DISTRICT COURT, CITY AND COUNTY OF DENVER, STATE OF COLORADO 1437 Bannock Street Denver, CO 80202	DATE FILED: February 5, 2013 1:28 PM FILING ID: E2E30779
STATE OF COLORADO, *ex rel*. JOHN W. SUTHERS, Attorney General, Plaintiff, v. THE McGRAW-HILL COMPANIES, INC., a New York corporation; and STANDARD & POOR'S FINANCIAL SERVICES LLC, a Delaware limited liability company Defendants.	▲ **COURT USE ONLY** ▲
Attorneys for Plaintiff: JOHN W. SUTHERS, Attorney General ANDREW P. McCALLIN, #20909* First Assistant Attorney General JENNIFER C. MINER DETHMERS, #32519* Assistant Attorney General Colorado Attorney General's Office Consumer Protection Section Ralph L. Carr Colorado Judicial Center 1300 Broadway, 7th Floor Denver, CO 80203 Telephone: 720-508-6215 Facsimile: 720-508-6040 E-mail: Andrew.McCallin@state.co.us Jennifer.Dethmers@state.co.us *Counsel of Record	Case Number: _____CV ________ Courtroom:

COMPLAINT

This is an action brought upon relation of Attorney General John W. Suthers for the State of Colorado (hereinafter "the State") under the Colorado Consumer Protection Act ("CCPA"), §§ 6-1-101, et seq. (2012) against Defendants for the deceptive trade practices that they engaged

in when rating structured finance securities from 2004 – 2012. Upon information and belief the State alleges:

I. SUMMARY OF THE CASE

1. This lawsuit seeks redress for The McGraw-Hill Companies, Inc.'s, Standard & Poor's Financial Services LLC's, and its business unit Standard & Poor's Ratings Services' (collectively, "S&P") deceptive trade practices of systematically and intentionally misrepresenting that their analysis of structured finance securities was objective, independent, and not influenced by either S&P's or its clients' financial interests. S&P knowingly and intentionally made these misrepresentations and omissions from 2004 through 2012.

2. S&P has represented and continues to represent that its analysis of structured finance securities is independent, objective, and the result of the highest quality credit analytics that are available to S&P. Indeed, S&P has emphasized its reputation for independence, objectivity, and integrity to the public consistently from 2004 through 2012.

3. Despite these public representations, S&P knowingly and intentionally allowed its desire for increased revenue and market share in the structured finance ratings market to influence the analytical models it developed for analyzing structured finance securities and, ultimately, the ratings that it assigned to these investments. Similar revenue and market share concerns dictated the manner in which S&P monitored the performance of structured finance securities that S&P had already rated. This conduct allowed S&P to continue to assign the high ratings that S&P's frequent customers required while enabling S&P to maximize its revenue and preserve its already high market share for rating structured finance securities. As concluded by the Senate Permanent Subcommittee on Investigations, "[c]ompetitive pressures, including that drive for market share and need to accommodate investment bankers bringing in business,

affected the credit ratings issued by … S&P." All the while, S&P maintained that its ratings were not impacted by these types of business concerns.

4. These ratings were important to the public and the market because they were relied on by pension funds and other investors to assess the risk of complex structured finance securities, like residential mortgage backed securities ("RMBS"). Pension funds and other investors generally would not consider a structured finance security unless it had a high rating.

5. To illustrate, Gregory W. Smith, General Counsel and Chief Operating Officer of the Public Employees' Retirement Association of Colorado ("PERA") testified before the House Subcommittee on Oversight and Investigations of the Committee on Financial Services in July 27, 2011, that PERA used credit ratings to screen the tens of thousands of new instruments in which it considers investing each year. Smith explained that PERA also uses ratings to help establish initial risk parameters for both internal and external portfolio managers.

6. S&P knew that its false representations of independence and objectivity were misleading and harmful to these participants in the structured finance securities market. As these securities are particularly complex and their creditworthiness is difficult to evaluate, the market and public rely on the advertised expertise and independence of the credit rating agencies to provide objective ratings about the creditworthiness of structured finance securities. Instead of providing objective and independent ratings, S&P placed its own financial interests above the interests of the public and the market that relied on its statements of objectivity and independence.

7. S&P's misrepresentations and omissions as to its objectivity and independence caused investors and the public to place undue faith in their ratings. Based on S&P's public statements of objectivity and independence, these investors and the public bought structured

finance securities with a false sense of confidence. Had they known the truth about the influences operating on S&P when rating these risky securities, they would not have had this same confidence in the ratings. They would not have bought these securities had they known the true facts.

8. These misrepresentations and omissions created distortions in the financial markets and added to the foreclosure crisis that started plaguing Colorado in 2006. As discussed below, nearly 80% of the mortgages originated in 2006 were packaged up and sold as RMBS. Investors like Colorado PERA placed great importance on the high ratings that S&P gave to these securities. Therefore, there was a demand for these RMBS. In turn, the issuers needed ever more mortgages to package into these securities. S&P served an important gate-keeping function in bringing these securities to market. Had it disclosed the true influences it was operating under when rating these securities, investors would not have had the same confidence in these ratings. Consequently, there would not have been as great a market for these RMBS, or in turn, the risky loans that were originated to create these structured finance securities

9. This lawsuit does not challenge S&P's judgment regarding which rating methodology to use, or how to apply it, when rating any specific structured finance security. Similarly, the State's lawsuit is not brought for the purpose of demonstrating that any particular S&P rating on a structured finance security was incorrect (*i.e.*, too high or too low.)

10. Rather, the State's lawsuit alleges that S&P represented that its analysis of structured finance securities was independent, objective and, as stated in its Code of Conduct, uninfluenced by "the potential effect (economic, political, or otherwise) of that action on [S&P], an affiliate, an Issuer, an investor, or any other market participant." These representations by S&P were false, and S&P knew it.

11. By intentionally and knowingly misrepresenting and omitting factors it considered when analyzing structured finance securities, S&P offered a service that was materially different from what it purported to provide to the marketplace.

12. S&P's conduct as described herein constitutes a deceptive trade practice in violation of the CCPA, C.R.S. § 6-1-105(1) & (2). Pursuant to the CCPA, the State seeks disgorgement, civil penalties, and injunctive and equitable relief to prevent these unfair, deceptive, and illegal business practices from happening in the future.

II. PARTIES

13. John W. Suthers is the duly elected Attorney General for the State of Colorado and has express authority under C.R.S. § 6-1-103 (2012) to enforce and prosecute violations of the CCPA.

14. Defendant The McGraw-Hill Companies, Inc. ("McGraw-Hill") is a New York corporation with its principal place of business at 1221 Avenue of the Americas, New York, NY 10020. McGraw-Hill is registered with the Colorado Secretary of State to conduct business within the State of Colorado.

15. Standard & Poor's Financial Services LLC is a Delaware limited liability company and wholly owned subsidiary of McGraw-Hill with a principal place of business at 55 Water Street, New York, NY 10041. Standard & Poor's Financial Services LLC has been registered to do business as a foreign entity in Colorado since December 2008. Within Standard & Poor's Financial Services LLC is the business unit Standard & Poor's Ratings Services, which operates as a credit rating agency that assigns credit ratings on a broad range of securities, including structured finance securities, issued in domestic and international financial markets.

Standard & Poor's Financial Services LLC is the successor entity to a unit that previously operated within an unincorporated division of McGraw-Hill.

16. S&P holds a dominant position in the credit rating agency market, particularly with respect to the analysis of structured finance securities. As of 2009, S&P had rated and monitored ratings on approximately 198,000 structured finance obligations.

17. S&P regularly transacts business in Colorado by rating structured finance securities issued by issuers located within Colorado. Additionally, S&P's analysis of structured finance securities is routinely used and relied on by investors and other participants in the financial markets located within Colorado. Based on S&P's public representations, these individuals and entities depend on S&P to provide independent and objective analysis of the credit risk of structured finance securities that is not affected by S&P's or its clients' financial interests.

III. JURISDICTION and VENUE

18. This court has jurisdiction over this matter pursuant to the CCPA, §§ 6-1-103 and -110(1), C.R.S.

19. Defendants' misrepresentations and omissions were publicly published nationwide and available in Denver. The ratings affected investors and participants in Denver. Therefore, venue is proper in this district pursuant to C.R.S. § 6-1-103.

IV. PUBLIC INTEREST

20. Through the misleading and deceptive trade practices of their business, Defendants misled consumers in Colorado and nationwide. Defendants' misrepresentations and omissions continued over a course of years and were relied upon by investors and the public when evaluating the ratings on structured finance securities. These legal proceedings are brought

to protect and uphold the public interest in our financial markets and the important role that independent ratings serve in these markets.

V. BACKGROUND

A. The Creation and Rating of Structured Finance Securities

1. What is a Structured Finance Security?

21. Broadly stated, structured finance securities are Asset-Backed Securities ("ABS"), which are financial products whose value is derived from the revenue stream flowing from a pool of underlying assets. These securities are sold to buyers / investors who rely upon the repayment of their principal and interest from the revenue stream generated from the underlying asset pool. Many different types of assets can serve as collateral for ABS. Some of the most common types of assets used to support an ABS are residential and commercial mortgages.

22. The largest type of structured finance securities are securities backed by RMBS. During 2006, approximately $2.5 trillion in mortgages were originated in the United States. Approximately 80% of those mortgages were securitized into RMBS. Approximately 25% of all RMBS issued were backed by subprime mortgages. Between 2002 and 2005 the annual volume of mortgage securities sold to private investors tripled to $1.2 trillion and the subprime portion of these obligations rose to approximately $456 billion.

23. Structured finance securities can also be backed by a variety of other types of assets, such as commercial mortgages ("CMBS"), student loans, and credit card balances.

24. Collections or "pools" of asset backed securities such as RMBS can themselves serve as the collateral for structured finance securities that gather together an asset pool of various ABS securities and then issue a further round of derivative securities.

25. The most common type of structured finance securities collateralized by other securities is known as collateralized debt obligations ("CDOs"). According to the Securities Industry and Financial Markets Association, the value of CDOs backed by RMBS during 2005 was $177 billion, during 2006 was $314 billion, and during 2007 was $263 billion. Additionally, from 2005-2007 there were hundreds of billions of dollars of CDOs backed by bonds and high yield loans called collateralized loan obligations ("CLOs").

26. As the market for mortgage-related structured finance securities grew, the securities that provided the underlying value for these investments became increasingly complex. In addition to issuing CDOs made up of RMBS or other CDOs ("CDOs squared"), issuers began to use credit default swaps and other derivative securities to serve as the underlying collateral of the obligation, which were designed to replicate the performance of subprime RMBS and CDOs. In this case, rather than purchasing subprime RMBS or CDOs, the CDO primarily entered into credit default swaps referencing subprime RMBS or CDOs. These CDOs, which are extremely complex financial products, in some cases are composed entirely of credit default swaps (*i.e.*, "synthetic CDOs") or a combination of credit default swaps and actual cash RMBS (*i.e.*, "hybrid CDOs").

27. While the asset pool underlying a structured finance security may vary, the mechanism for transforming the pool of assets into an ABS by way of the securitization process is generally the same.

28. The process for creating a RMBS begins when an arranger, generally an investment bank, packages mortgage loans into a pool and transfers them to a trust that will issue securities collateralized by the pool. The trust purchases the loan pool and becomes entitled to the interest

and principal payments made by the borrowers, which is used to make monthly interest and principal payments to the investors in the RMBS.

29. To appeal to investors with different risk appetites, the trust issues different classes of RMBS, known as tranches, which offer a sliding scale of interest rates based on the level of credit protection afforded to the tranche. Credit protection is designed to shield the securities within a tranche from the loss of interest and principal due to defaults of the loans in the overall pool. The degree of credit protection afforded any tranche of securities is known as credit enhancement.

30. The main source of credit enhancement is subordination. Subordination refers to the hierarchy of loss absorption among the tranches where any loss of interest and principal experienced by the trust from delinquencies and defaults in loans in the pool are allocated first to the lowest tranche until it loses all of its principal amount and then to the next lowest tranche up the capital structure. Consequently, the most senior tranche, and therefore the highest rated, would not incur any loss until all lower tranches had absorbed losses from the underlying loans.

31. The process for creating a typical CDO is similar to that of an RMBS. Specifically, a sponsor creates a trust or other special purpose entity to hold assets and issue securities. Instead of the mortgage loans that are held in RMBS pools, a CDO trust is typically comprised of approximately 200 debt securities such as RMBS or other CDOs. The trust then uses the interest and principal payments from the underlying debt securities to make interest and principal payments to investors in the CDO securities issued by the trust. CDO trusts are among the largest purchasers of subprime RMBS and have been one of the biggest drivers of demand for these securities.

32. A CDO trust also issues different classes of securities divided into tranches that provide differing levels of credit enhancement to the securities it issues through the use of subordination and other forms of credit enhancement. So long as the underlying assets continue to perform, the cash flow continues and the performance of each of the tranches of the CDO remains strong. Just as is the case with RMBS, the senior CDO tranches are paid first from the incoming cash flow generated from the collateral, followed by each subordinate tranche in the capital structure. Conversely, if the underlying assets begin to default, the cash flow diminishes and the investors at each CDO tranche level are subjected to risk starting from the bottom or equity tranches and proceeding upward.

2. The Need for a Credit Rating

33. A necessary step in the process of creating and ultimately selling any ABS, including an RMBS or a CDO, is the assignment of a credit rating for each of the tranches issued by the trust. Indeed, many institutional investors can invest only in securities that have received a certain rating level from S&P or another credit rating agency recognized by the Securities and Exchange Commission ("SEC").

34. S&P engaged in the following steps when it rated RMBS. First, upon receiving a range of data on a pool of mortgage loans from an investment bank or some other arranger, S&P assigned a lead analyst to the transaction. Information provided to the lead analyst about the transaction included the principal amount of the loan, geographic location of the property, credit history and FICO score of the borrower, loan-to-value ratio, type of loan, as well as the proposed capital structure of the trust and the proposed levels of credit enhancement to be provided to each tranche. The lead analyst was responsible for analyzing the loan pool, proposed capital structure, and proposed credit enhancement levels provided by the issuer.

35. The next step in the process was for the analyst to use S&P's analytical models to develop predictions as to how many loans in the collateral pool would default individually and in correlation with each other under varying levels of stress. S&P built its analytical models on a series of assumptions with respect to probability of default and asset correlation and, like any models, their output is subject to adjustment based on changes to the underlying assumptions.

36. The purpose of using analytical models to carry out a default and loss analysis is to determine how much credit enhancement a given tranche security would need for a particular category of rating. S&P would run the most severe stress test to determine the credit enhancement required for a RMBS tranche to receive its highest "AAA" rating. S&P would run the next most severe stress test to determine the amount of credit enhancement required of the next highest tranche, and so on down the capital structure.

37. After determining the level of credit enhancement required for each credit rating category, S&P would check the proposed capital structure of the RMBS trust against S&P's requirements for a particular credit rating.

38. Upon analyzing the proposed capital structure based on S&P's analytical models, if S&P determined that the issuer's proposal did not allow for sufficient credit enhancement to receive an "AAA," then it was supposed to let the issuer know that the most senior class of securities could only receive an "AA" or lower rating. Presented with this information, the issuer could accept that determination and have the trust issue the securities with the proposed capital structure and lower rating or it could adjust the structure to provide the requisite credit enhancement for the senior tranche to receive the desired "AAA" rating.

39. Similarly, the steps that S&P followed for assigning ratings to CDOs involved a review of the creditworthiness of each tranche of CDO. The process centered on an examination

of the pool of assets held by the trust and, through the use of analytical models developed by S&P, an analysis of how these assets would perform both individually and in correlation with each other during various stress scenarios. With respect to CDOs, however, S&P's analytical models looked only to the credit rating of each RMBS (or other structured finance security) in the underlying pool and did not include an analysis of the underlying loan pools.

B. The Market for Structured Finance Securities

40. The market for structured finance securities consists of the issuers (*i.e.*, sellers or sponsors), who create a trust to hold the underlying collateral and issue ABS such as RMBS and CDOs, and the buyers (*i.e.*, investors) that purchase these investments. Issuers of structured finance securities are financial companies such as banks, mortgage companies, finance companies, and investment banks. Buyers of structured finance securities are institutional investors, including financial institutions, pension funds, insurance companies, mutual funds, hedge funds, money managers, and investment banks.

41. Structured finance securities are typically not marketed to or purchased by retail investors. However, the credit ratings that RMBS, CMBS, CDOs, and other ABS receive, and the performance of these investments, have significant real world implications for the finances of individual investors. In particular, structured finance securities are often included in mutual fund and pension fund portfolios that play significant roles in the retirement and investment strategies of many individuals, including citizens of Colorado.

42. There are few credit rating agencies that assign ratings to structured finance securities. Consequently, the market for rating structured finance securities is extremely concentrated. S&P, and its primary competitor, Moody's Investors Service, Inc. ("Moody's"),

dominate the rating of these investments. For example, according to industry publication Asset-Backed Alert, S&P rated 97.5% of the CDOs issued in 2006.

43. The market for analyzing structured finance securities is also very lucrative. In 2006, S&P's revenues rose approximately 15% to $1.27 billion, with approximately one half of that growth derived from S&P's increased sale of structured finance security ratings.

44. Finally, unlike the markets for most financial products, the market for structured finance securities is comprised of a relatively narrow group of sellers (*i.e.*, investment banks) that act as repeat issuers or sponsors of RMBS, CMBS, CDOs and other ABS. Accordingly, there is a relatively small group that hires S&P to analyze their products on a regular basis.

45. The implication of this reality has been described by Professor John C. Coffee of Columbia University, a frequent expert witness before Congress on the credit rating agencies' role in the most recent financial crisis:

> The major change that destabilized rating agencies appears to have been the rise of structured finance . . . [T]he rating agency is no longer facing an atomized market of clients who each come to it only intermittently (and thus lack market power), but instead large repeat clients who have the ability to take their business elsewhere. Today, structured finance accounts for a major share of some rating agencies' total revenues; equally important, these amounts are paid by a small number of investment banks that know how to exploit their leverage. . . .

C. S&P's Role in the Market for Structured Finance Securities

46. Credit rating agencies distinguish among grades of debt creditworthiness. In other words, a credit rating is a statement as to the likelihood that the borrower or issuer will meet its contractual and financial obligations as they become due. Thus, S&P is a gatekeeper on whom investors and consumers necessarily rely.

47. S&P's role as a "gatekeeper" takes on special importance in the market for structured finance securities, because, historically, SEC regulations require an investment grade as a condition of allowing institutional investors to buy debt securities.

48. As explained by Gregory Smith of PERA, buyers / investors in structured finance securities and other consumers depend on the rating agencies' analysis to obtain a relative assessment of the credit risk associated with various investments. Indeed, issuers obtain a credit rating from S&P for the specific purpose of making the risk characteristics of the structured finance security understandable to the financial markets.

49. As such, the rating that S&P assigns to a particular structured finance security is a significant factor in any investor's decision to purchase or not purchase a structured finance security. The rating influences the decision making of investors and other consumers within Colorado. S&P is well aware that buyers / investors and other consumers use and rely on S&P's analysis in this manner.

50. In its 2004 Annual Report, McGraw-Hill noted: "[S&P] provides investors with the independent benchmarks they need to feel more confident about their investment and financial decisions."

51. Similarly, in its 2007 Annual Report, McGraw-Hill claimed that "S&P is highly valued by investors and financial decision-makers everywhere for its analytical independence, its market expertise and its incisive thought leadership." Along these same lines, Deven Sharma, the former President of Standard & Poor's Financial Services LLC, testified before Congress in 2008 as follows: "Ratings have been, and we believe will continue to be, an important tool for investors looking for a common and transparent language for evaluating and comparing creditworthiness across all sectors in both mature and developing global markets."

52. McGraw-Hill continued to encourage investors to rely on its ratings in its 2009 Annual Report: "Many investors around the world use credit ratings as part of their own analytic efforts. Ratings are provided free of charge to investors and give them a benchmark that can help them streamline their analysis." Moreover, in that same Report, S&P described itself as the "premier provider of independent credit ratings."

53. In 2010 S&P again claimed to be the "foremost provider of credit ratings offering objective and independent opinions on credit risk around the globe."

54. In its 2011 Annual Report, McGraw-Hill highlighted S&P's importance in providing credit ratings to investors worldwide when it proclaimed S&P to be "the world's foremost provider of credit analysis and ratings. S&P is part of the world's financial infrastructure, providing investors with information and independent benchmarks for their investment and financial decisions."

55. In July 2011, Sharma testified in front of the House Committee on Financial Services, Subcommittee on Oversight and Investigations. He represented that

> S&P has sought to help create transparency in capital markets by providing independent credit benchmarks. Investors and other market participants have long turned to S&P for its credit risk assessment of companies and securities. By and large, private sector investors and other market participants use our ratings not because they are required to do so, but because our ratings provide valued perspectives they may use in their important deliberations about making investment decisions.

56. Currently, on its website, S&P touts that it "performs independent evaluation and reporting of credit risk . . . . As a result, Standard & Poor's credit ratings, which are assigned based on transparent criteria, have long been utilized by capital market participants."

57. There are many buyers / investors of structured finance securities and other consumers located in Colorado that expect and depend on S&P to independently and objectively fulfill its self-described role as alleged above.

D. S&P's Credit Rating Scale for Structured Finance Securities

58. The result of S&P's analysis of structured finance securities is summarized in a rating on a letter-based scale ranging from AAA to D. According to its ratings definitions, S&P's letter grades are expressed in relative rank order, with a structured finance security rated "AAA" by S&P having "the highest rating assigned by [S&P,]" meaning that "the [issuer's] capacity to meets is financial commitment on the structured finance security is extremely strong." Structured finance securities rated "AA," "A," "BBB," "BB," "B," "CCC," "CC," "C," and "D" are represented by S&P to have progressively less creditworthiness with each succeeding reduction in grade level.

E. The Issuer Pays Model

59. The same entities that issue the structured finance securities select the credit rating agency to rate those securities. In exchange for analyzing the transaction and assigning a credit rating, S&P charges the issuer, or special-purpose vehicle, a fee based on the complexity and size of the transaction being analyzed. Typically, this fee is ultimately passed on to the investors in the transaction. Nevertheless, as has been repeatedly noted in Congressional testimony, this business model ensures that S&P is essentially "a watchdog paid by the persons it is to watch."

60. The Senate Permanent Subcommittee on Investigations succinctly explained the problems in the issuer pays model:

> Credit rating agencies were paid by the Wall Street firms that sought their ratings and profited from the financial products being rated. Under this "issuer pays" model, the ratings agencies were dependent upon those Wall Street firms to bring them business,

> and were vulnerable to threats that the firms would take their business elsewhere if they did not get the ratings they wanted. The ratings agencies weakened their standards as each competed to provide the most favorable rating to win business and greater market share. The result was a race to the bottom.

61. The financial incentives and conflicts of interest inherent in the issuer pays model led S&P to violate its public representations of independence and objectivity. As described by Smith in his 2011 Congressional testimony, the issuer pays model is "a fundamentally conflicted system that was a significant factor responsible for the inaccurate credit ratings leading up to the financial crisis."

62. Specifically, as the volume of RMBS and CDO issuance increased, the volume of opportunities to earn lucrative fees for issuing "AAA" ratings on these structured finance securities increased as well. For S&P to take advantage of these opportunities and, therefore, realize additional revenue, it consistently had to please the relatively small number of issuers of structured finance securities who had become S&P's repeat customers, or run the risk of not being retained by these issuers in the future.

63. Issuers of structured finance securities were well aware of S&P's incentive to alter its credit analysis in favor of higher ratings and therefore more fees. An issuer typically requests ratings from not only S&P but also from S&P's main competitors, Moody's and Fitch, Inc. ("Fitch"). This practice is known as "ratings shopping," because issuers offer their business to competing rating agencies and usually give the business to the firm (or firms) that will provide the desired rating levels.

VI. S&P REPRESENTS ITSELF TO THE PUBLIC AS PROVIDING INDEPENDENT AND OBJECTIVE ANALYSIS OF STRUCTURED FINANCE SECURITIES.

A. S&P Pledges to Safeguard the Integrity of the Ratings Process.

64. S&P represents to investors and other consumers, including those in Colorado, that its analysis of structured finance securities is independent, objective, and free from outside influence. S&P repeatedly and publicly emphasizes its independence and objectivity to investors and other consumers in a variety of public statements.

65. In McGraw-Hill's 2004 Annual Report, the company reiterated that

> [f]or more than a century, The McGraw-Hill Companies has been opening opportunity in the markets it serves by providing essential information and insight. The Corporation is aligned around three powerful and enduring forces driving economic growth worldwide: the need for capital, the need for knowledge and the need for information transparency.

To that end, McGraw-Hill stated that "[S&P] provides investors with the independent benchmarks they need to feel more confident about their investment and financial decisions."

66. Similarly, in its 2004 Code of Practices and Procedures, S&P noted that it "endeavors to conduct the rating and surveillance process in a manner that is transparent and credible and that also ensures that the integrity and independence of the rating and surveillance processes are not compromised by conflicts of interest, abuse of confidential information or other undue influences." S&P also promised that its mission has always remained the same – to provide high-quality, objective, independent, and rigorous analytical information to the marketplace." Further, S&P acknowledged that "[i]n all analytic processes, [S&P] must preserve the objectivity, integrity and independence of its ratings. In particular, the fact that [S&P] receives a fee from the issuer must not be a factor in the decision to rate an issuer or in the analysis and the rating opinion."

67. S&P's vow of independence, objectivity and integrity was further codified in October of 2005, when it adopted a Code of Professional Conduct (the "Code") for its ratings practices. In a 2006 report explaining its implementation of the Code, S&P noted that: (a) "[S&P] recognizes its role in the global capital markets and is committed to providing ratings that are objective, independent and credible;" (b) "It is a central tenet of [S&P] that its ratings decisions not be influenced by the fact that S&P receives fees from issuers;" (c) "Ratings are monitored on an ongoing basis in accordance with S&P's policies unless the rating is a point in time confidential rating without surveillance;" and (d) "[S&P's] Code reflects further alignment of its policies and procedures with the [International Organization of Securities Commissions] ("IOSCO") Code of Conduct."

68. Echoing the above pledge, S&P's Code also notes that "[S&P] fully supports the essential purpose of the IOSCO Code, which is to promote investor protection by safeguarding the integrity of the rating process. [S&P] believes that the Code is consistent with the IOSCO Code and appropriately implements IOSCO's Statements of Principles Regarding the Activities of Credit Rating Agencies."

69. One of the key principles set forth in the IOSCO Code (first published in December of 2004) was the need for credit rating agencies such as S&P to maintain independence from the issuers who pay it for its ratings.

70. In particular, the IOSCO Code sets forth the principle that

> the essential purpose of the Code Fundamentals is to promote investor protection by safeguarding the integrity of the rating process. IOSCO members recognize that credit ratings, despite their numerous other uses, exist primarily to help investors assess the credit risks they face when making certain kinds of investments. Maintaining the independence of [credit rating agencies] vis-à-vis the issuers they rate is vital to achieving this goal. Provisions of the Code Fundamentals dealing with [credit

> rating agency] obligations to issuers are designed to improve the quality of credit ratings and their usefulness to investors.

71. Similarly, the IOSCO Code also emphasizes that "[r]ating analyses of low quality or produced through a process of questionable integrity are of little use to market participants," and that "[w]here conflicts of interest or a lack of independence is common at a [credit rating agency] and hidden from investors, overall investor confidence in the transparency and integrity of a market can be harmed."

72. With these principles as a guide, since October of 2005, S&P has made several representations in its Code about the manner in which S&P maintains the independence and objectivity of its analysis and avoids conflicts of interest with issuers. The most important of these representations are found in sections 1.9, 1.12, and 2.1 – 2.4 of the Code in effect until January 2012. The sections discuss purported limitations on the factors that S&P considers when analyzing structured finance securities.

73. Specifically, Section 1.12 of S&P's Code stated: "[S&P] and its employees shall deal fairly and honestly with issuers, investors, other market participants, and the public." This statement also appears in S&P's revised June 2012 Code.

74. Section 2.1 of S&P's Code stated: "[S&P] shall not forbear or refrain from taking a Rating Action, if appropriate, based on the potential effect (economic, political, or otherwise) of the Rating Action on [S&P], an issuer, an investor, or other market participant."

75. Section 2.2 of S&P's Code stated: "[S&P] and its Analysts shall use care and analytic judgment to maintain both the substance and appearance of independence and objectivity."

76. Section 2.3 of S&P's Code stated: "The determination of a rating by a rating committee shall be based only on factors known to the rating committee that are believed by it to be relevant to the credit analysis."

77. Section 2.4 of S&P's Code stated: "Ratings assigned by [S&P] to an issuer or issue shall not be affected by the existence of, or potential for, a business relationship between [S&P] (or any Non-Ratings Business) and the Issuer (or its affiliates), or any other party, or the non-existence of any such relationship."

78. Section 1.9 of S&P's Code stated:

> [S&P] shall allocate adequate personnel and financial resources to monitoring and updating its ratings. . . . [O]nce a rating is assigned [S&P] shall monitor on an ongoing basis and update the rating by: (a) regularly reviewing the issuer's creditworthiness; (b) initiating review of the status of the rating upon becoming aware of any information that might reasonably be expected to result in a Rating Action (including withdrawal of a rating), consistent with the applicable rating criteria and methodology; and (c) updating on a timely basis the rating, as appropriate, based on the results of such review.

B. S&P Reassures the Public of its Role as an "Independent Expert."

79. McGraw Hill's 2006 Annual Report picked up on the same themes and once again reiterated claims of S&P's long history of independence and objectivity. Specifically, McGraw-Hill stated that "[m]any investors know [S&P] for its respected role as an independent provider of credit ratings. . . . As financial markets grow more complex, the independent analysis, critical thinking, opinions, news and data offered by [S&P] are an integral part of the global financial infrastructure."

80. Similarly, in its 2007 Annual Report, McGraw-Hill emphasized that "[s]ince 1916, markets across the globe have relied on the independent analysis and integrity of [S&P's] credit

ratings," and that "S&P is highly valued by investors and financial decision-makers everywhere for its analytical independence, its market expertise and its incisive thought leadership."

81. Furthermore, in testimony before the Senate Committee on Banking, Housing and Urban Affairs in April 2007, S&P's then Managing Director of RMBS, Susan Barnes, also testified at length regarding S&P's commitment to "ongoing" monitoring of the accuracy and integrity of its ratings. For instance, Barnes testified that

> [a]fter a rating is assigned, S&P monitors or 'surveils' the ratings to adjust for any developments that would impact the original rating. The purpose of this surveillance process is to ensure that the rating continues to reflect our credit opinion based on our assumption of the future performance of the transaction.

82. In her testimony before Congress, Barnes underscored that S&P's business is "grounded in the cornerstone principles of independence, transparency, credibility and quality. These principles have driven our long-standing track record of analytical excellence and objective commentary."

83. After the financial crisis in 2007, S&P claimed that it took further steps to increase the independence, integrity, and transparency of its ratings. Defendants claimed that S&P had put appropriate safeguards into place to protect against any potential or actual conflicts of interest stemming from the issuer pays model.

84. McGraw-Hill stated in the company's 2008 Annual Report that "[i]t's important to note that S&P has effectively served the global capital markets with high quality, independent and transparent credit ratings for many decades" and highlighted that "[t]o ensure the continued integrity and relevance of its ratings business, [S&P] . . . has undertaken a series of actions which further enhance transparency and the independence of its ratings process."

85. These themes were reiterated by Sharma in his October 2008 testimony before the House Committee on Oversight and Government Reform. He testified:

> The real question is not whether there are potential conflicts of interest in the 'issuer pays' model, but whether they can be effectively managed. . . . S&P maintains rigorous policies and procedures around the integrity of our analytical processes through a number of checks and balances. . . . Taken together, we believe these measures provide robust safeguards against the potential conflict of interest inherent in the 'issuer pays' model.

86. Sharma further explained that "[t]he key question for any approach, whether it be investor or issuer paid, is then whether the rating agency takes appropriate steps to preserve its independence. For S&P, that independence is a core principle of our business."

87. S&P took several public steps in 2008 to purportedly manage these potential conflicts of interest. S&P hired Mark Adelson in May 2008 as its Chief Credit Officer to manage the new independent criteria group and supervise key changes to S&P's rating criteria and methodologies. A few months later, S&P hired David Jacob to manage its global structured finance group in order "to improve transparency, build investor confidence, and continue to deliver high-quality, independent analytics."

88. In its 2009 Annual Report, McGraw-Hill reaffirmed its prior representations, declaring that it had

> taken significant steps to improve [its] ratings in response to the lessons of the financial crisis. These steps include measures to better account for the impact of periods of severe economic stress. For example, before giving a security our highest rating of AAA, we consider what would happen if the country faced an economic crisis on par with the Great Depression.

S&P claimed that it supported "strengthening regulations for credit ratings in ways that increase accountability and transparency, preserve analytical independence, foster competition in the industry, and achieve a globally consistent standard to prevent regulatory arbitrage."

89. Adelson agreed, claiming: "In the past two years, we have made a number of improvements to increase the quality and transparency of our ratings." S&P "enhanced and published the criteria" it used to rate residential mortgage-backed bonds, commercial real estate bonds, and CDOs, which "enable[d] investors to better understand [its] view regarding the credit risk associated with the complex securities."

90. In its 2010 Annual Report, McGraw-Hill asserted that it continued to take "steps to make our credit ratings more transparent." Similarly, in its 2010 Code of Conduct, S&P reaffirmed sections 1.9, 1.12, and 2.1-2.4, which proclaimed, among other things, that ratings "shall not be affected by the existence of, or potential for, a business relationship between" S&P and the issuer or any other party.

91. In Sharma's July 2011 testimony in front of Congress, he again represented that, "to provide the market with independent benchmarks about the creditworthiness of debt securities," S&P had

> undertaken a variety of initiatives designed to strengthen our governance and control framework, to enhance the analytics and criteria we use to rate issues and issuers, and to clearly communicate the rationale behind our actions and better identify and report on key areas of risk in order to further transparency in the markets.

He underscored that S&P had established an independent criteria review and approval process and supplemented controls against potential conflicts of interest. S&P also separated its marketing and analytical activities.

92. Sharma concluded his 2011 Congressional testimony by stating that S&P

> firmly believe[s] that perhaps the most important value of ratings is their independence. . . . *For the markets to have confidence in those ratings, they must ultimately represent the independent view of the rating agency. That means, of course, that they should be*

> *free of undue commercial considerations – and S&P is fully committed to that principle . . . .*

(Emphasis added.)

93. S&P revised its Code of Conduct in January 2012 and purported to take additional steps to maintain independence and avoid any conflicts of interest.[1] S&P again represented that business considerations – such as revenue, market share, and economic effects on S&P – would not impact its credit ratings. For example, in section 3.1, S&P established reporting lines and compensation arrangements

> for compliance officers and Employees in Control Roles and Analytical Roles that reinforce the independence of their respective judgments. For a compliance officer or Employee in a Control Role this means that [S&P] will not consider its financial performance when evaluating the performance or determining the compensation (including incentive awards) of those Employees. For an Employee in an Analytical Role this means that [S&P] will not consider the commercial implications (such as revenue, fees, or market share) of that Employee's analytical decisions when evaluating the performance or determining the compensation (including incentive awards) of that Employee.

94. Section 3.3 of the 2012 Code states that S&P will "establish and maintain measures to protect against Analysts and other Employees directly involved in Credit Rating Activities [from] engaging in Commercial Activities or other activities that may create an actual or potential conflict of interest or that may compromise the independence and objectivity of [S&P's] Credit Ratings Activities."

95. Further, section 3.5 of the 2012 Code provides that S&P will take a credit rating action "regardless of the potential effect (economic, political, or otherwise) of that action on [S&P], an affiliate, and Issuer, an investor, or any other market participant." S&P also committed to establishing policies to eliminate or manage "any actual or potential conflicts of

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[1] S&P's current Code of Conduct, as revised in June 2012, contains the same provisions mentioned herein.

interest that may influence [S&P's] Credit Rating Activities as well as the opinions and analyses of [S&P] or the judgment and analyses of its Analysts."

96. McGraw-Hill espoused these same principles in its Code of Business Ethics when it declared that "[n]o employee may exert or attempt to exert any improper influence on any editorial position or opinion, including those of any [S&P's] equity or rating analyst."

97. In its Securities Disclosure Policy dated June 18, 2012, S&P represented to its regulator, the SEC, that its products and services "are not influenced inappropriately by Conflicts of Interest."

98. Similarly, in its Confidentiality, Conflicts, and Firewall Policy dated January 2, 2012, submitted to the SEC, the companies stated:

> McGraw-Hill and S&P employees are prohibited from suggesting that Analysts consider improper factors not relevant to an objective analysis when arriving at their ratings, opinions, recommendations, analyses, estimates, target prices, or selection of securities in an index. *An example of such an improper factor would be McGraw-Hill's and S&P's commercial interests or related fees, payments, revenue, or market share*.

(Emphasis added.)

99. In addition, this policy prohibited analysts from attending meetings or events where commercial or sales activities are discussed.

100. S&P's Roles and Responsibilities Policy dated May 31, 2012, was designed to "ensure that Credit Ratings are independent, impartial, fair, and issued in good faith with no influence from outside business relationships." To that end, S&P prohibited employees in either an analytical or control role from participating in commercial activities and prohibited employees in commercial roles from participating in credit rating activities.

101. S&P currently purports to "maintain[] policies and procedures to protect the integrity of the analytic process." To protect against conflicts of interest that are inherent in the issuer pays model, S&P's "client business managers, who deal with commercial matters such as pricing, contract negotiations, and maintaining client relationships, do not participate or vote in rating committees." In addition, S&P states that it has established a number of safeguards to protect against potential conflicts of interest; for instance, S&P has delineated a "clear separation of function between those who negotiate the business terms for the rating assignment and the analysts who conduct the credit analysis and provide the rating opinion."

102. In sum, the statements made by Defendants in their Annual Reports, Codes of Conduct, web site, and public filings depict a pattern and practice of public statements intended to repeatedly emphasize several basic representations by S&P to buyers / investors and other consumers. First, Defendants represent that their analysis of structured finance securities has been and continues to be independent, objective, and free from any influence of maintaining or increasing its market share or revenues.

103. Second, recognizing that S&P holds a position of trust in the marketplace, Defendants represent that they deal fairly and honestly with the public, including the buyers / investors of the structured finance securities that they rate.

104. Third, Defendants represent that they agree with and have implemented the principles set forth in the IOSCO Code of Conduct by maintaining independence, objectivity, and integrity of their analysis of structured finance securities.

105. Fourth, Defendants represent that, although they acknowledge that the issuer pays model creates conflicts of interest, they have adequately managed any actual or potential

conflicts. Investors and other consumers depend on Defendants to properly manage this conflict of interest and rely on Defendants' representations that they have done so.

106. Fifth, Defendants represent that they have dedicated the resources necessary to conduct timely and thorough surveillance on their analysis of structured finance securities to ensure that the rating assigned continues to reflect their assessment of the credit risk.

107. The above representations made by Defendants are material to buyers / investors of structured finance securities as well as other consumers located in Colorado, and also have been reasonably interpreted by those same individuals and entities in light of the circumstances in which the representations have been made.

108. None of the above representations made by S&P were true, and S&P knew they were not true.

VII. S&P'S ANALYSIS OF STRUCTURED FINANCE SECURITIES WAS NOT INDEPENDENT AND OBJECTIVE.

109. S&P's sacrifice of its independence and objectivity due to its desire to earn more revenue has manifested itself in several ways.

A. Ratings Shopping Corrupts the Integrity of the Process.

110. "Ratings shopping" refers to the practice of an issuer offering its business to the rating agency requiring the least amount of credit enhancement necessary to achieve the issuer's desired rating.

111. In describing the effect of ratings shopping, a former S&P executive has been quoted as follows:

> The discussion tends to proceed in this sort of way. 'Look, I know that you aren't comfortable with such and such assumption but apparently Moody's are even lower and if that is the only thing standing between rating this deal and not rating this deal, are we really hung up on that assumption?' You don't have infinite

> information. Nothing is perfect. So the line in the sand shifts and shifts, and can shift quite a bit.

112. S&P continued to promote ratings shopping as recently as 2011. At that time, an internal S&P document compared S&P's counterparty criteria with that of Moody's and Fitch's and concluded that S&P's criteria was much more stringent. The document warned that "S&P's criteria is significantly costlier than Moody's. This is leading dealers to lobby investors to accept non-S&P rated transactions and issuers are increasingly motivated by their fiduciary responsibility to prudently manage transaction costs and risks." Furthermore, the document stated that sponsors may simply drop the S&P rating – and keep the Moody's and Fitch's ratings – rather than incur the substantial costs in complying with S&P's more stringent criteria.

113. The fact that outside influences impacted S&P's analysis of structured finance securities was not disclosed by S&P in its public statements. To the contrary, as Sharma testified in front of Congress in July 2011, S&P repeatedly stated that its analysis was not influenced by business considerations. Indeed, only six months later, S&P represented to the public and its regulator that its ratings were independent and free from any the influence of outside relationships, commercial interests, revenue, or market share. *See supra* ¶¶ 93-100.

B. S&P's Quest for Revenue Influenced its Analytical Models.

114. S&P's desire for more revenue led it to adjust the assumptions built into its analytical models used to rate RMBS and CDOs or, alternatively, to intentionally refrain from updating its analytical models based on the best information available to S&P in order to preserve the use of analytical models that were appealing to issuers. S&P engaged in this conduct knowingly and for the explicit purpose of allowing it to assign its highest rating of "AAA" to as large a portion as possible of the structured finance securities it rated.

115. S&P's focus on monitoring and growing its market share and generating additional revenue dominated the attention of S&P's senior management. This compulsion to maximize revenue influenced the analytical models that S&P developed and implemented for rating RMBS and other structured finance securities.

116. S&P believed that the only way for it to successfully compete for an issuer's structured finance business was to adjust its analytical models so that S&P's levels of proposed credit enhancement reflected the issuer's expectations. As a result, S&P focused on meeting the demands of the repeat issuers that paid it its fees, rather than providing an objective credit analysis that was free from S&P's or its clients' financial interests.

117. S&P decided to compete by loosening its analytical models, thereby making it easier to assign an "AAA" rating to as large a portion as possible of the structured finance securities it rated. This representation was entirely inconsistent with its public representations and, as a result, robust credit analysis took a backseat to growing S&P's revenue. In short, S&P chose to compete for business by misrepresenting that it was independent and objective.

118. S&P made a conscious decision to use an outdated version of its analytical model for analyzing RMBS. This decision was motivated by S&P's desire to continue to assign the "AAA" ratings with minimal credit enhancement that issuers coveted, thus preserving S&P's market share and earning much more revenue for the company.

119. In the words of one former senior S&P managing director in charge of rating RMBS, a primary factor in S&P's breakdown in ratings standards and lack of interest in keeping the model current was that "the RMBS group enjoyed the largest ratings market share among the three major rating agencies (often 92% or better), and improving the model would not add to S&P's revenues."

120. Rather than run the risk of disrupting its already dominant and highly profitable business of rating RMBS, S&P simply kept using a model that it knew to be outdated because the model already provided the "AAA" ratings with minimal levels of credit enhancement that S&P's most important customers desired. In other words, S&P's internal business strategy valued revenues over ratings quality of RMBS. As stated by a former senior S&P executive, "profits were running the show."

121. S&P's desire for increasing its revenue and maintaining its high market share also led S&P to adjust the analytical model used by S&P to rate CDOs in order to make it more business friendly and appealing to CDO issuers.

122. Indeed, by at least 2004, S&P's willingness to cater to the demands of issuers intruded on the entire analytical model that S&P developed for rating CDOs. During this time frame, S&P's senior management was primarily concerned about losing out on revenue to either Moody's or Fitch and believed that the only way for S&P to successfully compete for an issuer's business was to make sure that S&P's levels of proposed credit enhancement allowed S&P to assign a "AAA" rating to as large a portion as possible of the CDOs it rated.

123. During this time frame, S&P initiated a project to update its CDO Evaluator model, which was the primary analytical model that S&P used to rate CDOs. The stated purpose of this project was for S&P's analytical team to study the assumptions that served as the underpinnings of the model and make recommendations regarding changes that would allow the model to more accurately predict credit risk. In reality, a significant goal of the project was also to develop assumptions that would allow S&P to maintain and grow its market share for rating as many different types of CDOs as possible.

124. Indeed, the release of S&P's revised CDO Evaluator model was specifically delayed due to negative feedback from S&P's CDO issuer clients. In the words of senior leaders in S&P's structured finance department:

> Due to the not insignificant impact on lowly rated . . . synthetic reference pools . . . we have toned down and slowed down our roll out of [CDO Evaluator] to the market, pending further measures to deal with such negative results . . . . Bear Sterns pointed out that the potential business opportunities we would miss by effectively having to walk away from such high yield structures would NOT be compensated for by any increase in rating volume for highly rated collateral pools.

125. As a result, the analytical team at S&P responsible for making recommendations on how best to improve S&P's analysis of CDOs was repeatedly pressured by senior S&P executives responsible for revenue generation to adjust their recommendations so that S&P's analysis would not become any more conservative than S&P's closest competitors. This pressure was placed on the analytical team for the explicit purpose of allowing S&P to increase its revenue and grow its market share.

126. At the conclusion of this special project, S&P introduced a revised CDO Evaluator analytical model ("E3") that explicitly took into consideration S&P's revenue and market share goals. In particular, the correlations and probability of default assumptions underlying this model were adjusted to reflect what was best for S&P's ratings business. Indeed, concerns of revenue generation and market share preservation were the prime influences on the assumptions ultimately adopted by S&P in its analysis. These influences directly contradicted S&P's public representations and were not disclosed to consumers in Colorado.

127. In May of 2007, S&P privately acknowledged the full extent that its desire for increased revenue and market share had played, and was continuing to play, in its analysis of CDOs as part of a presentation made to the senior leaders of S&P's structured finance group. In

particular, in a slide titled "A Better Mousetrap," S&P summarized its past analytical approach as follows: "To come up with [probability of defaults] and asset correlations in [CDO Evaluator], we look at our raw data and come up with a statistical best fit. When this does not meet our business needs, we have to change our parameters ex-post to accommodate."

128. This private acknowledgment directly contradicts all of S&P's public representations with respect to the factors it considers when analyzing CDOs and other structured finance securities. But S&P went even further. The "Better Mousetrap" that S&P was developing called for S&P to first start with a set of assumptions that were best for its ratings business and then try to fit those assumptions into the available data. In the words of the analysts making the presentation: "[W]e came up with a new methodology emphasizing [] flexibility. We decide on a number of business friendly [probability of default] matrices first" and then decide whether that "set is reasonable." If the selected matrices were not "reasonable," S&P simply tried a different set of business friendly matrices and started the process anew. This proposal for how S&P should conduct its analysis going forward was met with approval from S&P's structured finance leadership.

129. Those S&P employees who resisted management's drive to adjust S&P's analysis in order to maximize revenue were ignored and marginalized.

C. After S&P Began Losing Market Share to Moody's in Early 2011, S&P Again Revised Criteria to Regain its Position as the Industry Leader.

130. This same story repeated itself in the spring of 2011 when S&P realized that, for the first time, Moody's had surpassed it in terms of structured finance revenue. At this time, S&P departed from its previously announced public efforts to portray a rating business that was independent and could manage its conflicts of interest. Upon hearing this development, Sharma

started pressuring Jacob, S&P's global head of structured finance, to explain S&P's loss in market share.

131. Jacob advised Sharma that the counterparty criteria advocated by Adelson, S&P's Chief Criteria Officer, was costing S&P business. When Sharma asked Jacob why he did not get involved to prevent this from happening, Jacob replied that he could not attempt to influence the rating criteria. Jacob reminded Sharma that, in order to prevent conflicts of interest, S&P had separated the commercial and business concerns of S&P from the criteria and ratings process. Jacob's position was consistent with S&P's public representations and Sharma's statements to Congress during this same time frame. *See supra* ¶¶ 92-93. Despite these representations of independence and objectivity, Sharma told Jacob that he had "to try to do something about it."

132. When Jacob refused to comply with Sharma's directive, Sharma said that he wanted to "chang[e] direction." From that point forward, Jacob believed his "days were numbered" at S&P.

133. Also during this time frame, Sharma organized a meeting entitled, "Relentlessly Driving Global Growth," in London in June 2011. At that meeting, which was attended by analysts, S&P's leadership emphasized S&P's failure to be "relevant" and discussed relaxing the counterparty criteria that was costing S&P business. Jacob was amazed that S&P's leadership was discussing business and market share concerns in front of the individuals responsible for rating securities. This violated S&P's previously announced policies that were designed to avoid this very type of pressure. Indeed, S&P itself prohibited this practice of allowing analysts to attend meetings where commercial or sales activities were discussed in its Confidentiality, Conflicts, and Firewall Policy. *See supra* ¶ 98.

134. After this meeting, S&P relaxed its counterparty criteria.

135. In December 2011, S&P announced Jacob's departure from the company and demoted Adelson from Chief Criteria Officer to Senior Research Fellow.

136. Thus, even after publicly announcing a new effort to manage conflicts of interests and portray a renewed sense of independence, S&P continued to let business concerns determine its ratings.

D. S&P's Surveillance Group Was Ignored and Designed to Fail.

137. S&P's focus on business considerations also influenced the manner in which it monitored, or conducted surveillance, on the structured finance securities that it had rated.

138. Prior to 2008, S&P performed only a sporadic and cursory review of its RMBS ratings and intentionally did not use the best surveillance tools that were at its disposal. This reality was in sharp contrast to the public representations of S&P's senior executives highlighting that the company maintained a robust surveillance process with substantial resources at its disposal that allowed S&P to timely and thoroughly monitor the performance of previously rated RMBS.

139. S&P did not dedicate the necessary resources to effectively conduct surveillance on previously rated RMBS and failed to use its analytical models as part of the monitoring process of these obligations. As noted by a senior S&P managing director in Congressional testimony in 2008:

> [T]here are two sides to the rating. You have an initial rating when the bonds are sold, and then you have the surveillance. And at some point in the mid-1990s, the management in [S&P] decided to make surveillance a profit center instead of an adjunct critical key part of keeping investors informed as to how their investments were performing after they bought the bonds. And as a result, they didn't have the staff or the information. They didn't even run the ratings model in the surveillance area which would have allowed them to have basically re-rated every deal S&P had rated to that

> time and see exactly what was going on and whether the support was there for those triple-A bonds.
>
> The [internal] reason [S&P management] gave for not doing it was because they were concerned that the ratings would get volatile and people would start to feel like all triple-As aren't the same. And it was a much more pragmatic business decision than really focusing on how to protect the franchise and the reputation by doing the right thing for the investors.

140. As this candid statement demonstrates, S&P knew that there was very little profit in diligently monitoring the performance of previously rated RMBS, because S&P already had been paid its fee. Indeed, proper surveillance could actually lead to S&P earning less revenue because it could be perceived as calling S&P's initial analysis into question.

141. Accordingly, S&P failed to properly fund and dedicate the appropriate number of personnel to surveillance, and did not use the best tools that it had available to conduct surveillance on previously rated RMBS. This failure by S&P reached a breaking point in late 2006 and early 2007. In the words of one of the leaders of S&P's surveillance team:

> What can we do now? My group is under serious pressure to respond to the burgeoning poor performance of sub-prime deals. [W]e are really falling behind. I am seeing evidence that I really need to add to staff to keep up with what is going on with sub-prime and mortgage performance in general.

142. In response to the suggestion that additional resources may be available by August of 2007, the same surveillance executive noted in early February of 2007 as follows:

> Let's talk about anything that we might be able to do in the interim. I talked to [a senior S&P executive] yesterday and he thinks that the ratings are not going to hold through 2007. He asked me to begin discussing taking rating actions earlier on the poor performing deals . . . . We do not have the resources to support what we are doing now. A new process, without the right support, would be overwhelming.

143. S&P's desire for increased revenue and market share also resulted in it ignoring the recommendations of its surveillance group and delaying the downgrade of impaired RMBS in order to further its own financial interests, as well as the financial interests of its issuer clients. Specifically, despite its meager resources, by January of 2007 S&P's surveillance group concluded that they needed to intensify their review of 2006 vintage subprime RMBS and begin taking large scale negative rating action. In February of 2007, S&P's surveillance team made formal recommendations to that effect to S&P senior management.

144. S&P senior management overruled the recommendations of S&P's surveillance group. S&P's delay in taking action on its surveillance group's recommendations was directly influenced by its desire to continue earning lucrative fees by rating CDOs and not upsetting its investment banking clients.

145. As an S&P employee noted on July 5, 2007, when S&P was in crisis mode in the days immediately preceding S&P's mass downgrades of impaired RMBS: "The fact is, there was a lot of internal pressure in S&P to downgrade lots of deals earlier on before this thing started blowing up. But the leadership was concerned of p[i]issing off too many clients and jumping the gun ahead of Fitch and Moody's." Indeed, on July 8, 2007, as the task of assigning blame began within S&P, S&P's surveillance leadership noted: ". . . we were ahead of the curve with our original recommendations in February. We had a process in place, but we were told it was too stressful."

146. Moreover, on or about June 11, 2007, S&P's surveillance group determined that, on average, tranches of subprime RMBS rated BBB and lower had greater than 100% severe delinquencies versus available credit support, which meant that the ratings of these RMBS tranches were, on average, almost certainly to be lowered. Despite this determination, S&P

continued to assign and confirm ratings for CDOs exposed to significant amounts of subprime RMBS tranches rated BBB and below. In sum, S&P took these RMBS ratings at face value as inputs for its analytical model and did nothing to account for the fact that many of the underlying RMBS tranches would almost certainly be downgraded. S&P engaged in this conduct, in part, because it wanted to maximize its revenue and please its CDO issuer clients.

147. This same type of behavior repeated itself when, in January 2011, S&P changed the way it calculated debt-service-coverage ("DSC") ratios for issuing new deals but not for transactions in surveillance. S&P originally calculated DSCs for securitized loans by doing two calculations and using the one providing the more conservative result, in other words, a "worse of" approach. In early 2011, the CMBS rating team changed the way it calculated DSC ratios. Instead of using a "worse of" approach, it used a more lenient approach based on averages. Although some at S&P claimed this change was merely an interpretation of published criteria, S&P's Chief Credit Officer vehemently disagreed, claiming that it was an "undocumented, unapproved, and unpublished change in criteria" in violation of S&P's policies. A criteria change requires a formal process, including a committee vote and publication of an updated article. Conversely, an interpretation of criteria does not require this burdensome process.

148. After the release of the original DSC criteria,

> there was a long dry spell with no new deals. When new deals started to happen in 2010, S&P performed preliminary analysis but was not engaged to actually rate any of them. In other words, the CMBS team was failing to win assignments when it actually used the "worse of" approach in 2010. After changing the DSC formula, S&P started to get engagements for rating new deals.

149. For each of the new assignments won in 2011, S&P published pre-sale reports; however, those reports omitted the actual DSC calculations. When asked why the reports omitted this information, the head of the CMBS unit stated that the group did not want to explain

why it used different calculations for new deals and for those under surveillance. Therefore, S&P was again taking different approaches to rating new deals and surveilling prior deals.

150. This conduct is yet another example of how S&P's internal business decisions – motivated by its desire to achieve or maintain revenue and market share goals – influenced its analytic judgment and directly contradicted S&P's Code of Conduct and other public representations about maintaining independence and objectivity in its analysis of structured finance securities.

VIII. VIOLATIONS OF THE COLORADO CONSUMER PROTECTION ACT

151. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1 through 150 of this Complaint.

152. The deceptive trade practices alleged herein were made during the course of Defendants' business.

153. By engaging in the acts and practices alleged herein, Defendants made or caused to be made to Colorado investors and the public, directly or indirectly, explicitly or by implication, representations which are material, reasonably interpreted, false and likely to mislead, including, but not limited to, the following:

a. that S&P's analysis of structured finance securities is independent, objective, and free from consideration of S&P's desire for revenue or additional business from issuers;

b. that S&P understands that it holds a position of trust in the marketplace and, as such, deals fairly and honestly with the public;

c. that S&P understands that the issuer pays model creates conflicts of interest but that these conflicts have been adequately managed and neutralized by the company as demonstrated by the principles set forth in S&P's Code of Conduct;

d. that S&P agrees with and has implemented the principles set forth in the IOSCO Code of Conduct pertaining to its obligation as a credit rating agency to maintain the independence, objectivity and integrity of its analysis of structured finance

securities; and

e. that S&P conducts timely and thorough surveillance on its analysis of structured finance securities to ensure that the rating assigned by S&P continues to reflect S&P's best assessment of the credit risk associated with the obligation.

154. By engaging in the acts and practices alleged herein, S&P knowingly made omissions of material fact to Colorado investors and the public with the intent that the investors purchase the structured finance securities. These omissions include, but are not limited to, the following:

a. that S&P's analysis of structured finance securities was influenced by its desire to please its clients, increase market share, and enhance revenue for the company;

b. that S&P allowed business and revenue considerations to influence the analytical models it developed to rate structured finance securities;

c. that S&P's surveillance of its ratings on RMBS and judgment regarding when to downgrade certain structured finance securities was influenced by business concerns such as revenue enhancement and maintaining market share;

d. that S&P did not operate its business in conformance with either its own Code of Conduct, or the principles set forth in the IOSCO Code;

e. that S&P's analysis of structured finance securities was based in part on the preferences of the narrow group of repeat issuers of structured finance securities that dominated S&P's revenues; and

f. that S&P's analysis of structured finance securities was based in part on a desire to promote S&P's own economic interests.

155. S&P made these misrepresentations and omissions knowingly and with the intent that investors and the public rely on its objectivity and independence.

156. S&P's acts and practices as alleged herein have directly and proximately caused substantial injury investors and other market participants in Colorado. Reasonable investors and other market participants would have given its ratings little or no credit had it disclosed those factors alleged herein that impaired its objectivity and impartiality.

FIRST CLAIM FOR RELIEF
(False representation as to the source, sponsorship,
or approval, or certification of services against all Defendants)

157. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1 through 156 of this Complaint.

158. Through the above-described conduct, Defendants knowingly made false representations as to the source, sponsorship, approval, or certification of services in violation of § 6-1-105(1)(b), C.R.S.

159. Through the above-described unlawful deceptive trade practices, Defendants have deceived and misled investors and the public in Colorado and other states.

SECOND CLAIM FOR RELIEF
(False representation as to affiliation, connection,
or association with or certification by another against all Defendants)

160. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1 through 159 of this Complaint.

161. Through the above-described conduct, Defendants knowingly made false representations as to affiliation, connection, or association with or certification by another in violation of § 6-1-105(1)(c), C.R.S.

162. Through the above-described unlawful deceptive trade practices, Defendants have deceived and misled investors and the public in Colorado and other states.

THIRD CLAIM FOR RELIEF
(False representations as to the characteristics, uses, or benefits of services
and false representations as to the sponsorship, approval, status, affiliation, or connection
of a person therewith against all Defendants)

163. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1 through 162 of this Complaint.

164. Through the above-described conduct, Defendants knowingly made false representations as to the characteristics, uses, or benefits of services in violation of § 6-1-105(1)(e), C.R.S.

165. Through the above-described conduct, Defendants knowingly made false representations as to the sponsorship, approval, status, affiliation, or connection of a person in violation of § 6-1-105(1)(e), C.R.S.

166. Through the above-described unlawful deceptive trade practices, Defendants have deceived and misled investors and the public in Colorado and other states.

FOURTH CLAIM FOR RELIEF

(False representation that services are of a particular standard, quality, or grade with knowledge that they are of another against all Defendants)

167. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1 through 166 of this Complaint.

168. Through the above-described conduct, Defendants knowingly misrepresented that S&P's services were objective and independent in violation of § 6-1-105(1)(g), C.R.S.

169. Through the above-described unlawful deceptive trade practices, Defendants have deceived and misled investors and the public in Colorado and other states.

FIFTH CLAIM FOR RELIEF

(Failure to disclose material information concerning services which information was known at the time public statements were made with the intent to induce investors to enter into a transaction against all Defendants)

170. Plaintiff incorporates herein by reference all of the allegations contained in paragraphs 1through 169 of this Complaint.

171. Through the above-described conduct, Defendants knowingly failed to disclose material information concerning their services which information was known at the time of their

public statements and such failure to disclose was intended to induce investors to enter into a transaction in violation of § 6-1-105(1)(u), C.R.S.

172. Through the above-described unlawful deceptive trade practices, Defendants have deceived and misled investor and the public in Colorado and other states.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff prays for judgment against Defendants and for the following relief:

A. An order declaring Defendants' above-described conduct to be in violation of the CCPA, § 6-1-105(1)(b), (c), (e), (g) and (u), C.R.S.

B. An order permanently enjoining Defendants, their officers, directors, successors, assigns, agents, employees, contractors and anyone in active concert or participation with any Defendant who have notice of such order from engaging in any deceptive trade practices defined in and proscribed by the CCPA and as set forth in this Complaint.

C. Appropriate orders necessary to prevent Defendants' continued or future deceptive or misleading trade practices or statements.

D. An order requiring Defendants to forfeit and pay to the general fund of the State of Colorado, civil penalties in an amount not to exceed $2,000 per violation pursuant to § 6-1-112(1), C.R.S. and not to exceed $10,000 per violation committed against an elderly person pursuant to § 6-1-112(3), C.R.S.

E. An order requiring Defendants to forfeit and pay to the State all unjust enrichment earned through the use or employment of the above-described deceptive trade practices.

F. An order requiring Defendants to pay the costs and expenses of this action incurred by the Attorney General, including but not limited to, Plaintiff's attorney fees under § 6-1-113(4), C.R.S.

G. Any such further relief as this Court may deem just and proper to effectuate the purposes of the CCPA.

Respectfully submitted this 5th day of February.

JOHN W. SUTHERS
Attorney General

s/ Andy McCallin
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Pursuant to C.R.C.P. 121, § 1-26(7), the original of this document with original signatures is maintained in the offices of the Colorado Attorney General, Ralph L. Carr Colorado Judicial Center, 1300 Broadway, Seventh Floor, Denver, CO 80203, and will be made available for inspection by other parties or the Court upon request.