

Final Rules: Removing Credit- Rating References from Regulation M



The Securities and Exchange Commission adopted amendments to remove references to credit ratings included in existing exceptions to Regulation M. The adopted amendments:

- Remove existing rule exceptions that reference credit ratings for nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities included in Rule 101 and Rule 102 of Regulation M;
- Replace those rule exceptions with new standards that are based on alternative standards of creditworthiness; and
- Add an amendment to a recordkeeping rule applicable to broker-dealers in connection with their reliance on the new exceptions.

Why This Matters

Regulation M is a set of rules designed to preserve the pricing integrity of the securities trading markets by prohibiting issuers, selling security holders, distribution participants, and any of their affiliated purchasers from engaging in activities that could artificially influence the market for an offered security. Rule 101(c)(2) and Rule 102(d)(2) currently except nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities that are rated investment grade by at least one nationally recognized statistical rating organization.

Through these amendments to Rule 101(c)(2) and Rule 102(d)(2), the Commission is removing references to credit ratings from these regulations and substituting in their place alternative standards of creditworthiness, as required by Section 939A(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

How the Rules Apply

New Amendments to Regulation M:

The Commission adopted amendments to remove the requirement that nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities be rated investment grade by at least one nationally recognized statistical rating organization.

In place of that requirement, new Rule 101(c)(2)(i) and Rule 102(d)(2)(i) except nonconvertible debt securities and nonconvertible preferred securities of issuers having a probability of default of 0.055 percent or less, as estimated as of the sixth business day immediately preceding the determination of the offering price, over the horizon of 12 full calendar months from such day, as determined and documented in writing by the distribution participant acting as the lead manager, using a “structural credit risk model,” as newly defined in Rule 100 of Regulation M. In addition, new Rules 101(c)(2)(ii) and 102(d)(2)(ii) except asset-backed securities that are offered pursuant to an effective shelf registration statement filed on the Commission’s Form SF-3.

Record Preservation Requirement:

To aid the Commission in its examination of broker-dealers who rely on the new exception in Rule 101 or Rule 102 for certain nonconvertible debt securities and nonconvertible preferred securities, new paragraph (b)(17) of Rule 17a-4 requires those broker-dealers to preserve the written probability of default determination supporting their reliance on the exception. Rule 17a-4(b)(17) requires broker-dealers relying on Rule 101’s or Rule 102’s exception for certain nonconvertible debt securities and nonconvertible preferred securities to preserve, for a period of not less than three years, the first two years in an easily accessible place, the written probability of default determination.

What’s Next

The final rules will become effective 60 days following the date of publication of the adopting release in the Federal Register.