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RATINGS AGENCIES

S&P Settles Fraud Suits for $1.5 Billion

Standard & Poor's has agreed to pay $1.5 billion to settle lawsuits filed by the U.S. Department of Justice, 19 states and a pension fund that accused the ratings agency of damaging the economy by inflating credit ratings in the years leading up to the 2008 financial crisis.

United States v. McGraw-Hill Cos. et al., No. 13-CV-0779, joint stipulation for dismissal filed (C.D. Cal. Feb. 4, 2015).

According to a statement issued Feb. 3 by S&P, a subsidiary of McGraw-Hill Cos, the ratings agency will pay $687.5 million each to the DOJ and the states. It also will pay $125 million to settle a lawsuit filed by California Public Employees' Retirement System. *Cal. Pub. Employees' Ret. Sys. Moody's Corp. et al.*, No. CGC-09-490241, *complaint filed* (Cal. Super. Ct., S.F. County July 9, 2009).

The parties filed a joint stipulation of dismissal with the U.S. District Court for the Central District of California on Feb. 4.

"After careful consideration, the company determined that entering into the settlement agreement is in the best interests of the company and its shareholders and is pleased to resolve these matters," McGraw-Hill said in the statement.

S&P did not admit to any wrongdoing in agreeing to settle.

U.S. Attorney General Eric Holder announced the settlement for the Justice Department and states.

"On more than one occasion, the company's leadership ignored senior analysts who warned that the company had given top ratings to financial products that were failing to perform as advertised," he said in a statement.

ALLEGATIONS AGAINST S&P

The claims in the cases arose from S&P's credit ratings of mortgage-backed securities and collateralized debt obligations purchased by federally insured financial institutions in the mid-2000s.

A mortgage-backed security is backed by pools of mortgage loans whose principal and interest payments are distributed to investors with varying maturity dates, cash flows and default risks.

Collateralized debt obligations are securities backed by pools of other debt securities, sometimes mortgage-backed securities, credit derivatives and other structured debt securities.

S&P analyzes securities from issuers and rates them according to risk for investors.

According to court filings, S&P allegedly worked with issuers to determine if its rating system would cause the company to lose profits and market share. It worried that if it rated securities lower than investment-grade, issuers would move their business to competing ratings services Moody's or Fitch, the Justice Department's complaint said.

Today's settlement signifies the third and final major round of litigation emanating from the financial crises of 2008.

First, the federal government and state attorneys general reached a national mortgage foreclosure settlement with five major banks — Bank of America, Countrywide, JPMorgan Chase, Citi and Wells Fargo — for over $30 billion to address their alleged role in the issuance of subprime mortgages. *United States v. Bank of Am. et al.,* No. 12-CV-361, *settlement reached* (D.D.C. Feb. 9, 2012).

Second, the federal government and state attorneys generals settled cases with individual banks over the securitization of subprime mortgage backed securities.

Now, the final major settlement addresses S&P's purportedly artificially awarding generous grades to those mortgage backed securities to lure pension funds and investors to buy the overvalued securities.

Today's settlement continues to highlight the unprecedented federal and state cooperation in the wake of the financial crises.

—Attorney Douglas F. Gansler, BuckleySandler LLP

S&P's ratings were artificially inflated to the benefit of issuers and to the detriment of investors, the plaintiffs claimed.

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REACTIONS TO THE SETTLEMENT

Douglas F. Gansler, a partner with **BuckleySandler LLP** who was not involved in the case, said the settlement may signal the final round of litigation stemming from the 2008 financial crisis.

"There remains the remote possibility of criminal charges against financial corporate executives," he said, "as well as the even more remote possibility of successful claims by individuals against financial institutions.

"It is unlikely there will be any further settlements of this magnitude involving major financial institutions coming out of the financial crisis," Gansler said. "Dodd-Frank will assure more transparency and protect the integrity of the rating methodology of the rating agencies."

Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 in response to the financial crisis to increase transparency, reduce risk and heighten regulatory presence in the financial markets.

David Reiss, a professor at **Brooklyn Law School**, also said the settlement closes an important chapter of the crisis.

Ratings agencies had avoided liability for their actions for quite some time based on the theory that they were First Amendment actors who dealt in opinions.

Recent cases have held that the rating agencies can be held liable for some of their ratings notwithstanding the First Amendment. *United States v. McGraw-Hill Cos. et al.,* No. 13-CV-0779, 2013 WL 3762259 (C.D. Cal. July 16, 2013) and *Federal Home Loan Bank of Boston v. Ally Financial Inc. et al.,* No. 11-10952, 2013 WL 5466631 (D. Mass. Sept. 30, 2013).

For instance, if the rating agency did not follow its own rating procedures, it could be held liable for fraud.

—David Reiss, Brooklyn Law School

"S&P would have faced a lot of unquantifiable risk if it had to admit wrongdoing in the settlement," he said. "It is unclear that the Justice Department would have wanted to expose one of the three major rating agencies to such a risk because it could have destabilized the rating agency industry."

Reiss added that the $1.5 billion settlement should have a deterrent effect.

"[It] likely gives ratings analysts some firm ground to stand on if they are pressured to lower their standards by others in their organizations," he said.

Dennis Kelleher, president and CEO of Better Markets, a nonprofit financial reform advocacy group, was critical of the deal.

"Today's reported settlement between DOJ and S&P is grossly inadequate," he said in a statement. "Ironically, the claims being made about the settlement appear to be as inflated as the credit ratings were in the years before the financial crash.

"Allowing S&P to eliminate its liability merely by using shareholders' money to pay a settlement, however big, seven years after the crash is not a meaningful punishment," Kelleher said. WJ