

## U.S. Inquiry Eyes S.&P. Ratings of Mortgages

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The Justice Department is investigating whether the nation's largest credit ratings agency, Standard & Poor's, improperly rated dozens of mortgage securities in the years leading up to the financial crisis, according to two people interviewed by the government and another briefed on such interviews.

The investigation began before Standard & Poor's cut the United States' AAA credit rating this month, but it is likely to add fuel to the political firestorm that has surrounded that action. Lawmakers and some administration officials have since questioned the agency's secretive process, its credibility and the competence of its analysts, claiming to have found an error in its debt calculations.

In the mortgage inquiry, the Justice Department has been asking about instances in which the company's analysts wanted to award lower ratings on mortgage bonds but may have been overruled by other S.& P. business managers, according to the people with knowledge of the interviews. If the government finds enough evidence to support such a case, which is likely to be a civil case, it could undercut S.& P.'s longstanding claim that its analysts act independently from business concerns.

It is unclear if the Justice Department investigation involves the other two ratings agencies, Moody's and Fitch, or only S.& P.

During the boom years, S.& P. and other ratings agencies reaped record profits as they bestowed their highest ratings on bundles of troubled mortgage loans, which made the mortgages appear less risky and thus more valuable. They failed to anticipate the deterioration that would come in the housing market and devastate the financial system.

Since the crisis, the agencies' business practices and models have been criticized from many corners, including in Congressional hearings and reports that have raised questions about whether independent analysis was corrupted by the drive for profits.

The Securities and Exchange Commission has also been investigating possible wrongdoing at S.& P., according to a person interviewed on that matter, and may be looking at the other two major agencies, Moody's and Fitch Ratings.

Ed Sweeney, a spokesman for S.& P., said in an e-mail: "S.& P. has received several requests from different government agencies over the last few years. We continue to cooperate with these requests. We do not prevent such agencies from speaking with current or former employees." S.& P. is a unit of the McGraw-Hill Companies, which is under pressure from some investors and has been considering whether to spin off businesses or make other strategic changes this summer.

The people with knowledge of the investigation said it had picked up steam early this summer, well before the debt rating issue reached a high pitch in Washington. Now members of Congress are investigating why S.& P. removed the nation's AAA rating, which is highly important to financial markets.

Representatives of the Justice Department and the S.E.C. declined to comment, as is customary for those departments, on whether they are investigating the ratings agencies.

Even though the Justice Department has the power to bring criminal charges, witnesses who have been interviewed have been told by investigators that they are pursuing a civil case.

The government has brought relatively few cases against large financial concerns for their roles in the housing blowup, and it has closed investigations into Washington Mutual and Countrywide, among others, without taking action.

The cases that have been brought are mainly civil matters. In the spring, the Justice Department filed a civil suit against Deutsche Bank and one of its units, which the government said had misrepresented the quality of mortgage loans to obtain government insurance on them. Another common thread — in that case and several others — is that no bank executives were named.

Despite the public scrutiny and outcry over the ratings agencies' failures in the financial crisis, many investors still rely heavily on ratings from the three main agencies for their purchases of sovereign and corporate debt, as well as other complex financial products.

Companies and some countries — but not the United States — pay the agencies to receive a rating, the financial market's version of a seal of approval. For decades, the government issued rules that banks, mutual funds and others could rely on a AAA stamp for investing decisions — which bolstered the agencies' power.

A successful case or settlement against a giant like S.& P. could accelerate the shift away from the traditional ratings system. The financial reform overhaul known as Dodd-Frank sought to decrease the emphasis on ratings in the way banks and mutual funds invest their assets. But bank regulators have been slow to spell out how that would work. A government case that showed problems beyond ineptitude might spur greater reforms, financial historians said.

"I think it would have a major impact if there was a successful fraud case that would suggest there would be momentum for legislation that would force them to change their business model," said Richard Sylla, a professor at New York University's Stern School of Business who has studied the history of ratings firms.

In particular, Professor Sylla said that the ratings agencies could be forced to stop making their money off the entities they rate and instead charge investors who use the ratings. The current business model, critics say, is riddled with conflicts of interest, since ratings agencies might make their grades more positive to please their customers.

Before the financial crisis, banks shopped around to make sure rating agencies would award favorable ratings before agreeing to work with them. These banks paid upward of \$100,000 for ratings on mortgage bond deals, according to the Financial Crisis Inquiry Commission, and several hundreds of thousands of dollars for the more complex structures known as

collateralized debt obligations.

Ratings experts also said that a successful case could hamper the agencies' ability to argue that they were not liable for ratings that turned out to be wrong.

"Their story is that they should be protected by full First Amendment protections, and that would be harder to make in the public arena, in Congress and in the courts," said Lawrence J. White, another professor at New York University's Stern School of Business, who has testified alongside ratings executives before Congress. "If they mixed business and the ratings, it would certainly make their story harder to tell."

The ratings agencies lost a bit of ground on their First Amendment protections in the recent financial reform bill, which put the ratings firms on the same legal liability level as accounting firms, Professor White said. But that has yet to be tested in court.

People with knowledge of the Justice Department investigation of S.& P. said investigators had made references to several individuals, though it was unclear if anyone would be named in any potential case. Investigators have been asking about a remark supposedly made by David Tesher about mortgage security ratings, two people said. The investigators have asked witnesses if they heard Mr. Tesher say: "Don't kill the golden goose," in reference to mortgage securities.

S.& P. declined to provide a comment for Mr. Tesher.

Several of the people who oversaw S.& P.'s mortgage-related ratings went on to different jobs at McGraw-Hill, including Joanne Rose, the former head of structured finance; Vickie Tillman, the former head of ratings; and Susan Barnes, former head of residential mortgage bond ratings. Investigators have told witnesses that they are looking for former employees and that has proved difficult because so many crucial people still work at the company.

One former executive who has been mentioned in investigators' interviews is Richard Gugliada, who helped oversee ratings of collateralized debt obligations. Calls to his home were not returned.

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