S&P Settlement - FAQs

Q. Who are the parties?

Plaintiff is the Commonwealth of Pennsylvania Office of Attorney General through the Bureau of Consumer Protection (Plaintiff).

Defendants are McGraw Hill Financial, Inc. and Standard & Poor's Financial Services, LLC (S&P). S&P is a successor entity to a business unit that until 2009 operated within an unincorporated division of McGraw Hill. S&P "operates a credit rating agency that assigns credit ratings on a broad range of securities, including structured finance securities, which are issued and published in domestic and international markets."

The federal government, 18 other states and the District of Columbia were also parties to lawsuits filed against S&P. All parties reached a settlement announced on Tuesday, Feb. 3, 2015.

Q. What is the cause of action?

From 2001 to 2014, S&P violated the Unfair Trade Practices and Consumer Protection Law (UTPCPL) by, among other things, "Representing that goods or services have sponsorship, approval, characteristics…uses, benefits or quantities that they do not have…" and, "Engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding."

Q. What is the case about?

S&P is the largest credit rating agency in America. This case alleged that S&P misrepresented the nature of its credit ratings process, which violated the UTPCPL. The Commonwealth alleged the violations occurred:

- In various public statements;
- In S&Ps own Code of Conduct;
- Through the S&P website, marketing materials and subscriber newsletters; and
- Contracts directed to Pennsylvania entities.

S&P repeatedly stated that it was "independent and objective" when performing credit ratings analysis and that the ratings published were the product of this independent and objective process. However, securities are rated through what the industry calls the "issuer pays" business model. This means that the entity issuing the securities pays the rating agency to review the financial soundness of the security and issue a rating. This business model exists throughout the credit rating industry, but is fraught with conflicts of interest. The issuer is keenly interested in obtaining the highest possible credit rating in order to increase the value of the security.

Unfortunately, this conflict puts pressure on the rating agency to come up with a rating acceptable to the issuer for fear of losing that issuer's business to a competitor. The Commonwealth alleges that this is exactly what happened in this matter.

Q. What securities were involved?

The specific misrepresentations alleged in this case relate to S&P's ratings of Residential Mortgage Backed Securities (RMBS) and Collateralized Debt Obligations (CDOs). Both RMBS and CDOs are classified as "structured finance securities."

RMBS and CDOs are extremely complicated securities, and their dramatic over-valuation and subsequent collapse were at the heart of the crippling financial crisis that rocked world markets in 2007 and 2008. As a credit rating agency, S&P's role is that of a gatekeeper-to impartially evaluate the relative risk of a given security and apply a rating (AAA, AA etc.) as a guide for investors.

The lawsuit contends that S&P failed utterly in this task concerning RMBS and CDOs, repeatedly giving inflated ratings to these securities, to the detriment of investors.

Q. Why settle?

This settlement brings closure and certainty after two years of litigation and holds S&P accountable for its actions. The settlement amount represents (approximately) the entirety of S&P's domestic revenues derived from their ratings of RMBS and CDOs from 2001-2007, the critical years when the value of these securities grew exponentially and ultimately burst.

Q. How is the Settlement Amount Being Divided?

The entire settlement amount is **$1.375 billion.** One half of the settlement amount, or **$687.5 million**, is to be allocated to the federal government. The remaining half is to be distributed among the states.

Pennsylvania was allotted $21.5 million which is equal to the amount received by 13 other states.

This equal distribution reflects the fact that each state actively and vigorously litigated its own case against S&P.

Q. How is Pennsylvania's Share Being Allocated?

Of the settlement, **$15,000,000** will be distributed among Commonwealth agencies in approximate proportion to the amount of RMBS and CDOs they purchased. Those agencies include: Treasury; Public School Employees Retirement System; State Employees Retirement System; Pennsylvania Municipal Retirement System; and the Turnpike Commission.

The **Office of Attorney General** will receive **$5,035,714** to reimburse costs of this litigation and to fund future consumer protection enforcement and educational activities.

Six agencies were subpoenaed for documents by S&P during the MDL phase of the litigation. Each of those agencies will receive $250,000 to reimburse their costs related to responding to those subpoenas. Those agencies are: Office of the Governor/Office of the Budget; Insurance Department; Treasury; SERS; PSERS; and PMRS.

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