UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9704 / January 21, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74102 / January 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16346

In the Matter of **STANDARD & POOR'S RATINGS SERVICES,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND 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 Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15E(d) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Standard & Poor's Ratings Services ("S&P" or "Respondent").

II.

In anticipation of the institution of these proceedings, S&P 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 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, S&P consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act and 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 S&P's Offer, the Commission finds[1] that:

Summary

1. These proceedings involve misconduct by S&P in 2012 concerning its criteria for rating conduit/fusion Commercial Mortgage Backed Securities ("CF CMBS") and related research. After being frozen out of the market for rating CF CMBS in late 2011, S&P sought to re-enter the market in 2012 by publishing new ratings criteria (the "2012 CMBS Criteria").

2. In connection with its release of the 2012 CMBS Criteria, S&P published an article describing an internal study purportedly showing average commercial mortgage loan pool losses of about 20% under Great Depression levels of economic stress. The article was flawed, in part because it relied on significant assumptions that were not adequately disclosed in the article and thereby contained false and misleading statements. The article was nonetheless published in June 2012 as additional support for the target credit enhancement (CE) level of 20% in the 2012 CMBS Criteria.

3. Separately, S&P also did not accurately describe certain aspects of its 2012 CMBS Criteria in the publication setting forth their operation.

4. S&P used the 2012 CMBS Criteria to determine credit ratings on approximately 25 CF CMBS between October 2012 and June 2014.

Respondent

5. S&P is a Nationally Recognized Statistical Rating Organization ("NRSRO") headquartered in New York City, New York. Standard & Poor's Ratings Services is comprised of a separately identifiable business unit within Standard & Poor's Financial Services LLC, a Delaware limited liability company wholly-owned by the McGraw Hill Financial ("MHFI"), and the credit ratings business housed within certain other wholly-owned subsidiaries of, or businesses continuing to operate as divisions of, MHFI.

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[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.

Facts

A. Background

6. Rating agencies' transparency is crucial to investors, including in the CF CMBS market. Without transparency, investors can neither assess the methodology employed by the rating agency nor the application of that methodology. S&P's policies reflected these priorities by requiring S&P employees to publish sufficient information about S&P's procedures and assumptions so that users of credit ratings could understand how S&P arrived at its ratings.

7. A CF CMBS is a type of mortgage-backed security backed by a pool of commercial real estate loans. Commercial properties that secure loans in CF CMBS pools are broadly divided into five categories: retail, office, multifamily, lodging, and industrial. CF CMBS are typically structured as multiple "tranches," or bonds, which have differing risk/return profiles. The bonds at the top of the capital structure generally receive priority in payment of principal and interest, while the bonds at the bottom experience losses first after the underlying loans incur losses. Because of these differences, the bonds at the bottom of the capital structure generally receive the highest rate of return, while the bonds at the top receive the lowest rate of return. The bonds at the bottom of the structure thus provide a cushion against loss to the bonds at the top of the structure. This cushion is a key element of the CE applicable to each bond in a CF CMBS transaction.

8. On June 26, 2009, S&P published an article entitled "U.S. CMBS Rating Methodology And Assumptions For Conduit/Fusion Pools." That criteria article established a 19% CE level for the AAA-rated tranche of a CF CMBS backed by an "archetypical pool" of commercial real estate loans. In July 2011 S&P published preliminary ratings for two CF CMBS transactions. On one of the deals, S&P gave a preliminary AAA rating to bonds with only 14.5% CE. After potential investors questioned the low level of CE for the AAA bonds in this transaction, S&P withdrew its preliminary ratings for the two transactions.

9. Following withdrawal of the preliminary ratings on the July 2011 transactions, S&P lost significant market share for rating new issuance CF CMBS. S&P sought to re-enter the market in 2012 by publishing new ratings criteria. The prior criteria had been described as being calibrated to produce a AAA credit enhancement level ("AAA CE") of 19% for an "Archetypical Pool" described in that criteria. The 2012 CMBS Criteria were described as having a "target" AAA CE of approximately 20% for a "typical well-diversified conduit-fusion CMBS transaction."

B. S&P's Great Depression Article

10. On June 4, 2012, as part of the development of new CF CMBS Criteria, S&P published an article entitled "Request For Comment: Rating Methodology And Assumptions for U.S. And Canadian CMBS." That publication outlined the parameters of S&P's proposed new CMBS ratings criteria and invited feedback and questions from market participants.

11. With respect to the CE to be provided to CF CMBS under the new Criteria, the article stated in relevant part: "For a typical conduit/fusion transaction, the application of the proposed criteria supports 'AAA' CE level around 20% . . . . This level was supported by multiple factors, including [S&P's] analysis of commercial real estate bond defaults and losses during the Great Depression . . . ."

12. The reference to analysis of Great Depression data corresponded, in part, to an internal study undertaken by a senior S&P employee, which S&P thereafter decided to summarize in an article to provide additional information supporting the 2012 CMBS Criteria. On June 28, 2012, S&P published an article entitled "Estimating U.S. Commercial Mortgage Loan Losses Using Data From The Great Depression" (the "Great Depression Article"). The Great Depression Article relied on data gathered by the staff of the Federal Reserve Bank of New York in preparing a February 2012 report analyzing commercial bond performance during the Great Depression era (the "Fed Data"). Among other things, the Great Depression Article stated that S&P's analysis of Great Depression loss and default information "suggest[s] an average loss of about 20% in periods of extreme economic conditions," thereby supporting the 20% target AAA CE in the proposed new criteria.

13. S&P's focus on the Great Depression, which is commonly understood to have begun in 1929 and to have continued for years thereafter, was consistent with existing S&P ratings practices and methodology. In 2009, S&P published "Understanding Standard & Poor's Ratings Definitions," in which it stated that AAA-rated bonds "should be able to withstand an extreme level of stress and still meet [their] financial obligations." A historical example of such a scenario is the Great Depression in the U.S. The Great Depression Article reinforced the selection of the Great Depression as the "benchmark" for testing the sufficiency of the proposed 20% CE level: "We [S&P] often use the U.S. Great Depression as a benchmark period for determining the appropriate CE level for 'AAA' ratings."

14. The Great Depression Article was flawed, in part because it suggested "about 20%" losses in periods of "extreme economic conditions" without adequately disclosing certain significant assumptions, including the following:

a) S&P's analysis of purported Great Depression losses and defaults included analysis of performance of commercial mortgages originated between 1900 and 1935, many of which were not affected by the extreme economic stress of the Great Depression;

b) The Fed Data analyzed by S&P incorporated discounting assumptions. Discounting loss estimates is contrary to industry standards. The application of a discounting factor lowered the Fed Data losses compared to industry standards; and

c) S&P excluded defaulted commercial mortgages that took longer than three years to resolve, thereby removing from its analysis many of the loans with the most severe losses. The exclusion of these loans also affected the results discussed in the Great Depression Article concerning estimated losses.

15. The impact of the assumptions and methodology incorporated in the Great Depression Article was inadequately disclosed when it was published on June 28, 2012. As a result, S&P knew, or was reckless in not knowing, that the Article was false and misleading.

16. Contemporaneous written evidence prepared by the senior criteria officer ("SCO") who conducted the analysis underlying the Great Depression Article reflects his concerns over his ability to furnish robust and unbiased research to support S&P's proposed CE level of 20%. The SCO's initial determination was that the CE calibration of the 2012 Criteria "may be understating the potential losses in a 'AAA' scenario."

17. For example, on April 16, 2012, after computing loss estimates that ranged above 50%, the SCO wrote in his handwritten notes "Criteria Committee has considered an anchor of 20% for 'AAA'—not sure of justification." After completing his independent analytical work, the SCO estimated losses of approximately 29.5%. He also concluded that the 20% AAA CE benchmark "may be understating the potential losses in a 'AAA scenario.'" His handwritten notes, written contemporaneously with the completion of his independent analytical work, asked "How do we reconcile the [underlying] data and my analysis with the 20% Benchmark?"

18. After discussions with the S&P CMBS ratings group responsible for rating new issuance transactions under the new Criteria, and its Criteria Officer, the SCO modified his analysis to incorporate one of the significant and inadequately described assumptions referenced above relating to time to resolution, and reached results that supported the 20% AAA CE anchor point.

19. In June 2012, when the SCO's study was being prepared for publication, the SCO repeatedly complained about the CMBS group's removal of information from the study.

20. In an unguarded contemporaneous discussion with a confidant, the SCO expressed his reservations generally that the Great Depression Article had become a "sales pitch" for the new criteria, and specifically concerning the removal of certain disclosures concerning the comparable transactions analyzed in connection with the Article.

21. The SCO also expressed concerns about the fact that the removal of those disclosures was reflected in "electronic document[s]" and "discoverable" and he could one day be "sit[ting] in front of Department of Justice, or the SEC . . . ."

22. Despite those concerns, in a self-evaluation written after the Great Depression Article was publicly released in support of the 2012 CMBS Criteria, the SCO lauded his role in the publication and stated that "In my role, I recognize the need to balance between the best theoretical solution and the best business solution."

23. As a result of the conduct described above, S&P willfully violated Section 17(a)(l) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities. The Great Depression Article was expressly referenced in the final 2012 CMBS Criteria, which were considered by investors in the offer and sale of securities.

C. S&P's 2012 CMBS Criteria

24. On September 5, 2012, S&P published its new CMBS Criteria in a publication titled "Rating Methodology And Assumptions For U.S. And Canadian CMBS" (the "Criteria Publication").

25. With respect to CE under the new 2012 CMBS Criteria, the Criteria Publication provided at Paragraph 51: "For a typical well-diversified conduit/fusion transaction, the application of the criteria support a 'AAA' CE level of approximately 20%. This would generally be reflective of a transaction with an S&P LTV range between 70% and 75%, S&P DSC between 1.40x and 1.70x and an effective loan count of around 30." Debt service coverage (DSC) and loan-to-value (LTV) ratios are the two key quantitative metrics used to rate CMBS.

26. Impact testing on a sample of transactions during the development of the criteria did not support the range of S&P DSC and S&P LTV referenced in Paragraph 51. Eight U.S. Non-agency transactions from that sample had metrics within the range cited in Paragraph 51. The impact testing showed that the AAA CE level for those eight transactions would range between 14.8% and 21.3% (with an average AAA CE of 18.8%) under the 2012 Criteria. In addition, six of the eight transactions had an effective loan count of less than 30 and thus were not "well diversified" within the meaning of the criteria. These transactions would have resulted in lower AAA CE if they had been well diversified. Paragraph 51 of the Criteria Publication thus was inaccurate.

27. Following publication and adoption of the 2012 CMBS Criteria, between October 2012 and June 2014, CMBS issuers engaged S&P to rate approximately 25 new issuance CMBS transactions using the new criteria.

28. As a result of the conduct described above, S&P violated Exchange Act Rule 17g-2(a)(6), which requires that NRSROs make and retain books and records which must be complete and current documenting the established procedures and methodologies used to determine credit ratings.

Undertakings

Respondent has undertaken to, within thirty (30) days of the date of the entry of this Order, retract all publicly available versions of the June 28, 2012 Great Depression Article, and remove references to the Article in the Criteria Publication.

Respondent has further undertaken to, within thirty (30) days of the entry of this Order, revise Paragraph 51 of the Criteria Publication to accurately describe the anchor point used to develop the DF Matrix that results in the credit enhancement level as described in that paragraph and to publicly disclose a corrected version of the Criteria Publication.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in S&P's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15E(d) and 21C of the Exchange Act, it is hereby ORDERED that:

A. S&P cease and desist from committing or causing any violations and any future violations of Section 17(a)(l) of the Securities Act and Exchange Act Rule 17g-2(a)(6).

B. S&P is censured.

C. S&P shall, within thirty (30) days of the entry of this Order, pay a civil money penalty of $15 million to the Securities and Exchange Commission. 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) S&P may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) S&P 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) S&P 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 S&P 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 Michael J. Osnato, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 4000, New York, New York 10281.

By the Commission.

Brent J. Fields
Secretary