
S&P Ratings to pay \$77 million to settle SEC and state violations

By Editorial Staff Thu, Jan 22, 2015

Long after the financial crisis brought serious ethical lapses at ratings agencies to light, S&P Ratings evidently continued to violate SEC regulations.

Standard & Poor's Ratings Services violated federal securities law through fraudulent misconduct in its ratings of certain commercial mortgage-backed securities (CMBS), the Securities and Exchange Commission announced this week.

To settle the charges, S&P agreed to pay the federal government more than \$58 million. The firm will also pay \$12 million to the New York Attorney General's office and \$7 million to the Massachusetts Attorney General's office, to settle parallel charges.

The SEC issued three orders instituting settled administrative proceedings against S&P:

- One order involved S&P's practices in its "conduit fusion CMBS ratings" methodology." S&P said it was using one approach when it actually used another in 2011 to rate six conduit fusion CMBS transactions and issue preliminary ratings on two others. S&P made some admissions, and agreed in 2011 not to rate conduit fusion CMBS for a year.
- Another SEC order found that after being frozen out of the market for rating conduit fusion CMBS in late 2011, S&P sought to re-enter the in mid-2012 by overhauling its ratings criteria. To illustrate the relative conservatism of its new rating criteria, S&P falsely tried to show that "its new credit enhancement levels could withstand Great Depression-era levels of economic stress" by publishing a misleading study. The original author of the study had objected that the firm's CMBS group had turned the article into a "sales pitch" for the new criteria, and that the removal of certain information from the article could lead to him "sit[ting] in front of [the] Department of Justice or the SEC." Without admitting or denying the accusation, S&P agreed to publicly retract the false and misleading Great Depression-related study and correct the descriptions in the publication about its criteria.
- A third SEC order involved internal controls failures in S&P's surveillance of residential mortgage-backed securities (RMBS) ratings. The order finds that S&P allowed breakdowns in the way it conducted ratings surveillance of previously-rated RMBS from October 2012 to June 2014. S&P changed an important assumption in a way that made S&P's ratings less conservative, and was inconsistent with the specific assumptions set forth in S&P's published criteria describing its ratings methodology. S&P did not follow its internal policies for making changes to its surveillance criteria and instead applied ad hoc workarounds that were not fully disclosed to investors.

Without admitting or denying the findings in the order, S&P agreed to improve its internal

controls environment. S&P self-reported this particular misconduct to the SEC and cooperated with the investigation, enabling the Enforcement Division to resolve the case more quickly and efficiently and resulting in a reduced penalty for the firm.

In a separate order instituting a litigated administrative proceeding, the SEC Enforcement Division alleges that the former head of S&P's CMBS Group fraudulently misrepresented the manner in which the firm calculated a critical aspect of certain CMBS ratings in 2011. Barbara Duka allegedly instituted the shift to more issuer-friendly ratings criteria, and the firm failed to properly disclose the less rigorous methodology. The matter against Duka will be scheduled for a public hearing before an administrative law judge for proceedings to adjudicate the Enforcement Division's allegations and determine what, if any, remedial actions are appropriate.

© 2015 RIJ Publishing LLC. All rights reserved.