-K [17 CFR 229.911(a)(5)] requires disclosure of any contacts between the sponsor or general partner and a third party providing a report, opinion or appraisal on the roll-up transaction. *See also* Item 1005 of Regulation M-A [17 CFR 229.1105].

final ratings but not use them? Why might a registrant choose not to use a credit rating? Would requiring disclosure of such ratings reveal potential ratings shopping practices of registrants? If not, is there other disclosure that would elicit disclosure about potential ratings shopping?

- Would requiring the proposed disclosure for preliminary or unused final ratings enhance investors' understanding of, and therefore the value of, the ratings? Would such disclosure help to address our concerns with ratings shopping? If you do not believe such disclosure would be helpful, how would you suggest that we address these concerns? Is disclosure of an indication from a credit rating agency of a likely or possible rating appropriate? What effect would our proposed rule have on ratings shopping? Would it encourage or discourage the practice? Why?

- To the extent that a preliminary rating that would be required to be disclosed pursuant to the proposed rule is not based on final and full information, to what extent would disclosure of such preliminary rating present a risk that investors could form a mistaken impression about the credit quality of the security or the registrant's ratings shopping?

- How would our proposed rule affect communications between registrants and credit rating agencies? Would the proposed requirement result in fewer discussions between credit rating agencies and registrants? Would it affect the quality of information provided by registrants to obtain a rating?

- What types of activities might replace the issuance of preliminary ratings if the proposed rule is adopted? To what extent might some alternative ratings shopping behavior develop?

- Would the proposal have a negative impact on smaller or newer credit rating agencies? Would smaller or newer credit rating agencies have a difficult time establishing their market position if registrants no longer seek multiple preliminary ratings? For example, would registrants be less likely to engage in initial conversations with smaller or newer credit rating agencies in order to understand their methodologies and procedures if we require the disclosure of preliminary ratings?

- How would changes in the structure of a security affect disclosure of preliminary ratings? Would it be difficult for registrants to track preliminary ratings?

- As proposed, a credit rating, including a preliminary credit rating, would be “obtained” if it is solicited by

⁸⁴ 17 CFR 230.409.

⁸⁵ For instance, an underwriter may approach a rating agency about a newly developed or refined structure for an asset-backed offering of a certain class of assets generally. In some cases, the rating agency may be asked to provide an indication of a rating on that structure without knowledge of the specific pool assets or names of the originators for

or on behalf of a registrant from a credit rating agency. Is this sufficient to capture all of the preliminary ratings sought from other credit rating agencies?

- Should we include additional guidance as to what constitutes a preliminary rating? Would additional guidance allow registrants and credit rating agencies to structure their dealings to avoid disclosure? Are there less formal preliminary indications given by credit rating agencies that should be included in the required disclosure? Would requiring disclosure of preliminary ratings interfere with other types of communications between registrants and credit rating agencies, such as discussions related to surveillance or maintenance ratings that credit rating agencies may provide on other classes of securities issued by the same registrant for which credit ratings have been provided? If so, how should we address this concern? Would the broad view of “preliminary credit rating” as proposed interfere with any non-rating services provided to the registrant? If so, how could we address this?

- Are there any concerns about the availability of the information about preliminary ratings that we are proposing registrants be required to disclose? Would credit rating agencies object to registrant’s disclosure of preliminary ratings where no compensation was paid to the credit rating agency?

- Would disclosure of preliminary ratings have negative effects for investors, registrants or credit rating agencies? For example, would investors be confused by disclosure of preliminary ratings? Would disclosure of preliminary ratings be confusing or misleading? If so, how could we revise the proposal to reduce the risk that investors would be confused or misled? Would credit rating agencies change their practices if preliminary ratings are required to be disclosed? If so, how might their practices change?

- Should our proposed disclosure regarding preliminary ratings distinguish among issuers of corporate debt, structured finance products and/or closed-end funds? Do corporate issuers, issuers of structured finance products and closed-end funds engage in ratings shopping equally or in the same manner? What are the differences? Is there different information regarding preliminary ratings that would be relevant for corporate debt, structured finance products and closed-end funds?

D. Disclosure in Exchange Act Reports

We are proposing to amend Exchange Act reports and rules to require a

registrant to provide investors with updated disclosure regarding changes to a previously disclosed credit rating.

If a credit rating that was previously disclosed under the rules proposed above has been changed, including when a rating has been withdrawn or is no longer being updated, that change would be required to be disclosed in a current report on Form 8-K.⁸⁷ We are proposing a new item requirement to Form 8-K, which would require a registrant (including a closed-end fund) to file a report within four business days of receiving a notice or other communication from any credit rating agency, that the organization has decided to change or withdraw a credit rating assigned to the registrant or any class of debt or preferred security or other indebtedness of the registrant (including securities or obligations as to which the registrant is a guarantor or has a contingent financial obligation) or take any similar action with respect to a credit rating that was previously disclosed pursuant to proposed Item 202(g) of Regulation S-K or proposed Item 10.6 of Form N-2.

As discussed above, we previously proposed in 2002 to require disclosure in current reports of changes in credit ratings when we amended the item requirements for current reports on Form 8-K. We did not adopt the proposal at the time.⁸⁸

Under the proposed item, the registrant would have to disclose the date that the registrant received the credit rating agency’s notice or communication, the name of the rating agency, and the nature of the rating agency’s decision. We are not proposing to require the registrant also discuss the impact of the change or other decision on the registrant, though it would be permitted to do so. Rather, consistent with similar Form 8-K items, we believe that a discussion of any material impact of the change in credit rating would be required to be disclosed in a registrant’s periodic reports.⁸⁹ We believe this

⁸⁷ As discussed in this section, we are proposing that foreign private issuers be required to provide disclosure regarding credit rating changes in their annual reports on Form 20-F. As a result, the disclosure for foreign private issuers would not be required to be made within four business days of the rating change.

⁸⁸ See note 39 above and the related discussion.

⁸⁹ When revisions were adopted to the 8-K reporting requirements in 2004, the Commission noted that it was not adopting requirements for certain new items such as Item 2.04—Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement that would have required registrants to provide a management’s analysis of the change to be included in the Form 8-K. The Commission noted that the analysis might be difficult to provide in the time period required for

would provide the registrant with additional time to analyze the impact of the rating change to the registrant between the filing of a current report and the filing of its next periodic reports. We note, though, that a change in a credit rating may require the registrant to make related disclosures under other Form 8-K items, such as Item 2.04—Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement.

Disclosure under this item would not be required until the rating agency notifies the registrant that the rating agency has made a decision to change the credit rating. If the registrant is still in negotiations or appealing a preliminary indication that a credit rating agency intends an action covered by the proposed item, no disclosure would be required. However, once good faith negotiations and appeals cease, disclosure would be required.

As noted above, we believe the application of our current rules would require a registrant to disclose in its periodic reports the impact on it, if material, of any change in a rating that was previously disclosed under the rules proposed above.⁹⁰ For example, if a credit rating agency withdraws or stops updating a rating, the registrant would be required by the proposed amendment to disclose that fact in a current report on Form 8-K, and our current rule requirements would require the registrant to discuss the impact of the change on the company, if material, either in MD&A or in an appropriate location in its next periodic report.

We have proposed to limit the disclosure regarding changes to a credit rating in a current report to credit ratings that were disclosed previously pursuant to the rules we propose today. Thus, a registrant would not be subject to the new requirement to disclose changes to credit ratings that were obtained or used prior to the effectiveness of any new disclosure requirements adopted as a result of this proposal. We believe this distinction

the filing of the 8-K and that the analysis might be more relevant and complete in the context of financial statements. The Commission reminded registrants, however, that any disclosure made in a report on Form 8-K must include all other material information, if any, that is necessary to make the required disclosure, in the light of the circumstances under which it is made, not misleading. See *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date* in note 43 above.

⁹⁰ As proposed, this new item in Form 8-K would also be applicable to asset-backed issuers. However, such issuers are unlikely to have additional disclosure in their periodic reports because a change in a rating of an asset-backed issuer’s own securities typically does not affect that issuer.

strikes an appropriate balance between the burden on registrants in preparing the disclosure and the needs of investors for information about credit ratings. Although our new requirements would not be applicable in that setting, we note that disclosure of credit ratings and changes in ratings may be required in periodic reports under our current rules as discussed above.⁹¹

We are proposing to require closed-end funds to make the same disclosures regarding changes to a credit rating as other registrants because we believe that this information is of similar relevance to investors in closed-end funds and other registrants. Specifically, we propose to amend Exchange Act Rules 13a-11(b)⁹² and 15d-11(b)⁹³ to require a closed-end fund to file a current report on Form 8-K containing the disclosures regarding changes to a credit rating within the period specified in Form 8-K unless substantially the same information has been previously reported by the fund.⁹⁴

We are proposing to require foreign private issuers to provide disclosure regarding changes to a credit rating annually in their reports on Form 20-F. While the disclosure would not be required as frequently or timely as it would be for domestic issuers, investors would still have access to the information in a foreign private issuer's annual report.

In proposing these amendments, we recognize that credit rating changes can be important information to an investor in making investment and voting decisions. Credit rating agencies typically disclose rating changes publicly via press release at the same time or shortly after they notify affected companies of the changes. Therefore, investors already can obtain access to information about rating changes if they know where to find the press releases and are willing to routinely monitor these releases to find information about

particular companies and securities. However, we believe some investors may not routinely monitor all press releases issued by credit rating agencies and therefore likely would benefit from disclosure about ratings changes filed by companies on Form 8-K.

Once a credit rating agency stops rating the securities, a registrant would be required to disclose that information in a current report, update a prospectus if necessary, and include any relevant analysis in its next periodic report but would then have no further disclosure obligation related to that rating in subsequent filings.

Request for Comments

- As proposed, we would require disclosure about changes to previously disclosed credit ratings in a registrant's Exchange Act reports, including whether a rating has been withdrawn or will no longer be updated. Would the proposed disclosure provide helpful information for investors? Is there other information about ratings that would be more important to investors? For example, should we include a requirement that the reason for the change in rating be disclosed? Would the disclosure increase reliance on credit ratings? If so, how?

- We have proposed to limit the disclosure regarding changes to a rating to ratings previously disclosed pursuant to proposed Item 202(g) of Regulation S-K or proposed Item 10.6 of Form N-2. As a result, changes to ratings that were obtained prior to the effectiveness of the rule, if adopted, will not be required to be disclosed. Should we expand the scope of the proposed rule to require that all changes to ratings be disclosed regardless of whether they were disclosed previously? Would this create a burden on registrants not in the public interest? Why or why not? How could this information be disclosed at the least cost to registrants?

- Is a requirement to file a current report on Form 8-K necessary in view of the typical practice by credit rating agencies to promptly issue press releases about rating changes under the subscriber paid model? Is current disclosure by credit rating agencies through press releases adequate? Would investors benefit from having companies disclose this information in a uniform place?

- Could registrants provide an analysis of the credit rating change in a Form 8-K in the time allowed for filing a Form 8-K? How does this disclosure compare to disclosure of other matters such as the acceleration of a direct or off-balance sheet obligation where disclosure of the event is required in a

Form 8-K, and analysis of the impact is allowed to be deferred to the next periodic report?

- We believe our current rules would require registrants to discuss the significance of a credit rating change in its next periodic report if the impact would be material to the company. Are there circumstances where a credit rating change would not trigger disclosure in the next periodic report? Should we adopt an explicit requirement that any credit rating change disclosed on Form 8-K would be required to be analyzed and discussed in the following periodic report?

- We have proposed to require disclosure when a rating has changed. Should we also require disclosure of other ratings actions, such as placing an issuer on "credit watch" or assigning a different outlook to the registrant's rating? Are these actions viewed as important by investors? Would requiring this disclosure create a burden for registrants not in the public interest?

- The proposed disclosure would apply only to credit ratings originally used in connection with registered offerings. Are there reasons that disclosure should be limited to registered offerings? Should we require disclosure of credit ratings used in connection with private offerings? Are there any concerns regarding disclosure of credit ratings related to private offerings?

- Is it appropriate to require closed-end funds to file reports on Form 8-K disclosing credit rating changes? Instead of filing reports on Form 8-K, should closed-end funds be permitted to disclose changes to credit ratings through other methods, such as a different filing with the Commission or a notice posted on an internet Web site and/or issuance of a press release? Is there empirical or other evidence demonstrating that one or more of those other methods would provide better dissemination of the information with respect to closed-end funds? What would be the disadvantages, if any, of not requiring a filing that would be available in the Commission's EDGAR system?

- Is the content of the proposed disclosure requirements on Form 8-K appropriate for closed-end funds or should it be modified? Are there additional disclosures regarding changes to a credit rating that closed-end funds should be required to make? For example, closed-end funds are not required to include MD&A in their periodic reports. Should a closed-end fund be required to disclose in a Form

⁹¹ Disclosure may also be required pursuant to Exchange Act Rule 12b-20 [17 CFR 240.12b-20], which requires that in addition to the information expressly required to be included in a report, the report is required to include any further material information necessary to make the required statements, in the light of the circumstances under which they are made not misleading.

⁹² 17 CFR 240.13a-11(b).

⁹³ 17 CFR 240.15d-11(b).

⁹⁴ Under Regulation FD [17 CFR 243.100 *et seq.*], closed-end funds are currently required to make public disclosure of certain material information on Form 8-K unless they disseminate the information through other methods of disclosure that are reasonably designed to provide broad, non-exclusionary distribution of the information to the public. In addition, pursuant to Rule 104 of Regulation BTR [17 CFR 245.104], closed-end funds are required to file notice of a blackout period, if any, on Form 8-K.

8-K or Form N-CSR⁹⁵ the impact on it, if material, of any change in a credit rating that was previously disclosed under proposed Item 10.6 of Form N-2?

- Are the proposed amendments for foreign private issuers appropriate? Should they be modified? Are there additional disclosures that foreign private issuers should make? Is the information relevant to investors if it is only required in the next annual report?

II. General Request for Comments

We request and encourage any interested person to submit comments regarding:

- The proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors, and other market participants, including NRSROs and other credit rating agencies. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

In addition, we request comment on the following:

- Should the Commission include a phase-in for registrants beyond the effective date to accommodate pending offerings? As proposed, compliance with the new standards would begin on the effective date of the new rules. Will a significant number of registrants have their offerings limited by the proposed rules? If a phase-in is appropriate, should it be for a certain period of time (for example, six months or one year or longer) or only for the term of a pending registration statement?

III. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rule amendments contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 (PRA).⁹⁶ The Commission is submitting these proposed amendments and proposed rules to the Office of Management and Budget (OMB) for review in accordance with the PRA. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control

number. The titles for the collections of information are:⁹⁷

"Regulation S-K" (OMB Control No. 3235-0071);
 "Form S-1" (OMB Control No. 3235-0065);
 "Form S-3" (OMB Control No. 3235-0073);
 "Form S-4" (OMB Control No. 3235-0324);
 "Form S-8" (OMB Control No. 3235-0066);
 "Form S-11" (OMB Control No. 3235-0067);
 "Form 10" (OMB Control No. 3235-0064);
 "Form 8-A" (OMB Control No. 3235-0056);
 "Form 8-K" (OMB Control No. 3235-0060);
 "Form F-1" (OMB Control No. 3235-0258);
 "Form F-3" (OMB Control No. 3235-0256);
 "Form F-4" (OMB Control No. 3235-0325);
 "Form 20-F" (OMB Control No. 3235-0288); and
 "Form N-2" (OMB Control No. 3235-0026).

We adopted all of the existing regulations and forms pursuant to the Securities Act, the Exchange Act or the Investment Company Act. These regulations and forms set forth the disclosure requirements for registration statements and Exchange Act reports that are prepared by registrants to provide investors with information to make investment decisions in registered offerings and in secondary market transactions.

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collection of information. There is no mandatory retention period for the information disclosed, and the information disclosed would be made publicly available on the EDGAR filing system.

B. Summary of Collection of Information Requirements

We are proposing to amend Item 202 of Regulation S-K to mandate disclosure by registrants regarding their credit ratings in their registration statements when a credit rating is used in connection with a registered offering.

⁹⁷ The paperwork burden from Regulation S-K is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulation S-K.

We are proposing parallel amendments for closed-end funds and foreign private issuers. We are also proposing to amend Exchange Act reporting requirements to require disclosure when there has been a change to a previously disclosed credit rating.

If a credit rating is used by the registrant, a selling securityholder, an underwriter or a member of a selling group in connection with a registered offering, then the registrant would be required to provide information about the credit rating in the registration statement. Such information would include general information about the rating, including any scope limitations on the rating, the identity of the person paying for the rating, a description of any non-rating services provided to the registrant within a specified period of time, including disclosure of the fees paid for such non-rating services, and disclosure of preliminary ratings obtained from a credit rating agency other than the credit rating agency providing the final rating and unused final ratings. A registrant would also be required to update the prospectus if a final rating is changed or is not available until after the effectiveness of the registration statement.

We are also proposing amendments to Form 8-K (for operating companies and closed-end funds) and to Form 20-F (for foreign private issuers) to require disclosure of changes in a credit rating, including when the rating is no longer being updated or has been withdrawn. For operating companies and closed-end funds, the change in a credit rating would be required to be reported within four business days on Form 8-K. For foreign private issuers, disclosure would be required annually on Form 20-F.

The proposals would increase existing disclosure burdens for Exchange Act reports on Form 8-K and registration statements by requiring disclosure of credit ratings, whether or not issued by an NRSRO, in registrants' registration statements and reports.

C. Paperwork Reduction Act Burden Estimates

For purposes of the Paperwork Reduction Act, we estimate that over a three-year period the average annual incremental increase in the paperwork burden for non-investment company registrants to comply with our proposed collection of information requirements to be approximately 2,120 hours of in-house company personnel time and to be approximately \$816,000 for the

⁹⁵ 17 CFR 249.331; 17 CFR 274.128. Form N-CSR is the periodic reporting form used by registered management investment companies.

⁹⁶ 44 U.S.C. 3501 *et seq.*; 5 CFR 1320.11.

services of outside professionals.⁹⁸ For closed-end funds, we estimate the annual incremental increase to be approximately 157 hours of in-house company personnel time and approximately \$108,400 for the services of outside professionals. These estimates include the time and the cost of preparing and reviewing disclosure and filing documents. Our methodologies for deriving the above estimates are discussed below.⁹⁹

Our methodologies for deriving the burden hour and cost estimates presented below represent the average burdens for all registrants who are required to provide the disclosure, both large and small. For registration statements, we estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden is carried by outside professionals retained by the registrant at an average cost of \$400 per hour.¹⁰⁰ The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

Our estimates are based on the assumption that the proposed disclosure would add disclosure for a subset of affected registrants (*i.e.* those issuing rated securities). We further assume that the new disclosure requirement would not affect the number of registrants. For registration statements, we estimate that the proposed amendments would impose an average of a 60 minute burden of preparation carried by the company internally and a \$1,200 cost for outside professionals retained by the registrant reflecting three hours of their time. This estimate includes the time necessary to obtain the relevant information, including certain information that would likely be provided by the credit rating agency

such as the relative rank of the rating in the credit rating agency's classification system. Further, based on statistics related to the number of registration statements filed for debt offerings in fiscal years 2007 and 2008 from our Office of EDGAR Information and Analysis, we estimate that 500 registration statements on Forms S-1, S-3, and S-4 will be affected annually by the disclosure requirements.¹⁰¹ We have attempted to be conservative in our estimates of affected filings. We recognize that not all debt offerings have credit ratings associated with them; however, given the relatively low number of debt filings over the past two fiscal years, we have included most of those filings within our estimate. For closed-end funds, we also estimate that approximately 82 registration statements on Form N-2¹⁰² would be affected annually by the disclosure requirements. For purposes of Form 20-F, there would be an increased burden in Forms 20-F used as registration statements and as annual reports. There were an average of 77 Forms 20-F filed as registration statements in fiscal years 2007 and 2008. Based on a review of a

sample of these filings, we estimate that 20 Form 20-F registration statements would include the required disclosure and that 20 Form 20-F annual reports would include disclosure regarding changes to a credit rating.

For current reports on Form 8-K, including Forms 8-K filed by closed-end funds, we estimate that registrants spend, on average, five hours completing the form. We estimate that 75% of that burden is carried by the company while 25% is carried by outside counsel at a cost of \$400 per hour. In order to estimate the number of additional Form 8-Ks that would be required to be filed pursuant to our proposed amendments, we have looked to the number of Forms 8-K filed with disclosure pursuant to Item 2.04-Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement. We believe that many rating changes may also accelerate financial obligations, so that looking to Item 2.04 gives some indication of the number of Forms 8-K that may be filed even though it does not cover the same disclosure. For example, we are aware that Item 2.04 likely would not be triggered by a credit rating upgrade. We solicit comment on better ways to estimate the number of 8-Ks that would be filed pursuant to our proposed requirements. In our fiscal year 2007 and 2008, there were an average of 396 Forms 8-K filed pursuant to Item 2.04. In addition, based on publicly available information concerning changes in credit ratings of senior securities issued by closed-end funds occurring during calendar years 2007 and 2008, Commission staff estimates that approximately 20 additional Forms 8-K would be filed annually by closed-end funds pursuant to proposed Item 3.04. As a result, we estimate that 420 additional Forms 8-K would be filed pursuant to proposed Item 3.04.

Table 1 below illustrates the incremental annual compliance burden in the collection of information in hours and cost for current reports and registration statements.¹⁰³

¹⁰³ The number of responses for Form N-2 reflected in the table equals the actual number of forms filed with the Commission during the 2008 fiscal year. This amount is an increase from the current approved number of annual responses to Form N-2 of 200.

¹⁰¹ All of the registration statements would be required to contain the proposed disclosure if the proposed trigger for the disclosure has been satisfied. We have assumed for purposes of this PRA analysis that the distribution of the estimated 500 filings will be proportional to the number of Forms S-1, S-3 and S-4 registration statements filed for debt offerings with approximately 60% of filings on Form S-3, 20% on Form S-1, and 20% on Form S-4. We have not included estimates for Form 10, Form S-8 and Form S-11 as we believe a negligible number of registrants use those forms to register debt securities.

¹⁰² Based on Commission filings, we estimate that there are approximately 802 active registered closed-end funds and approximately 205 annual responses to Form N-2. According to statistics maintained by the Investment Company Institute, approximately 322 of these closed-end funds have issued senior securities. See Investment Company Institute, Total Net Assets of Closed-End Funds, 2009: Q1, available at http://www.ici.org/pdf/cef_q1_09_sup_tables.pdf (last visited on Aug. 17, 2009) (showing data as of Mar. 31, 2009). Based on the proportion of the number of closed-end funds that have issued senior securities to the total number of active registered closed-end funds, we have assumed, for purposes of the PRA, that approximately 40% (322 divided by 802) of the annual Form N-2 responses will involve closed-end funds that have issued senior securities. We have further assumed that all closed-end funds issuing senior securities also will be required to disclose credit ratings in their registration statements under the proposed amendments. Therefore, we estimate that approximately 82 (40% of 205) registration statements on Form N-2 filed annually would include disclosure of credit ratings under the proposed amendments.

⁹⁸ We calculated an annual average over a three-year period because OMB approval of Paperwork Reduction Act submissions covers a three-year period. For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest whole number and the cost totals have been rounded to the nearest thousand.

⁹⁹ The estimates reflect the burden of collecting and disclosing information under the PRA. Other costs associated with the proposed amendments are discussed in Section IV below.

¹⁰⁰ We estimate an hourly rate of \$400 as the average cost of outside professionals that assist registrants in preparing disclosure and conducting registered offerings.

Form	Current Annual Responses	Proposed Annual Responses	Current Burden Hours	Increase in Burden Hours	Proposed Burden Hours	Current Professional Costs	Increase in Professional Costs	Proposed Professional Costs
8-K	108,424	108,844	406,590	1,575	408,165	\$54,212,000	\$210,000	\$54,422,000
20-F	942	942	614,891	120	615,011	\$737,868,600	\$16,000	\$737,884,600
S-1	768	768	182,392	100	182,492	\$218,870,800	\$120,000	\$218,990,800
S-3	2,065	2,065	236,959	300	237,259	\$284,350,500	\$360,000	\$284,710,500
S-4	619	619	628,904	100	629,004	\$754,686,601	\$120,000	\$754,806,601
N-2	200	205	86,468	82	86,550	\$3,531,600	\$98,400	\$3,630,000
Total	113,018	113,443	2,156,204	2,277	2,158,421	\$2,053,520,101	\$924,400	\$2,054,444,501

D. Solicitation of Comments

We request comments in order to evaluate: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the burden of the proposed collection of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.¹⁰⁴

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. S7–20–09. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–20–09, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE., Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days

after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IV. Cost-Benefit Analysis

A. Proposed Amendments

The proposed amendments would require disclosure regarding credit ratings by registrants in their registration statements under the Securities Act, Exchange Act and Investment Company Act if the registrant uses the rating in connection with the offer or sale of securities in a registered offering. Under proposed new paragraph (g) to Item 202 of Regulation S–K, Item 12 of Form 20–F and Item 10.6 of Form N–2, registrants would be required to disclose much of the specific disclosure currently permitted under Item 10(c) of Regulation S–K. The proposal would require disclosure of all material scope limitations of the credit rating and any related published designation, such as non-credit payment risks, assigned by the rating agency with respect to the security. The proposed changes would also require disclosure of the source of the payment for the credit rating. If any non-rating services have been provided by the credit rating agency to the registrant, disclosure of the fees paid for those services also would be required, so that investors would be aware of potential conflicts of interest with respect to the credit rating used by the registrant. Under the proposed amendments, if a registrant is required to disclose a credit rating, then it would also be required to disclose all preliminary ratings and unused final ratings it received from rating agencies other than the credit rating agency that provided the final rating. This disclosure is intended to provide investors with useful information to assess whether a registrant may have engaged in ratings shopping. In

addition, we are proposing to amend Exchange Act reports to require disclosure of a change in previously disclosed credit rating.

The additional information and transparency provided by our proposed amendments are intended to help provide investors with the information they need about credit ratings to put the rating in the appropriate context. The proposed amendments are aimed at addressing concerns that investors may not have sufficient information to understand the scope or meaning of ratings being used to market various securities, that they may not fully appreciate the potential conflicts of interest faced by credit rating agencies and how these conflicts may impact ratings, that ratings shopping may be occurring and may be leading to inflated ratings, and that our current disclosure rules do not require certain basic information about a potentially key element of their investment decision.

The proposed amendments may affect economic behavior if the amendments alter (a) the use of ratings by investors, (b) registrants' security issuance and ratings-seeking behavior, and (c) the credit rating agencies' behavior when providing ratings. These effects will likely vary depending on the asset class (e.g., corporate issues, structured finance products), the type of the registrant (e.g., corporate registrant, sponsor of the financial product, closed-end funds), the type of credit rating agency (e.g., subscriber-paid rating agencies, issuer-paid NRSROs, unregistered credit rating agencies), the type of investor (e.g., retail investors, institutional investors), and the ongoing changes in the regulatory environment. The economic benefits and costs on market participants associated with these economic effects are discussed below.

¹⁰⁴ We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

B. Benefits

Benefits to investors resulting from increased contextual information about ratings

The proposed amendments would require disclosure of information related to the rating used in a registered offering, such as the relative rank of the credit rating within the assigning credit rating agency's overall classification system, all material scope limitations of the rating, and any published designation that reflects the results of any other evaluation done by the credit rating agency in connection with the credit rating. Some investors may benefit from an improved understanding of the meaning and scope of ratings resulting from these new disclosures. While much of this information is publicly available, requiring it to be presented in the registration statement may increase the degree to which investors understand what the rating means. Additionally, new information, such as changes in ratings, would be disclosed in Exchange Act reports. While ratings are typically public information, available through news services or from the credit rating agency, investors may find it easier to access ratings in a central repository that is available over time. Investors should be better able to put the ratings in context when ratings and the proposed disclosure are presented together with other information in the registration statement. Less sophisticated investors may benefit more from these disclosures, as sophisticated investors may already have absorbed this information from other sources.

Disclosure of potential conflicts of interests faced by credit rating agencies would provide information to investors that is not currently available. Potential conflicts of interest may arise when a credit rating agency derives significant revenue from a registrant whose securities it also rates. Credit rating agencies, in some cases, offer non-ratings services to registrants, such as consulting services.¹⁰⁵ Both sophisticated and unsophisticated investors could benefit from understanding whether the rating was received in the context of other services; in particular, they may place less weight on ratings in which the agency was substantially compensated for other services. This additional information may, in some cases, reduce the

possibility of investors placing undue reliance on ratings. Alternatively, however, if new disclosures cause investors to believe that ratings are not subject to any potential conflict of interest, the additional disclosures may increase the degree to which investors rely on ratings.

The proposed amendments would enable investors to distinguish between solicited ratings (which can rely on both public and non-public information) and unsolicited ratings (which generally rely on only public information). Currently, it is not possible in every case for investors to make this distinction. Under the proposed amendments, if registrants use a rating to sell a security in a registered offering, it will be included in the registration statement; in other cases, it may not be. If a rating is disclosed in a registration statement, the registrant would be required to disclose who paid for the rating.

Benefits to Investors From Increased Informativeness of Ratings

The proposed amendments may have the long-term benefit of increasing the informativeness of credit ratings to investors, that is, the degree to which ratings correspond to the credit quality of the rated security or entity. Investors benefit from increased informativeness in several ways. Entities with different credit quality are exposed to distinct economic factors, and investors may take this fact into account when making investment decisions. Additionally, investors can use credit ratings in conducting fundamental analysis of individual securities. As a result, investors benefit from credit ratings that are more informative.

Increased informativeness of ratings can result from a reduction in "ratings shopping."¹⁰⁶ Currently registrants may solicit more ratings than they intend to use, choosing from among ratings providers without making any disclosure regarding the other solicited ratings. Criteria for selecting ratings agencies include the reputation of the agency and the rating itself.¹⁰⁷ There may be other, non-shopping reasons for soliciting multiple ratings, such as obtaining multiple expert views on the registrant's financial health. If the proposed amendments are adopted and registrants continue to solicit more

ratings than they intend to use, preliminary and unused final ratings would be made public if the registrant used a rating in connection with a registered offering. Credit rating agencies would know that their ratings would be disclosed if the registrant uses a final rating from a different credit rating agency in connection with a registered offering. Thus, the market could assess the relative informativeness of ratings used to sell the security and ratings from other agencies. This ability to compare a broader group of ratings, including preliminary ratings, for the same issue may allow investors to identify agencies whose ratings they perceive to be less reliable. This ability may be limited, however, as direct comparisons between preliminary ratings and final ratings may be affected by factors such as changes in information made available to the credit rating agency throughout the ratings process. The proposed disclosure could cause credit rating agencies to expend greater effort to examine the financial health of the underlying entity. Ultimately, increased efforts in the ratings process could improve ratings informativeness.

The proposed amendments may change the way rating agencies compete. This may indirectly improve ratings informativeness. Rating agencies may compete on the quality of ratings or they may engage in ratings-based competition that focuses on producing high ratings. Any potential reduction in ratings-based competition may result in credit rating agencies focusing on enhancing their reputations for producing quality ratings and competing on that basis, rather than competing to produce high ratings so that registrants select them. Rating agencies may have greater incentives to compete on the basis of the quality of ratings as they are likely to face reduced incentives to produce optimistic ratings in the hopes of being selected, since registrants' incentives to obtain a higher rating would be reduced. These changes in registrants' incentives and their consequent effect on credit rating agencies' incentives, however, will be limited, to the extent that preliminary ratings are incomplete or based on less than full and final information, or that registrants replace the use of preliminary ratings for ratings shopping with new alternative mechanisms. Any potential reduction in the rating-based competition is likely to result in more informative ratings.¹⁰⁸

¹⁰⁵ See Frank Partnoy, *How and Why Credit Rating Agencies are Not Like Other Gatekeepers*, (2006) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=900257 for a discussion of non-rating services provided by credit rating agencies.

¹⁰⁶ See Aaron Lucchetti and Serena Ng, *How Rating Firms' Calls Fueled Subprime Mess*, (Aug. 16, 2007), at <http://www.realestatejournal.com/buysell/mortgages/20070816-lucchetti.html>. See also Skreta and Veldkamp, and Bolton, Freixas and Shapiro in note 24 above.

¹⁰⁷ See Dion Bongaerts, Martijn Cremers, and William N. Goetzmann *Multiple Ratings and Credit Spreads* (June 30, 2009), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1307782.

¹⁰⁸ See Becker and Milbourn in note 14 above.

Benefits to Certain Rating Agencies From Enhanced Competitive Position

The proposed amendments may benefit certain rating agencies by enhancing their competitive position, relative to others. Enhanced competitive position may result in these agencies charging higher fees, rating more securities, or being more selective in the securities they rate. These effects result from two factors. First, smaller agencies may be asked to provide preliminary ratings less frequently, and may therefore see information about fewer rated securities, thereby limiting their ability to assess the credit quality of the issue that they are rating relative to the rest of the rated issues.¹⁰⁹ Second, registrants may not choose to use ratings from smaller agencies if the registrants elect not to seek the smaller agencies' preliminary ratings. Competitive realignment may represent a cost to the credit rating agencies who are not market leaders. Competitive effects are discussed in detail in the Costs section, below.

Reductions in Cost of Capital for Some Registrants

As discussed, the proposed amendments may increase the informativeness of ratings. Credit rating agencies interpret non-public information to which they have access, together with public information.¹¹⁰ This practice may reduce the asymmetry of information between registrants and investors. Additionally, the mandatory disclosure of information about credit ratings used in connection with a registered offering could level the playing field for all registrants and would benefit registrants that in the past may have hesitated to provide such disclosure voluntarily. These reductions in the asymmetry of information between registrants and investors could reduce registrants' cost of capital as investors may demand a lower risk premium when they have access to more information.¹¹¹

¹⁰⁹ See Jeremy Fons, *Rating Competition and Structured Finance*, J. Structured Fin. (Fall 2008), at <http://www.ijournals.com/doi/abs/10.3905/JSF.2008.14.3.007>.

¹¹⁰ In the discussion of their rating methodologies, Standard and Poor's and Moody's explain how they use confidential non-public information that registrants provide for the purpose of assigning ratings. See http://www2.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html for the Standard and Poor's rating methodology. See <http://v3.moodys.com/sites/products/AboutMoodyRatingsAttachments/2001400000389218.pdf?frameOfRef=corporatefor> for Moody's description of their use of non-public information.

¹¹¹ See David Easley and Maureen O'Hara, *Information and the Cost of Capital*, J. Fin. (2004)

If the proposed amendments have the effect of reducing ratings shopping and ratings inflation that may result from such shopping, ratings scales may shift downward that is, debt issues of the same credit quality may receive a lower rating than currently as an indirect effect of the proposed amendments. In some cases, because of ratings-based investment restrictions faced by some institutional investors, this may result in changes in the cost of capital for registrants, including potential increases and decreases. For example, registrants of securities that would currently be given an investment grade rating, but that would receive a lower rating as an indirect result of the proposed amendments, could face a higher cost of capital. Those registrants whose securities would be investment grade under both sets of circumstances may face a lower cost of capital. Reductions in cost of capital constitute benefits to registrants. Additional potential costs are discussed in more detail in the Costs section, below.

C. Costs

Costs of New Disclosures

Registrants will face costs associated with the process of preparing and reporting the proposed disclosures. For purposes of the Paperwork Reduction Act, we estimate that over a three-year period the average annual incremental increase in the paperwork burden for non-investment company registrants to comply with our proposed collection of information requirements to be approximately 2,120 hours of in-house company personnel time and to be approximately \$816,000 for the services of outside professionals. For closed-end funds, we estimate the annual incremental increase to be approximately 157 hours of in-house company personnel time and approximately \$108,400 for the services of outside professionals. These estimates include the time and the cost of preparing and reviewing disclosure and filing documents. These disclosure costs may be limited by the fact that close-end funds that disclose ratings in their registration statements are already subject to comparable disclosure requirements and that some operating companies may already be providing this information voluntarily.

(arguing that the information composition between public and non-public information affects the cost of capital since investors demand a higher return from their investments when they face asymmetric information).

Temporary Uncertainty Resulting From Potential Shift in Ratings

As discussed, the proposed amendments may cause ratings scales to shift downward; disclosure of preliminary and unused final ratings in certain circumstances may reduce ratings shopping, in turn reducing the upward bias in ratings resulting from registrants choosing the highest of several ratings. The amount of this shift is uncertain. This uncertainty represents a potential cost to investors, who may temporarily have fewer highly rated investment options. It also represents a cost to registrants, who may be less sure of the rating they will receive for securities.

Costs to Investors Resulting From Potential Undue Reliance on Ratings

Requiring ratings disclosure may reinforce the importance of ratings, possibly causing investors to place undue reliance on the rating. This effect may be mitigated by accompanying contextual disclosures, such as disclosures on ratings limitations and by any improvements in the quality of ratings.

Costs to Registrants Resulting From Increased Prices of Ratings

Any enhancement of the competitive position of market leaders that may arise in the medium- or long-term may result in higher prices for assigning ratings, both through a reduction in potential price competition among existing agencies and a reduction in the threat of entry by new agencies. Competitive effects of the proposed amendments are discussed below in this section, as well as in the Competition, Efficiency, and Capital Formation section.

Increases in Cost of Capital for Some Registrants Resulting From Potential Declines in the Level of Ratings

As mentioned in the Benefits section, in some cases, the proposed amendments may alter issuance behavior by affecting investor demand for securities with specific ratings. Some investors are limited, either by regulation or custom, to investing only in the highest rated securities, while others are limited to investing in "investment grade" securities. If ratings shift downward as a result of the proposed amendments, there may be fewer securities available meeting these investment criteria, potentially resulting in a larger price premium for top-rated securities and for investment-grade securities. These price premia may affect issuance behavior. For example, registrants of securities that would currently be given an investment grade

rating, but that would receive a lower rating as an indirect result of the proposed amendments, would potentially face a higher cost of capital, while those registrants whose securities would be investment grade under both sets of circumstances may face a lower cost of capital. These changes in cost of capital may, in turn, affect issuance decisions. In particular, registrants whose securities would no longer be considered investment grade may face greater difficulty in raising capital. These differences in the cost of capital across new classes of “investment-grade” and “non-investment grade” securities may diminish in the long-term. In the short-term, however, the differential in the cost of capital across these two classes of securities are likely to remain due to the limited access to “non-investment grade” securities by certain investors. Similar considerations apply to the ratings at the top of the scale. Some registrants may be effectively shut out from the commercial paper market, for example, if they can no longer obtain top ratings.

These effects depend on the rigidity of institutional ratings-based constraints. If ratings scale downward, these constraints may adapt. For example, a wider range of ratings may be considered investment grade, and the commercial paper market may become viable for lower rated registrants. Any such adaptation is more likely to occur in the long term, however, as ratings-based investment restrictions are costly to modify.

Costs to Certain Rating Agencies Resulting From Potential Changes in Competitive Environment

Although NRSROs and other credit rating agencies are not subject to the proposed amendments, some of these rating agencies may incur costs. As mentioned in the benefits section, established market leaders in ratings may indirectly benefit from the proposed amendments, at the expense of smaller, less established credit rating agencies. Currently, the credit ratings industry is highly concentrated. For “corporate issuers” in 2007, for example, Standard and Poor’s, Moody’s, and Fitch issued 39%, 33%, and 21% of outstanding credit ratings, respectively, for a total of 93% of outstanding credit ratings.¹¹² This concentration could increase in several ways as described below, such as an increase in market share of certain ratings agencies among

the dominant agencies or a reduction in market share of the remaining agencies.

The proposed disclosure requirements for preliminary and unused final ratings may lead registrants to solicit fewer ratings, potentially only as many as they intend to ultimately use. In structured financial products, for example, the market may customarily require registrants to obtain two ratings, but registrants can solicit preliminary ratings from more than two agencies. If the registrant knows that preliminary ratings must be disclosed in certain circumstances, including the most optimistic ratings, then its incentive to shop for ratings may be reduced, because such a practice would become apparent to the market, and its selection of the higher rating may be discounted. Registrants may instead choose to initially solicit ratings only from agencies who are market leaders in the type of product they are issuing. Specifically, they may gravitate toward agencies that have established reputations for high quality ratings and agencies that, for other reasons, such as branding or market share, are best known to investors. They may choose to involve other credit rating agencies only if they do not meet specific ratings hurdles, such as the top rating category, or investment grade. Agencies who are not market leaders may, as a result, receive information about fewer issues, potentially affecting the perceived quality of their ratings. This may cause registrants to purchase fewer ratings from such agencies. Ultimately, this could strengthen the relative position of market leaders and potentially harm the competitive position of other rating agencies. Relatedly, registrants’ conversations with smaller, less-established NRSROs and other credit rating agencies may help them to understand the agencies’ methodologies and procedures; these conversations may help smaller NRSROs introduce themselves to registrants. To the extent that registrants contact only established NRSROs, they may not develop this understanding of other agencies’ methodologies.

The effect on market leaders’ competitive position could be mitigated by an additional factor. A decrease in ratings shopping depends in part on the ability of investors to easily compare final and preliminary ratings. However, investors may feel that they cannot easily compare these ratings. When rating agencies make preliminary ratings, they do so with a more limited set of information. As the ratings process proceeds to a final rating, more information can become available. For example, as time passes, material

information about the industry or registrant from public sources may become available. Additionally, the registrant (or those acting on its behalf) may continue to share information with rating agencies. Consequently, investors may consider preliminary ratings to be informative only in a limited sense, and registrants may not experience a significant penalty for using a final rating that is substantially different than preliminary ratings.¹¹³ Thus, to some degree, registrants may still shop for ratings, and agencies may continue to compete based on the level of ratings.

The changes in the competitive position of rating agencies discussed above may not occur for structured finance products because of the amendments to Rule 17g-5 being adopted today, since all NRSRO’s would be entitled to receive information about all such issues.¹¹⁴ This would depend, however, on whether credit rating agencies choose to access this information. Access comes with certain obligations, including the obligation to rate 10% of the securities for which information is received.

Another factor that could potentially impact the competitive forces among the credit rating agencies is the mandatory disclosure that a fee was paid for the credit rating and the aggregate fees paid for any other non-rating services provided during such period. This disclosure may present some costs to the extent that it reveals competitive or proprietary information about the business model of the credit rating agency proving the credit rating. To the extent that there are negative competitive effects, some rating agencies may stop providing some of these non-rating services which could result in declines in their revenues.

V. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 23(a) of the Exchange Act¹¹⁵ requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. Section 23(a)(2) prohibits the Commission from adopting any rule which would impose a burden on competition not necessary or appropriate in furtherance of the

¹¹³ These factors would also reduce the efficacy of ratings shopping, however, since registrants would also face some uncertainty about what the final rating would be.

¹¹⁴ See the proposing release related to Rule 17g-5 under the Exchange Act considered by the Commission on September 17, 2009.

¹¹⁵ 15 U.S.C. 78w(a).

¹¹² See Annual Report on Nationally Recognized Statistical Rating Organizations (2008) at <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0608.pdf>.

purposes of the Exchange Act. Section 2(b) of the Securities Act,¹¹⁶ Section 3(f) of the Exchange Act,¹¹⁷ and Section 2(c) of the Investment Company Act¹¹⁸ require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.

The proposed amendments would require registrants to make specified disclosure to investors regarding credit ratings if credit ratings are used in connection with a registered offering. We believe these disclosures would help investors understand the limits and purposes of credit ratings as well as potential conflicts of interest or ratings shopping practices that could affect the quality of the credit rating. Therefore, if adopted, the Commission believes that the disclosure required by these amendments would promote investor protection. We believe that if investors have more information regarding credit ratings, including the scope of the rating, they will be better able to place the rating in its proper context. The Commission anticipates that these proposed amendments could improve investors' ability to make informed investment decisions, which will, therefore, lead to potential increased efficiency and competitiveness of the U.S. capital markets. The Commission expects that this increased market efficiency and investor confidence also may encourage more efficient capital formation for the reasons discussed below and in Section IV above. Specifically, the proposed amendments would enhance the availability of information to investors and the markets with regard to credit ratings so that investors will more clearly understand the terms of the credit rating and its limitations.

As discussed in more detail in Section IV, the proposed amendments may reduce the level of ratings-based competition among credit rating agencies. This may indirectly improve ratings informativeness. Any potential reduction in ratings-based competition may result in credit rating agencies increasingly focusing on enhancing their reputations for producing quality ratings and competing on that basis, rather than competing to produce high ratings so that registrants select them. These changes in registrants' incentives and their consequent effect on credit

rating agencies' incentives, however, will be limited, to the extent that preliminary ratings are incomplete or based on less than full and final information, or that registrants replace the use of preliminary ratings for ratings shopping with new alternative mechanisms.

Furthermore, the proposed amendments may also increase the informativeness of ratings by reducing the asymmetry of information between registrants and investors. The mandatory disclosure of credit ratings in registration documents would level the playing field for all companies and would benefit companies that in the past may have hesitated to provide such disclosure voluntarily, thereby promoting competition. Furthermore, these reductions in the asymmetry of information between registrants and investors could reduce registrants' cost of capital as investors may demand a lower risk premium when they have access to more information.

Market efficiency and capital formation may be enhanced by more informative ratings because investors would have access to better information and could act on that information accordingly.

The Commission recognizes that requiring disclosure of preliminary ratings and unused final ratings could have an effect on competition among the credit rating agencies. To the extent that the proposed disclosure reduces ratings shopping, then competition among credit rating agencies may be reduced as registrants seek only ratings they intend to use and do not shop around among many agencies. The proposed amendments may benefit the competitive position of certain rating agencies if, for example, registrants seek fewer credit ratings. Enhanced competitive position would enable these agencies to charge higher fees, to rate more securities, or to be more selective in the securities they rate. Competitive realignment may represent a cost to the credit rating agencies who are not market leaders. This may increase the cost of capital for issuers who use smaller credit rating agencies if they are unable to pay the increased fees of the larger credit rating agencies or if the larger credit rating agencies elect not to rate them.

If the proposed amendments have the effect of reducing ratings shopping and ratings inflation resulting from such shopping, rating scales may shift downward—that is, debt issues may receive a lower rating than currently as an indirect effect of the proposed amendments. In some cases, because of ratings-based investment restrictions

faced by some institutional investors, this may result in changes in the cost of capital for registrants, including potential increases and decreases. For example, registrants of securities that would currently be given an investment grade rating, but that would receive a lower rating as an indirect result of the proposed amendments, would potentially face a higher cost of capital, while those registrants whose securities would be investment grade under both sets of circumstances may face a lower cost of capital.

The Commission solicits comment on the effects of the proposed amendments on efficiency, competition, and capital formation. The Commission requests comment on whether the required disclosure of ratings in registration statements, especially ratings that a registrant would otherwise choose not to disclose, may affect positively or negatively registrants' ability to raise capital. The Commission requests comment on the anticipated effect of the new disclosure requirements on competition in the market for credit rating agencies. The Commission requests commenters to provide empirical data and other factual support for their views, if possible.

VI. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis (IRFA) has been prepared in accordance with the Regulatory Flexibility Act.¹¹⁹ It relates to proposed revisions to Regulation S-K, rules under the Securities Act, and forms under the Exchange Act, the Securities Act, and the Investment Company Act regarding disclosure regarding credit ratings.

A. Reasons for, and Objectives of, the Proposed Action

As discussed throughout the release, we are proposing amendments to our rules to require disclosure of information regarding credit ratings used by registrants in connection with a registered offering of securities so that investors will better understand the credit rating and its limitations. The amendments we are proposing today also would require additional disclosure that would inform investors about potential conflicts of interest that could affect the credit rating. In addition, we are proposing amendments to require disclosure of preliminary credit ratings and unused final ratings in certain circumstances so that investors have enhanced information about the credit ratings process that may bear on the quality or reliability of the rating. The

¹¹⁶ 15 U.S.C. 77b(b).

¹¹⁷ 15 U.S.C. 78c(f).

¹¹⁸ 15 U.S.C. 8a-2(c).

¹¹⁹ 5 U.S.C. 601.

proposed amendments would be applicable to registration statements filed under the Securities Act, the Securities Exchange Act and the Investment Company Act, and Forms 8-K and 20-F.

B. Legal Basis

We are proposing the amendments contained in this document under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act, Sections 12, 13, 15(d) and 23(a) of the Exchange Act, and Sections 8, 24(a), 30, and 38 of the Investment Company Act.

C. Small Entities Subject to the Proposed Action

The proposed amendments could affect some companies that are small entities. The disclosure requirements as proposed would apply to any registrant that uses a credit rating in connection with a registered offering, though based on the staff's observations of market practice, we believe it is unlikely that a small entity would use a credit rating in connection with a registered offering. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."¹²⁰ The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Securities Act Rule 157¹²¹ and Exchange Act Rule 0-10(a)¹²² defines a company, other than an investment company, to be a "small business" or "small organization" if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,229 companies, other than registered investment companies, that may be considered small entities. Investment Company Act Rule 0-10(a)¹²³ defines a "small business" or "small organization" for purposes of the Investment Company Act as an investment company that, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. We estimate that there are approximately 30 registered closed-end funds that may be considered small entities. The proposed amendments could affect small entities that have a class of securities that are registered under Section 12 of the Exchange Act or that are required to file

reports under Section 15(d) of the Exchange Act or Section 30 of the Investment Company Act. In addition, the proposals also could affect small entities that file, or have filed, a registration statement that has not yet become effective under the Securities Act or the Investment Company Act and that has not been withdrawn.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The disclosure requirements we are proposing today are intended to enhance credit rating disclosure so that investors will better understand credit ratings and their limitations. These amendments would require small entities that are operating companies or closed-end funds to provide the same disclosure as larger entities if they use a credit rating in connection with a registered offering. The disclosure required would include general information about the credit rating, including all material scope limitations of the credit rating and any related published designation, such as non-credit payment risks, assigned by the rating organization with respect to the security. In addition, the proposed amendments would require disclosure of additional non-rating services provided by the credit rating agency and its affiliates to the registrant and its affiliates, including disclosure of the fees paid for those services, so that investors will be aware of potential conflicts of interest with respect to the credit rating obtained by the registrant. Small entities would be required to include the disclosure in their Securities Act, Exchange Act, and Investment Company Act registration statements. In addition, small entities would be required to provide updating of the rating disclosure. In certain circumstances, small entities would be required to provide disclosure of preliminary ratings or unused final ratings so that investors will be informed of when a registrant may have engaged in ratings shopping.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe the proposed amendments would not duplicate, overlap, or conflict with other federal rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities subject to the rules. In connection with the proposed disclosure amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Use of performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

The proposed amendments would provide investors with more information regarding credit ratings and their limitations so that investors will be able to place the credit rating in its appropriate context. We do not believe these disclosures will create a significant new burden on smaller entities subject to the proposed amendments. To the extent that a small entity must comply with the proposed amendments, we believe uniform, comparable disclosures across all companies will help investors and the markets. Therefore, we are not proposing special requirements, standards or exemptions for small entities. However, because small entities rarely receive credit ratings from credit rating agencies in connection with their offerings, it is unlikely that the proposed amendments would have a significant impact on a substantial number of small entities.

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- How the proposed amendments can achieve their objective while lowering the burden on smaller entities subject to the rules;
- The number of small entity companies that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entity companies discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

¹²⁰ 5 U.S.C. 601(6).

¹²¹ 17 CFR 230.157.

¹²² 17 CFR 240.0-10(a).

¹²³ 15 U.S.C. 270.0-10(a).

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,¹²⁴ a rule is “major” if it has resulted, or is likely to result in:

- An annual effect on the U.S. economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a “major rule” for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment, or innovation.

VIII. Statutory Authority and Text of Rule and Form Amendments

We are proposing the amendments contained in this document under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act; Sections 12, 13, 15(d) and 23(a) of the Exchange Act; and Sections 8, 24(a), 30, and 38 of the Investment Company Act.

List of Subjects

17 CFR Parts 229, 239, 240, 249 and 274

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u–5, 78w, 78ll, 78mm, 80a–8, 80a–9, 80a–20, 80a–29, 80a–30, 80a–31(c), 80a–37, 80a–38(a), 80a–39, 80b–11, and 7201 *et seq.*; 18 U.S.C. 1350, unless otherwise noted.

* * * * *

§ 229.10 [Amended]

2. Amend § 229.10 by removing and reserving paragraph (c).

3. Amend § 229.202 by:

- a. Adding paragraph (g); and
- b. Adding Instructions 1 through 5 to Item 202(g).

The additions read as follows:

§ 229.202 (Item 202) Description of registrant’s securities.

* * * * *

(g) *Credit ratings.* If a registrant, any selling security holder, any underwriter, or any member of a selling group in a registered offering uses a credit rating, as that term is defined in 15 U.S.C. 78c(a)(60), from a credit rating agency, as that term is defined in 15 U.S.C. 78c(a)(61), with respect to the registrant or a class of securities issued by the registrant, in connection with a registered offering, the registrant shall disclose the following information for each rating used:

(1) The identity of the credit rating agency assigning the credit rating and whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62);

(2) The credit rating assigned;

(3) The relative rank of the credit rating within the assigning credit rating agency’s overall classification system;

(4) The date the credit rating was assigned;

(5) The credit rating agency’s definition or description of the category in which the credit rating agency rated the class of securities;

(6) The identity of the party who is compensating the credit rating agency for providing the credit rating;

(7) A description of any other non-rating services provided by the credit rating agency or its affiliates to the registrant or its affiliates, and if such other services have been provided, separate disclosure of the fee paid for the credit rating required to be disclosed and the aggregate fees paid for any other non-rating services provided during the registrant’s last completed fiscal year and any subsequent interim period up to the date of the filing;

(8) All material scope limitations of the credit rating;

(9) How any contingencies related to the securities are or are not reflected in the credit rating;

(10) Any published designation reflecting the results of any other evaluation done by the credit rating agency in connection with the credit rating, along with an explanation of the designation’s meaning and the relative rank of the designation;

(11) Any material differences between the terms of the securities as assumed or

considered by the credit rating agency in rating the securities and:

(i) The minimum obligations of the security as specified in the governing instruments of the security; and

(ii) The terms of the securities as used in any marketing or selling efforts;

(12) A statement informing investors that a credit rating is not a

recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific security to which it applies; and that investors should make their own evaluation as to whether an investment in the security is appropriate;

(13) A description of a final rating obtained by the registrant but not used in connection with the offering, including the information set forth in paragraphs (g)(1) through (12) of this section; and

(14) A description of any preliminary rating of the class of securities that received the rating being disclosed pursuant to this Item 202(g) of this part if such preliminary rating was obtained by or on behalf of the registrant and received from a credit rating agency other than the credit rating agency that provided the credit rating disclosed pursuant to this Item 202(g) of this part. Such description shall include:

(i) The identity of the credit rating agency that determined or indicated the rating and an indication of whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62);

(ii) The preliminary rating determined or indicated or a description of the category or range of categories in which the preliminary credit rating agency placed the class of securities;

(iii) The date the preliminary rating was conveyed to the registrant, any party acting on the registrant’s behalf or the underwriters;

(iv) The relative rank of the preliminary rating within the preliminary credit rating agency’s overall classification system;

(v) Any material scope limitations of the preliminary rating; and

(vi) Any material differences between the terms of the securities on which the preliminary rating was determined and the terms of the securities on which the final rating was determined.

* * * * *

Instructions to Item 202(g):

1. Disclosure is not required by this Item 202(g) if the only disclosure of a credit rating in a filing with the

¹²⁴ Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

Commission relates to changes to a credit rating, liquidity of the registrant, the cost of funds of a registrant or the terms of agreements that refer to credit ratings, and the credit rating is not otherwise used in connection with a registered offering.

2. If a registrant includes information about credit ratings in a prospectus pursuant to this Item 202(g) and the rating has not yet been issued in final form, the registrant shall update the description of each rating as set forth below:

A. If a change in a rating, including the assignment of a final rating, already included in the prospectus is available subsequent to the filing of the registration statement, but prior to its effectiveness, the registrant shall convey to the purchaser the rating change.

B. If an additional rating, including a final rating, that the registrant is required to disclose, or if a material change in a rating already included, becomes available during any period in which offers or sales are being made, the registrant shall disclose such additional rating or rating change by means of a post-effective amendment, or supplement to the prospectus pursuant to § 230.424(b) of this chapter, unless, in the case of a registration statement on Form S-3 (§ 239.13 of this chapter), it has been disclosed in a document incorporated by reference into the registration statement subsequent to its effectiveness and prior to the termination of the offering or completion of sales.

3. For purposes of this Item 202(g), a credit rating is "used in connection with a registered offering of securities" in circumstances, including but limited to, when such rating is used in connection with an unregistered offering of securities, and the securities offered privately are subsequently exchanged for substantially similar registered securities even if the credit rating was not used in connection with the registered exchange offering.

4. A preliminary rating includes any rating that is not published, any range of ratings, any oral or other indications of a potential rating or range of ratings and all other preliminary indications of a rating. A preliminary rating includes ratings on a particular structure of a security even if not tied to a specific registrant or group of assets. Disclosure of a preliminary rating is required even if there have been changes to the security for which a final rating is disclosed pursuant to this Item 202(g).

5. For purposes of determining whether disclosure of any preliminary rating or unused final rating is required, a credit rating is obtained from a credit

rating agency if it is solicited by or on behalf of a registrant from a credit rating agency.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

4. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

5. Amend Form S-3 (referenced in § 239.13) by revising Part I, Item 9 to read as follows:

Note The text of Form S-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Item 9. Description of Securities To Be Registered

Furnish the information required by Item 202 of Regulation S-K (§ 229.202 of this chapter), unless capital stock is to be registered and securities of the same class are registered pursuant to Section 12 of the Exchange Act, in which case furnish only the information required by Item 202(g) of Regulation S-K.

6. Amend Form S-4 (referenced in § 239.25) by revising Part I, Item 4(a)(3) to read as follows:

Note The text of Form S-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S-4

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Item 4. Terms of the Transaction

(a) Furnish a summary of the material features of the proposed transaction. The summary should include, where applicable:

(3) The information required by Item 202 of Regulation S-K (§ 229.202 of this chapter), description of registrant's securities, unless: (i) The registrant would meet the requirements for use of Form S-3, (ii) capital stock is to be registered and (iii) securities of the same class are registered pursuant to Section 12 of the Exchange Act and (i) listed for

trading or admitted to unlisted trading privileges on a national securities exchange; or (ii) are securities for which bid and offer quotations are reported in an automated quotations system operated by a national securities association. Notwithstanding the foregoing, furnish the information required by Item 202(g) of Regulation S-K.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

7. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201, *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

8. Amend § 240.13a-11 by revising paragraph (b) to read as follows:

§ 240.13a-11 Current reports on Form 8-K (§ 249.308 of this chapter).

(b) This section shall not apply to foreign governments, foreign private issuers required to make reports on Form 6-K (17 CFR 249.306) pursuant to § 240.13a-16, issuers of American Depositary Receipts for securities of any foreign issuer, or investment companies required to file reports pursuant to § 270.30b1-1 of this chapter under the Investment Company Act of 1940, except:

(1) Where such investment companies are required to file notice of a blackout period pursuant to § 245.104 of this chapter; and

(2) A closed-end company (as defined in 15 U.S.C. 80a-5(a)(2)) is required to file a current report on Form 8-K containing the information required by Item 3.04 of Form 8-K within the period specified in that form unless substantially the same information as required by that item has been previously reported by the registrant.

9. Amend § 240.15d-11 by revising paragraph (b) to read as follows:

§ 240.15d-11 Current reports on Form 8-K (§ 249.308 of this chapter).

(b) This section shall not apply to foreign governments, foreign private issuers required to make reports on Form 6-K (17 CFR 249.306) pursuant to § 240.15d-16, issuers of American Depositary Receipts for securities of any

foreign issuer, or investment companies required to file reports pursuant to § 270.30b1-1 of this chapter under the Investment Company Act of 1940, except:

(1) Where such investment companies are required to file notice of a blackout period pursuant to § 245.104 of this chapter; and

(2) A closed-end company (as defined in 15 U.S.C. 80a-5(a)(2)) is required to file a current report on Form 8-K containing the information required by Item 3.04 of Form 8-K within the period specified in that form unless substantially the same information as required by that item has been previously reported by the registrant.

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

10. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a *et seq.*, 7201 *et seq.*, and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

11. Amend Form 20-F (referenced in § 249.220f) by redesignating Instruction 3 to Item 10 as Instruction 4, adding new Instruction 3 to Item 10, redesignating Items 12.C. and 12.D. as Items 12.D. and 12.E., adding new Item 12.C. and the Instructions to Item 12.C., and revising Instruction 1 to Item 12. to read as follows:

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 20-F

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Item 10. Additional Information

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Instructions to Item 10

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3. In registration statements filed under the Securities Act or Exchange Act that relate to a class of preferred securities for which a credit rating, as that term is defined in 15 U.S.C. 78c(a)(60), from a credit rating agency, as that term is defined in 15 U.S.C. 78c(a)(61), is being used in connection with the registered offering, disclose the information required under Item 12.C.1 of Form 20-F. If filing Form 20-F as an annual report, furnish the information required by Item 12.C.2 of Form 20-F if there have been any changes to a rating required to be disclosed by Item 12.C.1 of Form 20-F.

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Item 12. Description of Securities Other than Equity Securities

* * * * *

C. Credit ratings.

1. If a company, any selling security holder, any underwriter, or any member of a selling group in a registered offering uses a credit rating, as that term is defined in 15 U.S.C. 78c(a)(60), from a credit rating agency, as that term is defined in 15 U.S.C. 78c(a)(61), with respect to the company or a class of securities issued by the company, in connection with a registered offering, the company shall disclose the following information for each rating used:

(a) The identity of the credit rating agency assigning the credit rating and whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62);

(b) The credit rating assigned;

(c) The relative rank of the credit rating within the assigning credit rating agency's overall classification system;

(d) The date the credit rating was assigned;

(e) The credit rating agency's definition or description of the category in which the credit rating agency rated the class of securities;

(f) The identity of the party who is compensating the credit rating agency for providing the rating;

(g) A description of any other non-rating services provided by the credit rating agency or its affiliates to the company or its affiliates, and if such other services have been provided, separate disclosure of the fee paid for the credit rating required to be disclosed and the aggregate fees paid for any other non-rating services provided during the company's last completed fiscal year and any subsequent interim period up to the date of the filing;

(h) All material scope limitations of the credit rating;

(i) How any contingencies related to the securities are or are not reflected in the credit rating;

(j) Any published designation reflecting the results of any other evaluation done by the credit rating agency in connection with the credit rating, along with an explanation of the designation's meaning and the relative rank of the designation;

(k) Any material differences between the terms of the securities as assumed or considered by the credit rating agency in rating the securities and:

(i) The minimum obligations of the security as specified in the governing instruments of the security; and

(ii) The terms of the securities as used in any marketing or selling efforts;

(l) A statement informing investors that a credit rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific security to which it applies; and that investors should make their own evaluation as to whether an investment in the security is appropriate;

(m) A description of a final rating obtained by the company but not used in connection with the offering, including the information set forth in paragraphs (a)–(l) of this item; and

(n) A description of any preliminary rating of the class of securities that received the rating being disclosed pursuant to this Item 12 if such preliminary rating was obtained by or on behalf of the company and received from a credit rating agency other than the credit rating agency that provided the credit rating disclosed pursuant to this Item 12. Such description shall include:

(i) The identity of the credit rating agency that determined or indicated the rating and whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62);

(ii) The preliminary rating determined or indicated or a description of the category or range of categories in which the preliminary credit rating agency placed the class of securities;

(iii) The date the preliminary rating was conveyed to the company, any party acting on the company's behalf or the underwriters;

(iv) The relative rank of the preliminary rating within the preliminary credit rating agency's overall classification system;

(v) Any material scope limitations of the preliminary rating; and

(vi) Any material differences between the terms of the securities on which the preliminary rating was determined and the terms of the securities on which the final rating was determined.

2. Credit rating agency decisions.

(a) Disclose the information required by paragraph (b) of this Item 12.C.2. if the company is notified by, or receives any communication from, any credit rating agency to the effect that the organization has decided to change or withdraw the credit rating assigned to the company or any class of debt or preferred security or other indebtedness of the company (including securities or obligations as to which the company is a guarantor, or may become directly or contingently liable for arising out of an off-balance sheet arrangement) that was

previously required to be disclosed pursuant to Item 12.C.1 of this Form.

(b) If the registrant has received any notification or other communication as described in paragraph (a) of this Item 12.C.2., file the notice as an exhibit to the annual report on Form 20-F and disclose the following information:

(i) The date the company received the notification or communication;

(ii) The name of the credit rating agency and whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62); and

(iii) The nature of the rating agency's decision.

* * * * *

Instructions to Item 12

1. You do not need to provide the information called for by this Item 12 if you are using the form as an annual report for your fiscal years ending before December 15, 2009. For your fiscal years ending on or after December 15, 2009, except for Item 12.C.2, Item 12.E.3. and Item 12.E.4 of this Form, you do not need to provide the information called for by this Item 12 if you are using this form as an annual report. You do not need to provide the information required by Item 12.C.2. of this Form if you are using the form as a registration statement.

* * * * *

Instructions to Item 12.C.1.

1. Disclosure is not required by this Item 12.C.1. of this Form if the only disclosure of a credit rating in a filing with the Commission relates to changes to a credit rating, liquidity of the company, the cost of funds of a company or terms of agreements that refer to credit ratings, and the credit rating is not otherwise used in connection with a registered offering.

2. If a company includes information about credit ratings in a prospectus pursuant to Item 12.C.1. of this Form and the rating has not yet been issued in final form, the company shall update the description of each rating as set forth below:

A. If a change in a rating, including the assignment of a final rating, already included in the prospectus is available subsequent to the filing of the registration statement, but prior to its effectiveness, the company shall convey to the purchaser the rating change.

B. If an additional rating, including a final rating, that the company is required to disclose, or if a material change in a rating already included, becomes available during any period in which offers or sales are being made, the

company shall disclose such additional rating or rating change by means of a post-effective amendment, or supplement to the prospectus pursuant to Rule 424(b) under the Securities Act (§ 230.424(b) of this chapter), unless, in the case of a registration statement on Form F-3 under the Securities Act (referenced in § 239.33 of this chapter), it has been disclosed in a document incorporated by reference into the registration statement subsequent to its effectiveness and prior to the termination of the offering or completion of sales.

3. For purposes of this Item 12, a credit rating is "used in connection with a registered offering" in circumstances, including but limited to, when such rating is used in connection with an unregistered offering of securities, and the securities offered privately are subsequently exchanged for substantially similar registered securities even if the credit rating was not used in connection with the registered exchange offering.

4. A preliminary rating includes any rating that is not published, any range of ratings, any oral or other indications of a potential rating or range of ratings and all other preliminary indications of a rating. A preliminary rating includes ratings on a particular structure of a security even if not tied to a specific company or group of assets. Disclosure of a preliminary rating is required even if there have been changes to the security for which a final rating is disclosed pursuant to this Item 12.

5. For purposes of determining whether disclosure of any preliminary rating or unused final rating is required, a credit rating is obtained from a credit rating agency if it is solicited by or on behalf of a company from a credit rating agency.

Instructions to Item 12.C.2.

1. No disclosure need be made under Item 12.C.2. of this Form during any discussions between the company and any credit rating agency regarding any decision required to be disclosed unless and until the credit rating agency notifies the company that the credit rating agency has made a final decision to take such action.

2. For purposes of Item 12.C.2. of this Form, the term "credit rating agency" has the meaning set forth in Section 3(a)(60) of the Exchange Act [15 U.S.C. 78c(a)(60)].

3. For purposes of Item 12.C.2. of this Form, off-balance sheet arrangement has the meaning set forth in Item 5.E.2. of this Form.

* * * * *

12. Amend Form 8-K (referenced in § 249.308) by revising Section 3—Securities and Trading Markets to add Item 3.04 to read as follows:

Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 8-K

* * * * *

Item 3.04. Credit Rating Agency Decisions

(a) Furnish the information required by paragraph (b) of this Item 3.04 if the registrant is notified by, or receives any communication from, any credit rating agency to the effect that the organization has decided to change or withdraw the credit rating assigned to the registrant or any class of debt or preferred security or other indebtedness of the registrant (including securities or obligations as to which the registrant is a guarantor or may become directly or contingently liable for arising out of an off-balance sheet arrangement) that was previously required to be disclosed pursuant to Item 202(g) of Regulation S-K or Item 10.6 of Form N-2.

(b) If the registrant has received any notification or other communication as described in paragraph (a) of this Item 3.04, file the notice as an exhibit to the report on Form 8-K and furnish the following information:

(1) The date the registrant received the notification or communication;

(2) The name of the credit rating agency and whether such organization is a nationally recognized statistical rating organization as that term is defined in 15 U.S.C. 78c(a)(62); and

(3) The nature of the rating agency's decision.

Instructions to Item 3.04

1. No disclosure need be made under this Item 3.04 during any discussions between the registrant and any credit rating agency regarding any decision required to be disclosed unless and until the credit rating agency notifies the registrant that the credit rating agency has made a final decision to take such action.

2. For purposes of this Item 3.04, the term "credit rating agency" has the meaning set forth in Section 3(a)(60) of the Exchange Act [15 U.S.C. 78c(a)(60)].

3. For purposes of this Item 3.04, off-balance sheet arrangement has the meaning set forth in Item 303(a)(4)(ii) of Regulation S-K [17 CFR 229.303(a)(4)(ii)].

* * * * *

**PART 239—FORMS PRESCRIBED
UNDER THE SECURITIES ACT OF 1933****PART 274—FORMS PRESCRIBED
UNDER THE INVESTMENT COMPANY
ACT OF 1940**

13. The authority citation for part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

* * * * *

14. Amend Form N–2 (referenced in §§ 239.14 and 274.11a–1), Item 10 by revising paragraph 6 and Instructions to read as follows:

Note: The text of Form N–2 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM N–2

* * * * *

**Item 10. Capital Stock, Long-Term Debt,
and Other Securities**

* * * * *

6. *Credit ratings:* If the Registrant, any selling security holder, any underwriter, or any member of a selling group in a registered offering uses a credit rating, as that term is defined in section 3(a)(60) of the Exchange Act [15 U.S.C. 78c(a)(60)], from a credit rating agency, as that term is defined in section 3(a)(61) of the Exchange Act [15 U.S.C. 78c(a)(61)], with respect to the registrant or a class of securities issued by the Registrant, in connection with a registered offering, the Registrant shall disclose the following information for each rating used:

a. The identity of the credit rating agency assigning the credit rating and whether such organization is a nationally recognized statistical rating organization as that term is defined in section 3(a)(62) of the Exchange Act [15 U.S.C. 78c(a)(62)];

b. The credit rating assigned;

c. The relative rank of the credit rating within the assigning credit rating agency's overall classification system;

d. The date the credit rating was assigned;

e. The credit rating agency's definition or description of the category in which the credit rating agency rated the class of securities;

f. The identity of the party who is compensating the credit rating agency for providing the credit rating;

g. A description of any other non-rating services provided by the credit rating agency or its affiliates to the Registrant or its affiliates, and if such other services have been provided, separate disclosure of the fee paid for

the credit rating required to be disclosed and the aggregate fees paid for any other non-rating services provided during the Registrant's last completed fiscal year and any subsequent interim period up to the date of the filing;

h. All material scope limitations of the credit rating;

i. How any contingencies related to the securities are or are not reflected in the credit rating;

j. Any published designation reflecting the results of any other evaluation done by the credit rating agency in connection with the credit rating, along with an explanation of the designation's meaning and the relative rank of the designation;

k. Any material differences between the terms of the securities as assumed or considered by the credit rating agency in rating the securities and (1) the minimum obligations of the security as specified in the governing instruments of the security; and (2) the terms of the securities as used in any marketing or selling efforts;

l. A statement informing investors that a credit rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning credit rating agency; that each credit rating is applicable only to the specific security to which it applies; and that investors should make their own evaluation as to whether an investment in the security is appropriate;

m. A description of a final rating obtained by the registrant but not used in connection with the offering, including the information set forth in paragraphs (a)–(l) of this item; and

n. A description of any preliminary rating of the class of securities that received the rating being disclosed pursuant to this paragraph 6 if such preliminary rating was obtained by or on behalf of the Registrant and received from a credit rating agency other than the credit rating agency that provided the credit rating disclosed pursuant to this paragraph 6. Such description shall include:

(1) The identity of the credit rating agency that determined or indicated the rating and an indication of whether such organization is a nationally recognized statistical rating organization as that term is defined in section 3(a)(62) of the Exchange Act [15 U.S.C. 78c(a)(62)];

(2) The preliminary rating determined or indicated or a description of the category or range of categories in which the preliminary credit rating agency placed the class of securities;

(3) The date the preliminary rating was conveyed to the Registrant, any party acting on the Registrant's behalf, or the underwriters;

(4) The relative rank of the preliminary rating within the preliminary credit rating agency's overall classification system;

(5) Any material scope limitations of the preliminary rating; and

(6) Any material differences between the terms of the securities on which the preliminary rating was determined and the terms of the securities on which the final rating was determined.

Instructions:

1. Disclosure is not required by paragraph 6 of this item if the only disclosure of a credit rating in a filing with the Commission relates to changes to a credit rating, liquidity of the Registrant, the cost of funds of a Registrant or the terms of agreements that refer to credit ratings, and the credit rating is not otherwise used in connection with a registered offering.

2. If a Registrant includes information about credit ratings in a prospectus pursuant to paragraph 6 of this item and the rating has not yet been issued in final form, the Registrant shall update the description of each rating as set forth below:

a. If a change in a rating, including the assignment of a final rating, already included in the prospectus is available subsequent to the filing of the registration statement, but prior to its effectiveness, the Registrant shall convey to the purchaser the rating change.

b. If an additional rating, including a final rating, that the Registrant is required to disclose, or if a material change in a rating already included, becomes available during any period in which offers or sales are being made, the Registrant shall disclose such additional rating or rating change by means of a post-effective amendment, or supplement to the prospectus pursuant to Rule 497 under the 1933 Act [17 CFR 230.497].

3. For purposes of paragraph 6 of this item, a credit rating is "used in connection with a registered offering of securities" in circumstances, including but limited to, when such rating is used in connection with an unregistered offering of securities, and the securities offered privately are subsequently exchanged for substantially similar registered securities even if the credit rating was not used in connection with the registered exchange offering.

4. A preliminary rating includes any rating that is not published, any range of ratings, any oral or other indications of a potential rating or range of ratings

and all other preliminary indications of a rating. A preliminary rating includes ratings on a particular structure of a security even if not tied to a specific registrant or group of assets. Disclosure of a preliminary rating is required even if there have been changes to the security for which a final rating is disclosed pursuant to this paragraph 6.

5. For purposes of determining whether disclosure of any preliminary rating or unused final rating is required, a credit rating is obtained from a credit rating agency if it is solicited by or on behalf of a Registrant from a credit rating agency.

6. If the prospectus relates to securities other than senior securities of the Registrant that have been assigned a credit rating by a credit rating agency, the information required by this paragraph may be provided in the Statement of Additional Information unless the rating criteria will materially affect the investment policies of the Registrant (e.g., if the rating agency establishes criteria for selection of the Registrant's portfolio securities with which the Registrant intends to comply), in which case it should be included in the prospectus.

* * * * *

By the Commission.

Dated: October 7, 2009.

Elizabeth M. Murphy,
Secretary.

[FR Doc. E9-24546 Filed 10-14-09; 8:45 am]

BILLING CODE 8011-01-P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 220

[Release Nos. 33-9071; 34-60798; IC-28943; File No. S7-21-09]

RIN 3235-AK45

Concept Release on Possible Rescission of Rule 436(g) Under The Securities Act of 1933

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: As part of the Commission's review of the role of credit rating agencies in the operation of the securities markets, and in light of disclosure regarding credit ratings that is being proposed in a companion release, the Commission is seeking comment on whether Rule 436(g) under the Securities Act of 1933 should be rescinded. In particular, we would like to understand whether there continues

to be a sufficient basis to exempt nationally recognized statistical rating organizations from Section 7 and 11 of the Securities Act.

DATES: Comments should be received on or before December 14, 2009.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/concept.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-21-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-21-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov/rules/concept.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m.. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

Blair F. Petrillo, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: In a companion release,¹ the Commission is proposing amendments to rules under the Securities Exchange Act of 1934² and Regulation S-K,³ and forms under the Securities Act of 1933,⁴ the

Exchange Act and the Investment Company Act of 1940⁵ to require disclosure by registrants regarding credit ratings in their registration statements under the Securities Act and the Exchange Act, and by closed-end management investment companies in registration statements under the Securities Act and the Investment Company Act, if the registrant uses the rating in connection with a registered offering. In connection with the proposed amendments, we are soliciting comment on whether the Commission should rescind Rule 436(g) under the Securities Act.⁶

I. Introduction

We are considering whether we should propose rescinding Rule 436(g) under the Securities Act. Rule 436(g) provides an exemption for credit ratings provided by nationally recognized statistical rating organizations ("NRSROs") from being considered a part of the registration statement prepared or certified by a person within the meaning of Sections 7⁷ and 11⁸ of the Securities Act. The exemption currently does not apply to credit rating agencies that are not NRSROs. We are concerned that there is no longer a sufficient basis to exempt NRSROs and to distinguish between NRSROs and credit rating agencies that are not NRSROs for purposes of liability under Section 11 of the Securities Act. Rescinding the exemption would cause NRSROs to be included in the liability scheme for experts set forth in Section 11, as is currently the case for credit rating agencies that are not NRSROs.

We solicit comment on what impact removing the rule would have on markets and their participants. Scrutiny of credit ratings and the process of obtaining a credit rating appears to have increased as a result of the turmoil in the credit markets over the past few years. As discussed below and in the companion release proposing to require disclosure regarding credit ratings, as credit ratings have become more significant, we have sought to protect investors while recognizing the role credit ratings play in the offer and sale of securities. In that regard, we are now exploring whether Rule 436(g) is still appropriate in light of the growth and development of the credit rating industry and investors' use of credit ratings. We are mindful of the potential significant impact that rescinding Rule 436(g) could have on registrants,

¹ See the proposing release considered by the Commission on September 17, 2009 regarding proposed disclosure regarding credit ratings in registration statements.

² 15 U.S.C. 78a et seq.

³ 17 CFR 229.10 through 1123.

⁴ 15 U.S.C. 77a et seq.

⁵ 15 U.S.C. 80a-1 et seq.

⁶ 17 CFR 220.436(g).

⁷ 15 U.S.C. 77g.

⁸ 15 U.S.C. 77k.