

THE REVIEW OF SECURITIES & COMMODITIES REGULATION

AN ANALYSIS OF CURRENT LAWS AND REGULATIONS
AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 47 No. 5 March 5, 2014

CREDIT RATING AGENCY LITIGATION

With a few exceptions, the courts have dismissed civil lawsuits against the rating agencies for their role in rating structured finance securities. Contrary to popular perception, the grounds have not been the First Amendment, but statutory interpretations and common law principles. The authors review the cases and find that although the First Amendment was not directly involved, principles of interpretation associated with the First Amendment have informed the decisions.

By Roberta A. Kaplan and Jacob H. Hupart *

Since the financial crisis, the credit rating agencies have been criticized for their perceived role in rating structured finance securities, such as residential mortgage-backed securities (“RMBS”) and collateralized debt obligations (“CDOs”).¹ Specifically, critics have alleged that the rating agencies issued inflated ratings

that ultimately misled investors.² Not surprisingly, the three major credit rating agencies – Moody’s, Fitch, and

¹ See FINANCIAL CRISIS INQUIRY COMMISSION, FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011). A residential mortgage-backed security is a bond backed by the revenue stream from a large number of home loans that have been bundled into a loan pool. A collateralized debt obligation involves the re-securitization of income-producing assets, and typically includes a substantial number of RMBS securities from multiple mortgage pools, though it could also include other types of assets, including commercial mortgage-backed securities, corporate bonds, or other CDO securities.

² See UNITED STATES SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (2011); SECURITIES AND EXCHANGE COMMISSION, SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF’S EXAMINATIONS OF SELECT CREDIT RATING AGENCIES (2008). One credit rating agency, S&P, has been sued by the Department of Justice in a complaint alleging that “S&P issued inflated ratings that misrepresented the securities’ true risks . . . [and] 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.” Press Release, Department of Justice, Department of Justice Sues Standard & Poor’s for Fraud in Rating Mortgage-Backed Securities in the Years Leading Up to the Financial Crisis (Feb. 5, 2013), available at <http://www.justice.gov/opa/pr/2013/February/13-ag-156.html>.

* ROBERTA A. KAPLAN is a partner in the litigation department of Paul, Weiss, Rifkind, Wharton & Garrison LLP. Ms. Kaplan represented Fitch Ratings in connection with the financial crisis. She also has an extensive pro bono practice, including her successful argument before the United States Supreme Court on behalf of Edith Windsor in *United States v. Windsor*, which held unconstitutional a key provision of the Defense of Marriage Act (DOMA). JACOB H. HUPART is an associate at the same firm.

IN THIS ISSUE

- CREDIT RATING AGENCY LITIGATION
- INVESTMENT COMPANY PERFORMANCE: THE BOARD’S OVERSIGHT ROLE, Page 65