

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 92952 / September 13, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20542

In the Matter of

DBRS, INC.

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15E(d) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against DBRS, Inc. (“DBRS” or “Respondent”).

II.

In anticipation of the institution of these proceedings, DBRS has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and over the subject matter of these proceedings, which are admitted, DBRS consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds that:

Summary

1. This matter concerns DBRS's failure to establish, maintain, enforce, and document policies and procedures reasonably designed to assess the probability that an issuer of collateralized loan obligation ("CLO") combination notes ("Combo Notes") will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security, as required by Rule 17g-8(b)(1) of the Exchange Act.

2. From at least August 2016, DBRS failed to establish, maintain, enforce, and document reasonably designed policies and procedures as required by Rule 17g-8(b)(1). As a consequence, DBRS issued and maintained credit ratings on CLO Combo Notes pursuant to policies and procedures that departed from the requirements set forth in Rule 17g-8(b)(1).

3. Specifically, DBRS issued credit ratings to CLO Combo Notes that were limited to repayment of a defined Combination Note Rated Principal Balance ("Rated Balance"). DBRS's credit ratings of CLO Combo Notes did not address cash flows payable to holders of the CLO Combo Notes in excess of the Rated Balance, even though holders were entitled to these cash flows under the terms of the security to the extent that they were paid with respect to the underlying components. Payment of the Rated Balance was therefore not the entire promise to holders of the CLO Combo Notes under the payment terms (including the priority terms) of the security (the "Payment Terms"). Holders were entitled to all the principal and interest proceeds of the CLO Combo Note's components, and such proceeds in the aggregate could exceed the Rated Balance.

Respondent

4. DBRS is a Nationally Recognized Statistical Rating Organization ("NRSRO") registered with the Commission since 2007, and headquartered in New York, NY. Since July 2019, DBRS has been a wholly owned subsidiary of Morningstar, Inc., a publicly traded company. DBRS currently operates under the trade name DBRS Morningstar.

Facts

5. Between August 2016 and November 2019, upon engagement by certain entities, DBRS assigned credit ratings to five CLO Combo Notes, two of which are currently outstanding. CLOs are structured finance vehicles typically backed by portfolios of corporate loans and are usually structured by the issuer or sponsor as a series of tranches of rated interest-paying securities, along with a tranche of unrated securities commonly known as equity. CLO Combo Notes typically combine one or more rated or unrated CLO tranches and unrated CLO equity tranches from a given CLO transaction.

6. The aggregate cash flows payable to a holder of a CLO Combo Note, from its components, are the same as the cash flows payable to a holder of corresponding amounts of the corresponding CLO tranches. Although the CLO Combo Notes rated by DBRS did not bear a stated rate of interest, the CLO Combo Note holder was entitled to the same underlying cash flows as if they held the corresponding CLO tranches, but allocated as provided in the CLO Combo Note transaction documents.

***DBRS Rated CLO Combo Notes to a Rated Balance that is
a Portion of the Payout to Investors on the Underlying Components***

7. During the relevant period, DBRS assigned credit ratings to CLO Combo Notes that addressed the issuer's ability to repay the Rated Balance, as defined and disclosed in the transaction documents, on or before maturity. Typically the Rated Balance, as so defined, equaled the aggregate of the original principal amounts, or notional amounts, of the components. The Rated Balance decreased during the term of the CLO Combo Note as proceeds from the components were allocated to reduce the Rated Balance. The payments made to CLO Combo Note holders, i.e., the principal and interest cash flows from the underlying components, were not capped at the Rated Balance, and the issuer was obligated to continue paying proceeds to the holders of the components, including CLO Combo Note holders, from the underlying components. Credit ratings that DBRS issued to CLO Combo Notes opined on the risk of default on the Rated Balance only and did not opine on the risk of default on all amounts that the issuer was obligated to pay based on all the principal and interest cash flows from the underlying components. Consequently, DBRS's credit rating addressed the risk of default in payment of only a portion of those payment amounts; the credit rating did not address the risk of default in payment of the proceeds in excess of the Rated Balance, even though holders of the CLO Combo Notes were entitled to receive such amounts in accordance with the Payment Terms.

8. DBRS's policies stated that its credit ratings were an opinion about a security's credit risk or risk of default. DBRS's "Credit Rating Global Policy" outlined DBRS's general approach to assessing credit risk. In that policy, DBRS stated that "credit ratings typically provide an opinion on the risk that investors may not be repaid in accordance with the terms under which the obligation was issued." DBRS assigned credit ratings to CLO Combo Notes using its "Long Term Obligations Scale" ("Scale"). The Scale provided "an opinion on the risk of default," which DBRS defined as "the risk that an issuer will fail to satisfy its financial obligations in accordance with the terms under which an obligation has been issued." Each credit rating category defined in the Scale reflects a different credit quality and capacity for payment of the related financial obligations.

9. In rating CLO Combo Notes, DBRS applied the methodology entitled "Rating CLOs and CDOs of Large Corporate Credit." Before DBRS assigned a credit rating to a CLO Combo Note, a DBRS screening committee approved the applicability of the CLO methodology to rate that CLO Combo Note. DBRS assigned credit ratings on five CLO Combo Notes using the "BBB(low)" rating symbol, the lowest of what are commonly understood as investment-grade credit ratings.

Use of DBRS's CLO Combo Note Credit Ratings

10. The CLO Combo Notes rated by DBRS were typically purchased by life insurance companies, which are regulated by state insurance commissioners. The National Association of Insurance Commissioners ("NAIC") is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. The NAIC's Securities Valuation Office ("SVO") is responsible for the day-

to-day credit quality assessment of securities owned by state-regulated insurance companies. The SVO regulates the investments owned by insurance companies by requiring insurance companies to reserve an amount of capital based on the perceived credit risk of its investments, also known as risk-based capital (“RBC”) reserves. Generally, investments with lower risk require a lower RBC, which is calculated as a percentage of the amount invested; higher risk investments require a higher percentage of RBC. During the relevant period, under NAIC guidelines, a CLO Combo Note rated BBB(low) by DBRS would incur a 1.3% RBC charge. In contrast, investing directly in the unrated equity component of that same CLO Combo Note would require a life insurance company to reserve 30% of the investment as an RBC charge.

11. Life insurance companies that invested in DBRS-rated CLO Combo Notes were able to use the investment-grade credit ratings assigned by DBRS to compute RBC charges. DBRS was generally aware that insurance companies purchased CLO Combo Notes rated by DBRS and that its assigned credit ratings could be reported to the NAIC by the insurance companies.¹

DBRS’s Policies and Procedures

12. During the relevant period, DBRS’s Scale provided that its credit ratings constituted opinions on “the risk that an issuer will fail to satisfy its financial obligations in accordance with the terms under which an obligation has been issued.” DBRS did not explain in its policies and procedures how it determines, for rating purposes, the financial obligations of a security. Specifically, DBRS lacked policies and procedures that were reasonably designed for DBRS to assess such financial obligations of the CLO Combo Notes consistently with their Payment Terms. The Payment Terms of the CLO Combo Notes were based on the principal and interest cash flows paid with respect to their underlying components, and were not based on only the portion of such proceeds allocated to the Rated Balance. DBRS’s policies and procedures failed to address this distinction.

13. DBRS failed to establish, maintain, enforce, and document policies and procedures that were reasonably designed to assess the probability that an issuer of CLO Combo Notes will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security, because DBRS’s policies and procedures were not reasonably designed for DBRS to rate the risk of default on the issuer’s financial obligations associated with CLO Combo Notes as set forth in the Payment Terms of the security. More specifically, DBRS had no policies or procedures that explained the financial obligations of a CLO Combo Note such that the financial obligations would be assessed for ratings purposes consistently with the CLO Combo Note’s Payment Terms, including by addressing the distinction noted in the previous paragraph.

Violation

¹ In 2019, NAIC’s SVO published proposed amendments to its policies and procedures manual to prohibit insurance companies from using NRSRO credit ratings to assign NAIC risk categories for CLO Combo Notes, among other securities. The proposal, which was adopted in 2020, instead required the SVO itself to compute the RBC categorization requirements. The demand for CLO Combo Notes has since slowed. DBRS stopped assigning new ratings to CLO Combo Notes in 2019, which was after NAIC published its proposed amendments.

14. Section 938(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), entitled “Universal Ratings Symbols,” provides that the Commission shall require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures that, in relevant part, “(1) assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.” See Dodd-Frank Act, Pub. L. No. 111-203, §938(a)(1) (2010).

15. The Commission implemented Section 938(a) by adopting Rule 17g-8(b) of the Exchange Act. Rule 17g-8(b)(1) provides, in relevant part: “A[n NRSRO] must establish, maintain, enforce, and document policies and procedures that are reasonably designed to: (1) Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.”

16. As a result of the conduct described above, DBRS willfully² violated Rule 17g-8(b)(1) of the Exchange Act.

IV.

Undertakings

Respondent has undertaken to do the following within 180 days of the entry of this Order:

A. DBRS shall complete a comprehensive review of its policies, procedures, and internal controls that relate to the findings in this Order, including to assess compliance with Rule 17g-8(b)(1).

B. DBRS shall submit a report that summarizes actions taken to comply with the undertaking, and that describes the revised or new policies and procedures established and documented, and the actions taken to maintain and enforce those policies and procedures as required by Rule 17g-8(b)(1). The report shall be supported by exhibits sufficient to demonstrate compliance, including but not limited to DBRS’s revised or new policies and procedures and any revisions to existing ratings. The Staff may make reasonable requests for further evidence of compliance and DBRS agrees to provide such evidence. The report and supporting material shall be submitted no later than 180 days from the date of this Order to Jeffrey P. Weiss, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E.,

² “Willfully,” for purposes of imposing relief under Section 15E(d) of the Exchange Act, “means no more than that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term “willfully” for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has “willfully omit[ted]” material information from a required disclosure in violation of Section 207 of the Advisers Act).

Washington, DC 20549. Respondent agrees that if the Division of Enforcement believes that Respondent has not satisfied these undertakings, the Division of Enforcement may petition the Commission to reopen the matter to determine whether additional sanctions are appropriate.

C. DBRS shall certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and include exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and DBRS agrees to provide such evidence. The certification and supporting material shall be submitted to Jeffrey P. Weiss, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

D. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day. For good cause shown, the Staff may extend any of the procedural dates relating to the undertakings.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent DBRS's Offer.

Accordingly, pursuant to Sections 15E(d) and 21C of the Exchange Act, it is hereby ORDERED that:

A. DBRS cease and desist from committing or causing any violations and any future violations of Rule 17g-8(b)(1) of the Exchange Act.

B. DBRS is hereby censured.

C. DBRS shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$1,000,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying DBRS, Inc. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey P. Weiss, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

D. DBRS shall comply with the undertakings enumerated in Section IV above.

By the Commission.

Vanessa A. Countryman
Secretary