

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 98636 / September 29, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21772

<p>In the Matter of</p> <p style="text-align:center">DBRS, Inc.</p> <p>Respondent.</p>

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, in the public interest and for the protection of investors 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, Respondent has submitted an Offer of Settlement (“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 the subject matter of these proceedings, which are admitted, Respondent 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 finds¹ that:

Summary

1. The implementation of and adherence to established policies, procedures, and methodologies for determining credit ratings is a cornerstone of the legal framework governing nationally recognized statistical rating organizations ("NRSROs"). Consequently, among other things, NRSROs are required to establish an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.

2. Between July 2019 and November 2022, DBRS had an ineffective internal control structure governing implementation of and adherence to its published procedures and methodologies for determining credit ratings for certain commercial mortgage-backed securities ("CMBS") multi-borrower transactions. During this time, DBRS made systematic adjustments to credit enhancement levels implied by the results of the quantitative predictive model (the "Insight Model") DBRS used to rate multi-borrower CMBS transactions, in a manner not guided or described by DBRS's published procedures or methodologies for rating multi-borrower transactions. By failing to include guidance for or a description of the systematic adjustments in DBRS's published procedures or methodologies, DBRS's internal control structure was ineffective in governing implementation of and adherence to its published procedures and methodologies for determining credit ratings, in violation of Section 15E(c)(3)(A) of the Exchange Act.

3. Additionally, between November 2019 and March 2020, DBRS disclosed that it used a legacy single-asset/single-borrower ("SASB") methodology to rate three SASB transactions, but instead used a key element of a proposed SASB methodology that DBRS had not yet approved and adopted. Consequently, DBRS failed to accurately identify the rating methodology it used to rate these three SASB transactions and failed to enforce its policies and procedures requiring credit ratings to be determined and issued based on approved methodologies. These violations also stemmed from DBRS's ineffective internal control structure. DBRS thereby violated Section 15E(c)(3)(A) of the Exchange Act and Rules 17g-7(a)(1)(ii)(B) and 17g-8(a)(1) and (2) thereunder.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Respondent

4. Respondent is a Delaware corporation headquartered in New York, New York. DBRS has been registered with the Commission as an NRSRO since 2007. On July 2, 2019, DBRS was acquired by Morningstar, Inc., the parent of Morningstar Credit Ratings, LLC (“MCR”), after which DBRS and MCR integrated their businesses.

Background

A. DBRS’s Governance of CMBS Credit Ratings

5. Since at least July 2019, DBRS has filed with the Commission annual Form NRSRO certifications with an Exhibit 2 describing the procedures and methodologies that DBRS uses to determine CMBS credit ratings as those published on its website.

6. These have included procedures and methodologies for rating multi-borrower transactions and SASB transactions. DBRS also maintains policies and procedures requiring DBRS credit ratings to be determined and issued based on approved methodologies, and policies and procedures requiring approval of new and changed methodologies by DBRS’s Structured Finance Criteria Committee and Independent Review Function.

B. DBRS Multi-Borrower Methodology and Insight Model

7. Since at least July 2019, DBRS has publicly disclosed that it uses its North American CMBS Multi-Borrower Rating Methodology (“Multi-Borrower Methodology”) to determine credit ratings for CMBS multi-borrower transactions, that is, CMBS transactions secured by diversified pools of commercial real estate (“CRE”) assets. These include CRE collateralized loan obligation (“CLO”) transactions, conduit/fusion transactions, agency multifamily transactions such as the Freddie Mac K series, and others.

8. Broadly speaking, the Multi-Borrower Methodology states that DBRS analyzes the CRE collateral underlying a proposed transaction and the likelihood of potential losses to determine the amount of credit enhancement required for each rating category in a proposed transaction. To this end, the Multi-Borrower Methodology describes as a core step in DBRS’s credit rating process a “fundamental collateral analysis” on underlying CRE collateral, which concludes with DBRS’s estimated net cash flow, a property quality designation, and a sponsor strength score.

9. According to the Multi-Borrower Methodology, these items and other loan-level data are used as inputs to the Insight Model, which generates expected loan-level base case expected losses that are aggregated to form pool-level base case expected losses. The credit enhancement levels that DBRS requires for a transaction are based on these expected pool-level base case losses and the applicable multiple range specified for the various tranche ratings by the methodology.

10. The Multi-Borrower Methodology did not describe systematic adjustments to credit enhancement levels implied by the results of the Insight Model.

C. DBRS Made Systematic Adjustments to Credit Enhancement Levels Implied by Insight Model Results

11. Between July 2019 and November 2022, DBRS rating analysts made systematic adjustments to the credit enhancement levels implied by the results of the Insight Model for CMBS multi-borrower transactions, specifically CRE CLO and agency transactions.

12. Initially, rating analysts made these systematic adjustments during discussion groups, prior to rating committee discussions. Nothing in the Multi-Borrower Methodology guided or described such adjustments.

13. Beginning in approximately March 2021, rating analysts made these adjustments for CRE CLO transactions pursuant to internal, nonpublic written guidance (“Quoting Guidance”), which prescribed specific adjustments based on Insight Model-implied credit enhancement levels for all CRE CLO transactions (see Figure 1). In approximately October 2021, DBRS revised the Quoting Guidance to prescribe adjustments for all agency transactions (see Figure 2), and rating analysts began making adjustments for agency transactions pursuant to this guidance. The adjustments prescribed by the Quoting Guidance applied across the board, formulaically, to all CRE CLO and agency transactions in a manner not guided or described by the Multi-Borrower Methodology.

CLO Quoting Guidance Based on Model Output

	Model Output - General Levels	Category A - Adj. for HC	Model Output - General Levels	Category B - Adj. for HC	Model Output - General Levels	Category C - Adj. for HC
AAA	~30% or lower	3.50%	~32% - 38%	3.00%	~39% or greater	2.50%
AA (high)		3.50%		3.00%		2.50%
AA		3.50%		3.00%		2.50%
AA (low)		3.50%		3.00%		2.50%
A (high)		3.50%		3.00%		2.50%
A		3.50%		3.00%		2.50%
A (low)		3.50%		3.00%		2.50%
BBB (high)		3.00%		2.50%		2.00%
BBB		3.00%		2.50%		2.00%
BBB (low)	~13% or lower	3.00%	~14% - 17%	2.50%	~18% or greater	2.00%
BB (high)		2.50%		2.00%		1.50%
BB		2.50%		2.00%		1.50%
BB (low)		2.50%		2.00%		1.50%
B (high)		2.00%		1.50%		1.00%
B	~6% or lower	2.00%	~7% - 9%	1.50%	~10% or greater	1.00%
B (low)		2.00%		1.50%		1.00%

Figure 1: March 2021 Quoting Guidance, CRE CLO tab.

Freddie Quoting Guidance Based on Model Output

Notes
1.) Calculate the average of the i) actual model loss, and ii) the low end loss (using the low end of the multiple range x pool expected loss)
2.)

Figure 2: October 2021 Quoting Guidance, Freddie Tab.

14. Between July 2019 and November 2022, DBRS rating analysts systematically increased the credit enhancement levels from those implied by the Insight Model in rating CRE CLO transactions and systematically decreased the credit enhancement levels from those implied by the Insight Model in rating agency transactions.

15. These adjustments were typically hard-coded into spreadsheets and lacked loan-specific, transaction-specific, or other qualitative explanation akin to adjustments described in the Multi-Borrower Methodology.

16. For CRE CLO transactions, rating analysts simply added percentage points to the credit enhancement levels implied by the Insight Model, in accordance with the Quoting Guidance. For agency transactions, DBRS rating analysts calculated the average of the credit enhancement implied by the Insight model and the low end of the multiple range in the Multi-Borrower Methodology, as provided by the Quoting Guidance. The practice of using the low end of the multiple range was not described in the Multi-Borrower Methodology, which stated that rating analysts generally start at the *midpoint* of the multiple range: “When applying the multiples to a transaction’s base case pool loss, DBRS generally starts at the midpoint of the multiple range for each rating level and considers various quantitative and qualitative factors when adjusting up or down from the midpoint.”

17. DBRS issued a new version of its Multi-Borrower Methodology and Insight Model in November 2022. The application of these new versions incorporated the effects of the systematic adjustments previously made for CRE CLO or agency transactions, as described above. DBRS stopped using the Quoting Guidance to rate new transactions once the November 2022 versions of the Multi-Borrower Methodology and Insight Model were implemented.

D. DBRS Rated Three SASB Transactions Using a Methodology Other Than the Disclosed Methodology

18. Following Morningstar, Inc.’s July 2019 acquisition of DBRS, DBRS disclosed that it would generally use MCR’s then-existing U.S. Single-Asset/Single-Borrower Ratings

Methodology (“legacy SASB Methodology”) to rate SASB transactions during the entities’ integration.

19. In November 2019, DBRS proposed a new SASB methodology with a request for comment. DBRS did not adopt the proposed SASB methodology until March 2020, following review and approval by the Structured Finance Criteria Committee and Independent Review Function, steps required to implement a methodology under DBRS’s policies and procedures. Among other differences, the new SASB methodology adopted in March 2020 contained higher loan-to-value (“LTV”) benchmarks, or “hurdles,” for hotels than the legacy SASB Methodology.

20. Between November 2019 and March 2020, DBRS rated at least three SASB transactions involving hotel properties effectively using the LTV benchmarks in the proposed, but not yet approved and adopted, SASB methodology. DBRS rating analysts were unable simply to change the LTV hurdles coded into their SASB rating spreadsheets, as those fields were locked to prevent editing. Instead, analysts introduced new columns in which they pasted the proposed LTV hurdles and calculated the difference between the proposed and legacy LTV hurdles. Analysts then added that amount to the legacy hurdles that were coded into their SAB rating spreadsheets using the one adjustment column that was not locked.

21. This had the effect of substituting the proposed, but not yet approved and adopted, LTV hurdles for those in the legacy SASB methodology. But in its Rule 17g-7 disclosure forms and in presale reports for these three transactions, DBRS disclosed that it had used the in-effect legacy SASB methodologies to rate the transactions.

22. The adjustments to incorporate the higher proposed LTV hurdles in the proposed SASB methodology were meaningful: they added between 2% and 7% to the credit enhancement for investment grade ratings classes. Indeed, their magnitude was greater than the combined effect of the property-specific LTV hurdle adjustments that DBRS specifically disclosed in two of its presale reports. But DBRS did not disclose its effective use of the proposed LTV hurdles to rate these transactions.

23. Instead, in two of its presale reports, DBRS stated that the legacy SASB Methodology applied and generally described “certain adjustments to the LTV hurdles” in its SASB model due to lower net cash flow for the asset “than we may have previously concluded” resulting from changes to DBRS’s cash flow criteria. DBRS’s presale reports further stated that there would likely be no ratings impact on the SASB transactions if the proposed SASB methodology was adopted.

E. DBRS’s Internal Control Structure Was Ineffective in Governing Implementation of and Adherence to Published Procedures and Methodologies for Determining Credit Ratings

24. Between July 2019 and November 2022, DBRS had an ineffective internal control structure governing implementation of and adherence to its published procedures and methodologies for determining credit ratings for certain CMBS multi-borrower transactions, specifically CRE CLO and agency transactions. During this time, rating analysts made systematic

adjustments to credit enhancement levels implied by the results of the Insight Model, including pursuant to the Quoting Guidance, even though neither the Multi-Borrower Methodology nor any other published procedure guided or described such adjustments. DBRS had no mechanism, such as a review of internal guidance documents or a review of analysts' actual practices, sufficient to identify the systematic adjustments or the lack of published guidance for them.

25. And between November 2019 and March 2020, DBRS rating analysts rated at least three SASB transactions involving hotel properties effectively using LTV benchmarks in a proposed SASB methodology that had not yet been reviewed and approved by DBRS's Structured Finance Criteria Committee and Independent Review Function, as required to implement a methodology under DBRS's policies and procedures. DBRS's internal control structure was therefore ineffective in governing implementation of and adherence to its published procedures and methodologies for determining SASB credit ratings.

Violations

26. As a result of the conduct described in Paragraphs 5-25, DBRS willfully² violated Section 15E(c)(3)(A) of the Exchange Act by failing to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to its policies, procedures, and methodologies for determining the CMBS multi-borrower and SASB credit ratings described above.

27. As a result of the conduct described in Paragraphs 18-23, DBRS willfully violated Exchange Act Rules 17g-8(a)(1) and (2) by failing to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the procedures and methodologies used to determine the SASB credit ratings described above were approved, developed, and modified in accordance with DBRS's policies and procedures.

28. As a result of the conduct described in Paragraphs 18-23, DBRS willfully violated Exchange Act Rule 17g-7(a)(1)(ii)(B) by failing to disclose the version of the SASB methodology used with respect to credit ratings of the three SASB transactions described above.

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 Investment Advisers Act of 1940).

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors 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. Respondent DBRS cease and desist from committing or causing any violations and any future violations of Section 15E(c)(3)(A) of the Exchange Act and Rules 17g-7(a)(1)(ii)(B) and 17g-8(a)(1) and (2) thereunder.

B. Respondent DBRS is censured.

C. Respondent DBRS shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$2,000,000 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 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 Osman Nawaz, Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 Pearl Street, Suite 20-100, New York, New York 10004-2616.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary