

July 30, 2010

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# Client Alert

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## DODD-FRANK ACT REPEALS EXEMPTION FROM SECURITIES ACT LIABILITY FOR CERTAIN RATING AGENCIES

### Introduction

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”) was enacted. Among other things, the Act repealed an exemption for certain rating agencies from liability for statements about their ratings made in registration statements and prospectuses.

### Repeal of Rule 436(g)

Effective July 22, 2010, the Act repealed Rule 436(g) under the Securities Act of 1933 (the “Securities Act”). Rule 436(g) established a safe harbor for certain rating agencies, providing that ratings assigned by a nationally recognized statistical rating organization (“NRSRO”) were not considered a part of a registration statement prepared or certified by an “expert”, within the meaning of Sections 7 and 11 of the Securities Act, and therefore NRSRO consent was not required to include such ratings in Securities Act registration statements and related prospectuses.

### Registered Offerings

Nothing in the Securities Act specifically identifies a rating agency and its rating as an “expertising” part of a registration statement. However, absent the Rule 436(g) safe harbor, the more conservative view is that consent of an NRSRO will be required in order to include or incorporate by reference the relevant rating agency’s actual or expected ratings (or any portion of a report or opinion of such rating agency) in a registration statement, prospectus or prospectus supplement, except as otherwise described below. The consenting rating agency in the view of the Securities and Exchange Commission (the “SEC”) will be treated as, and have the liability of, an “expert” in connection with such document. Despite the fact that SEC disclosure rules and regulations may require a registration statement or prospectus to include actual or expected ratings, as with SEC-registered asset-backed securities<sup>1</sup> for which obtaining specified ratings is a condition to closing the related transaction, Standard & Poor’s Rating Services, Moody’s Investors Service and Fitch, Inc. have each stated that they do not intend to provide any such consents without further internal review.

<sup>1</sup> Under Item 1101(c)(1) of Regulation AB, an “asset-backed security” is a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period.

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## Asset-Backed Securities and the Six-Month “No-Action” Period

Issuers of asset-backed securities registered with the SEC and conditioned on the assignment of a rating by one or more rating agencies are required under Items 1103(a)(9) and 1120 of Regulation AB to disclose the minimum required rating, the identity of each rating agency and any arrangements to have such ratings monitored.

The refusal of rating agencies to consent to the inclusion of such rating information in response to the repeal of Rule 436(g) shut down the market for asset-backed securities and scuttled a number of offerings, including a proposed offering by Ford Motor Co.’s financing arm. In response to these market developments and in order to facilitate a transition for issuers of registered asset-backed securities. On July 22, 2010, the Office of Chief Counsel of the Division of Corporation Finance of the SEC issued a “no-action” letter (the “July No-Action Letter”) allowing this rating information to be omitted for six months from a prospectus relating to an offering of asset-backed securities under Regulation AB. Securities that are registered with the SEC and are not asset-backed securities will not benefit from the July No-Action Letter.

**EETC Certificates.** In our view, an “enhanced” equipment note pass-through certificate (“EETC Certificate”) should not be treated as an asset-backed security or a security backed by an asset pool. Rather, it should be treated as a corporate secured bond. We base our view in part on the approach taken by the staff of the SEC in the American Airlines, Inc. “no-action” letter dated July 28, 1987, in which the SEC agreed that the sole “issuer” for purposes of the Securities Act, the Securities Exchange Act of 1934 and the Trust Indenture Act of 1939 in EETC Certificate transactions is the airline obligor on the underlying equipment notes. In subsequent informal advice, the staff of the SEC has confirmed the application of the American Airlines “no-action” letter and that EETC Certificates supported by notes of a single corporate entity are not within the purview of Regulation AB. Accordingly, EETC Certificate transactions are not subject to the disclosure rules in Regulation AB and therefore NRSRO ratings are not required by the SEC to be included in an EETC Certificate transaction. For this reason, the July No-Action Letter does not apply, as no rating agency disclosure relief is needed.

## Rule 144A, Regulation S and Other Private Placement Transactions

Rule 436(g) applies only to registered offerings, not to Rule 144A, Regulation S and other exempt private placement transactions. However, it is current market practice with respect to some non-registered issuances to disclose actual or expected ratings in the offering materials and consent (either directly or implicitly) to disclose such ratings is often obtained from the NRSROs.

NRSROs may be concerned that the loss of the Rule 436(g) exemption from liability in registered transactions also opens them up to greater liability in Rule 144A, Regulation S and other private placement transactions. It is not yet clear whether the NRSROs will consent or object to disclosure of ratings in connection with offerings not registered with the SEC. Although NRSRO consent is not strictly required in such transactions, typically issuers will not include such ratings information without appropriate consent. In any event, it is possible that an objecting NRSRO would control disclosure of its ratings in offering materials by withholding its rating letter.

## Disclosure of Ratings Information

On July 22, 2010, the SEC issued new Compliance and Disclosure Interpretations (the “July CD&I”) relating to the disclosure of ratings in registered offerings not subject to Regulation AB and in SEC filings such as Form 10-Ks, Form 10-Qs and Form 20-Fs. The July CD&I clarify that rating agency consent is not required to disclose a rating in a filing with the SEC that is related only to changes to a rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings<sup>2</sup>.

<sup>2</sup> Examples where consent would not be required include disclosure of ratings in a risk factor regarding risk of failure to maintain a certain rating and the impact of a change in credit rating; in the context of liquidity discussions; and in descriptions of debt covenants, interest or dividends tied to credit ratings.

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The July CD&I states that any registration statement on Form S-3 or Form F-3 containing ratings information that was declared effective before July 22, 2010 may continue to be used without filing NRSRO consents for ratings information. However, consent as to the disclosure of ratings information will be required when the next post-effective amendment to the registration statement is filed with the SEC (including as a result of incorporation by reference of an annual report on a Form 10-K or Form 20-F) or a subsequent periodic or current report containing ratings information is filed with the SEC.

The July CD&I also clarified the SEC position that ratings information included in a free writing prospectus that complies with Rule 433 under the Securities Act or in a term sheet or press release that complies with Rule 134 under the Securities Act does not require rating agency consent, unless such documents are also filed as prospectuses under Rule 424 under the Securities Act.

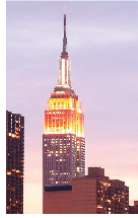
In addition, ratings may continue to be communicated to investors in a variety of ways, including by:

- (a) oral communication;
- (b) rating agency websites; and
- (c) Bloomberg or similar publications.

## **Regulation FD**

The Act also directs the SEC to remove, within 90 days of the effectiveness of the Act, the exemption from Regulation FD for information provided to entities whose primary business is the issuance of credit ratings. Previously, this exemption allowed issuers to provide rating agencies with material non-public information without such information being required to be publicly disclosed. The effect of this change is expected to be minimal as rating agencies and issuers will likely revise engagement letters to provide that such material non-public information be treated as confidential, and therefore not subject to the public disclosure requirements of Regulation FD.

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