

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION— S.D.N.Y.: Ratings agency hit with charges for disclosure and internal controls failures, (Feb. 17, 2021)

Securities Regulation Daily Wrap Up

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By [R. Jason Howard, J.D.](#)

Transactions totaling \$30 billion questioned in complaint.

A civil action filed by the SEC alleges that Morningstar Credit Ratings, LLC, failed to disclose that it permitted analysts to make undisclosed adjustments in 30 commercial mortgage-backed securities (CMBS), transactions rated from 2015 to 2016, in violation of the disclosure and internal controls provisions of the federal securities laws in rating CMBS ([SEC v. Morningstar Credit Ratings, LLC](#), February 16, 2021).

Adjustments. According to the complaint, analysts adjusted key stresses in a model used by Morningstar in determining a rating for a transaction. These frequently made adjustments were "overwhelmingly used" to reduce the stress applied in the model, thereby lowering the credit enhancement required for many of the ratings awarded. In using these adjustments to lower the credit enhancement, Morningstar could assign higher credit ratings, "to the benefit of the issuers that hired and payed Morningstar," as those issuers were then able to pay investors less interest than they would have prior to the adjustment. The complaint also alleges a failure to "establish and enforce an effective internal control structure in governing the adjustments in at least 31 CMBS transactions," including one in March 2017.

"To increase transparency and guard against conflicts of interest, the federal securities laws require credit rating agencies to disclose how ratings are determined and to have effective internal controls to ensure they adhere to their ratings methodologies," [said](#) Daniel Michael, Chief of the SEC Enforcement Division's Complex Financial Instruments Unit. "In this action, the complaint alleges that Morningstar failed on both counts by permitting analysts to make undisclosed adjustments over which Morningstar had no effective internal controls."

Relief sought. The complaint charges Morningstar with violating the disclosure and internal control provisions applicable to credit rating agencies, and seeks injunctive relief, disgorgement with prejudgment interest, and civil penalties.

The case is [No. 1:21-cv-01359](#).

Attorneys: James Patrick Connor for the SEC.

Companies: Morningstar Credit Ratings, LLC

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