Department of Justice

Office of Public Affairs

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Department of Justice Sues Standard & Poor's for Fraud in Rating Mortgage-Backed Securities in the Years Leading Up to the Financial Crisis

Complaint Alleges that S&P Lied About its Objectivity and Independence And Issued Inflated Ratings for Certain Structured Debt Securities.

Attorney General Eric Holder announced today that the Department of Justice has filed a civil lawsuit against the credit rating agency Standard & Poor's Ratings Services alleging that S&P engaged in a scheme to defraud investors in structured financial products known as Residential Mortgage-Backed Securities (RMBS) and Collateralized Debt Obligations (CDOs). The lawsuit alleges that investors, many of them federally insured financial institutions, lost billions of dollars on CDOs for which S&P issued inflated ratings that misrepresented the securities' true credit risks. The complaint also alleges that S&P falsely represented that its ratings were objective, independent, and uninfluenced by S&P's relationships with investment banks when, in actuality, S&P's desire for increased revenue and market share led it to favor the interests of these banks over investors.

"Put simply, this alleged conduct is egregious – and it goes to the very heart of the recent financial crisis," said Attorney General Holder. "Today's action is an important step forward in our ongoing efforts to investigate – and – punish the conduct that is believed to have contributed to the worst economic crisis in recent history. It is just the latest example of the critical work that the President's Financial Fraud Enforcement Task Force is making possible."

Attorney General Eric Holder was joined in announcing the filing of the civil complaint by Acting Associate Attorney General Tony West, Principal Deputy Assistant Attorney General for the Civil Division Stuart F. Delery, and U.S. Attorney for the Central District of California André Birotte Jr. Also joining the Department of Justice in making this announcement were the attorneys general from California, Connecticut, Delaware, the District of Columbia, Illinois, Iowa and Mississippi, who have filed or will file civil fraud lawsuits against S&P alleging similar misconduct in the rating of structured financial products. Additional state attorneys general are expected to make similar filings today.

"Many investors, financial analysts and the general public expected S&P to be a fair and impartial umpire in issuing credit ratings, but the evidence we have uncovered tells a different story," said Acting Associate Attorney General West. "Our investigation revealed that, despite their representations to the contrary, S&P's concerns about market share, revenues and profits drove them to issue inflated ratings, thereby misleading the public and defrauding investors. In so doing, we believe that S&P played an important role in helping to bring our economy to the brink of collapse."

Today's action was filed in the Central District of California, home to the now defunct Western Federal Corporate Credit Union (WesCorp), which was the largest corporate credit union in the country. Following the 2008 financial crisis, WesCorp collapsed after suffering massive losses on RMBS and CDOs rated by S&P.

"Significant harm was caused by S&P's alleged conduct in the Central District of California," said U.S. Attorney for the Central District of California Birotte. "Across the seven counties in my district, we had huge numbers of homeowners who took out subprime mortgage loans, many of which were made by some of the country's most aggressive lenders only because they later could be securitized into debt instruments that were given flawed 'AAA' ratings by S&P. This led to an untold number of foreclosures in my district. In addition, institutional investors located in my district, such as WesCorp, suffered massive losses after putting billions of dollars into RMBS and CDOs that received flawed and inflated ratings from S&P."

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The complaint, which names McGraw-Hill Companies, Inc. and its subsidiary, Standard & Poor's Financial Services LLC (collectively S&P) as defendants, seeks civil penalties under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) based on three forms of alleged fraud by S&P: (1) mail fraud affecting federally insured financial institutions in violation of 18 U.S.C. § 1341; (2) wire fraud affecting federally insured financial institutions in violation of 18 U.S.C. § 1343; and (3) financial institution fraud in violation of 18 U.S.C. § 1344. FIRREA authorizes the Attorney General to seek civil penalties up to the amount of the losses suffered as a result of the alleged violations. To date, the government has identified more than $5 billion in losses suffered by federally insured financial institutions in connection with the failure of CDOs rated by S&P from March to October 2007.

"The fraud underpinning the crisis took many different forms, and for that reason, so must our response," said Stuart F. Delery, Principal Deputy Assistant Attorney General for the Department's Civil Division. "As today's filing demonstrates, the Department of Justice is committed to using every available legal tool to bring to justice those responsible for the financial crisis."

According to the complaint, S&P publicly represented that its ratings of RMBS and CDOs were objective, independent and uninfluenced by the potential conflict of interest posed by S&P being selected to rate securities by the investment banks that sold those securities. Contrary to these representations, from 2004 to 2007, the government alleges, S&P was so concerned with the possibility of losing market share and profits that it limited, adjusted and delayed updates to the ratings criteria and analytical models it used to assess the credit risks posed by RMBS and CDOs. According to the complaint, S&P weakened those criteria and models from what S&P's own analysts believed was necessary to make them more accurate. The complaint also alleges that, from at least March to October 2007, and because of this same desire to increase market share and profits, S&P issued inflated ratings on hundreds of billions of dollars' worth of CDOs. At the time, according to the allegations in the complaint, S&P knew that the quality of non-prime RMBS was severely impaired, and that the ratings on those mortgage bonds would not hold. The government alleges that S&P failed to account for this impairment in the CDO ratings it was assigning on a daily basis. As a result, nearly every CDO rated by S&P during this time period failed, causing investors to lose billions of dollars.

The underlying federal investigation, code-named "Alchemy," that led to the filing of this complaint was initiated in November 2009 in connection with the President's Financial Fraud Enforcement Task Force. The task force was established to wage an aggressive, coordinated and proactive effort to investigate and prosecute financial crimes. With more than 20 federal agencies, 94 U.S. attorneys' offices and state and local partners, it's the broadest coalition of law enforcement, investigatory and regulatory agencies ever assembled to combat fraud. Since its formation, the task force has made great strides in facilitating increased investigation and prosecution of financial crimes; enhancing coordination and cooperation among federal, state and local authorities; addressing discrimination in the lending and financial markets and conducting outreach to the public, victims, financial institutions and other organizations. Over the past three fiscal years, the Justice Department has filed nearly 10,000 financial fraud cases against nearly 15,000 defendants including more than 2,900 mortgage fraud defendants. For more information on the task force, please visit www.StopFraud.gov .

Due to public interest in this case, the Department of Justice is releasing documents that may not be in an accessible format. If you have a disability and the format of any material on the site interferes with your ability to access some information, please email the Department of Justice webmaster at webmaster@usdoj.gov or contact Adora Andy at 202.514.2007. To enable us to respond in a manner that will be of most help to you, please indicate the nature of the accessibility problem, your preferred format (electronic format (ASCII, etc.), standard print, large print, etc.), the web address of the requested material, and your full contact information so we can reach you if questions arise while fulfilling your request.

Portable Document Format (PDF) files may be viewed with a free copy of Adobe Acrobat Reader.

Related Material:

- Standard & Poor's Complaint
- Attorney General Eric Holder Speaks at the Press Conference Announcing Lawsuit Against S&P
- Acting Associate Attorney General Tony West Speaks at the Press Conference Announcing Lawsuit Against S&P
- Principal Deputy Assistant Attorney General for the Civil Division Stuart F. Delery Speaks at the Press Conference Announcing Lawsuit Against S&P

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