RETURN DATE: MARCH 30, 2010

STATE OF CONNECTICUT	:	SUPERIOR COURT
	:	
	:	JUDICIAL DISTRICT OF
Plaintiff,	:	OF HARTFORD
	:	
v.	:	AT HARTFORD
	:	
THE MCGRAW-HILL COMPANIES, INC. and STANDARD & POOR'S FINANCIAL SERVICES LLC	:	
	:	
Defendants.	:	MARCH 10, 2010

COMPLAINT

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' (referred to herein collectively as "S&P") unfair, deceptive, and illegal business practice of systematically and intentionally misrepresenting that the ratings assigned to structured finance securities by S&P were objective, independent and not influenced by either S&P's or its clients' financial interests. These representations were untrue and S&P knew it.

2. S&P represents that its ratings of structured finance securities are independent, objective, and the result of the highest quality credit analytics that are available to S&P. Indeed, S&P's reputation for independence, objectivity and integrity is emphasized by S&P to the users of its ratings at nearly every turn.

3. As a senior S&P executive publicly stated in 2005: "Since any structured finance transaction involves complex structures and the transfer of complex credit risks, the key to a successful transaction is an independent and objective analysis of both the structure and the credit risk. And it is in this function that [S&P's] Structured Finance ratings have excelled."

4. This principle has been further emphasized by S&P in its publicly available Code of Conduct in which S&P explicitly pledges that its ratings on structured finance securities are objective and uninfluenced by "the potential effect . . . [of the rating on S&P,] an issuer, an investor, or other market participant."

5. Despite this intentional and explicit representation, S&P failed to live up to its statements of independence and objectivity when rating structured finance securities and thereby violated the trust that it successfully cultivated with the marketplace. Moreover, S&P knew its false representations of independence and objectivity were especially misleading and harmful to participants in the structured finance securities market because structured finance securities are particularly complex and their creditworthiness is difficult, if not impossible, to evaluate even for the most sophisticated financial entities.

6. Starting in at least 2001, S&P knowingly allowed its desire for increased revenue and market share in the structured finance ratings market to influence the rating methodologies it developed for rating structured finance securities, as well as the ratings that were ultimately assigned to these investments. Similarly, revenue and market share concerns dictated the manner in which S&P monitored structured finance security ratings once they had been assigned.

7. In particular, by at least 2001, S&P's desire to maximize revenue and market share by rating as many structured finance deals as possible led S&P to cater to the preferences of large investment banks and other repeat issuers of structured finance securities that dominated S&P's revenue base, rather than focusing on what S&P said it was doing, which was providing independent and objective credit analysis.

8. Thus, when formulating its rating methodologies for structured finance securities, S&P utilized a methodology that its senior managers knew was outdated and did not capture all the credit risk that S&P knew existed. Similarly, S&P knowingly failed to use the best analytic tools available to it to conduct surveillance on those structured finance securities that it already had rated. S&P engaged in this conduct because it enabled S&P to continue to assign the high ratings that S&P's frequent customers desired, thus enabling S&P to maximize its revenue and preserve its already high market share for rating structured finance securities.

9. For purposes of clarity, 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 takes issue with the fact that S&P represented that its ratings on structured finance securities were independent, objective and, as stated in its Code of Conduct, "not . . . affected by the existence of, or potential for, a business relationship between

[S&P] . . . and the Issuer . . . or any other party, or the non-existence of any such relationship." This representation by S&P was false and S&P knew it.

11. By intentionally and knowingly misrepresenting and / or omitting factors it considered when rating structured finance securities, S&P offered a product and / or 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, unfair and illegal business practice in violation of the Connecticut Unfair Trade Practices Act. Pursuant to Conn. Gen. Stat. § 42-110m, the Connecticut Attorney General, in the name of the State of Connecticut, seeks restitution, disgorgement, and civil penalties, as well as other injunctive and equitable relief to prevent these unfair, deceptive and illegal business practices from happening in the future.

II. PARTIES

13. Plaintiff State of Connecticut, represented by Richard Blumenthal, Attorney General of the State of Connecticut, brings this action in its sovereign enforcement capacity pursuant to Conn. Gen. Stat. § 42-110m and at the request of Jerry Farrell, Jr, Commissioner of the Department of Consumer Protection for the State of Connecticut.

14. Defendant 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 Connecticut Secretary of State to conduct business within the State of Connecticut.

15. Standard & Poor's Financial Services LLC is a Delaware limited liability company and wholly owned subsidiary of defendant McGraw-Hill with a principal place of business at 55 Water Street, New York, NY 10041. 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.

16. S&P holds a dominant position in the credit rating agency market, particularly with respect to the rating of structured finance securities. For example, S&P routinely rates over 90% of the structured finance securities issued into the global capital markets. As of 2009, S&P had rated and currently monitored ratings on approximately 198,000 structured finance obligations.

17. S&P regularly transacts business in the State of Connecticut and derives substantial revenue from its business within the State of Connecticut. S&P rates structured finance securities issued by issuers located within Connecticut. Additionally, S&P's ratings on structured finance securities are routinely viewed and relied on by investors and other participants in the financial markets located within the State of Connecticut. Based on S&P's public representations, these individuals and entities depend on S&P to provide independent and objective assessments of the relative credit risk of structured finance securities, unaffected by S&P's or its clients' financial interests.

III. BACKGROUND

A. The Creation and Rating of Structured Finance Securities

1. What is a Structured Finance Security?

18. 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 assets 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.

19. The largest type of structured finance securities are securities backed by residential mortgages ("RMBS"). For example, during 2006, approximately $2.5 trillion in mortgages were originated in the United States. Approximately 80% of those mortgages were securitized into RMBS. Additionally, 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.

20. 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.

21. 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.

22. The most common type of structured finance securities collateralized by other securities are 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 by high yield loans called collateralized loan obligations ("CLOs").

23. A key entity in the structured finance securities market is a structured investment vehicle ("SIV"). A SIV is a special purpose entity that borrows money by issuing short and medium term debt and then uses that money to buy longer term securities. A SIV's long term assets typically include investment grade rated RMBS and CDOs, which entitle the investor in the SIV to principal and interest drawn from the revenue generated by the underlying collateral.

24. 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").

25. 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.

26. For example, 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.

27. To appeal to investors with different risk appetites, the trust also 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.

28. The main sources of credit enhancement are subordination, over-collateralization, and excess spread. 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 the lower tranches have absorbed losses from the underlying loans.

29. Over-collateralization refers to the amount by which the principal balance of the mortgage pool exceeds the principal balance of the securities issued by the trust. This excess principal creates an additional equity tranche below the lowest debt tranche. The equity tranche absorbs losses up to its total value before any debt tranche is affected by defaults in the underlying collateral. Commensurate with this "first loss" position, however, the equity tranche offers the greatest possibility for investment gains if the underlying collateral does not default. The equity tranche is often retained by the issuer / sponsor of the structured finance security.

30. Finally, excess spread refers to the difference between the interest rate on the underlying loans and the interest rate paid to the investors in the securities, which normally results in the trust taking in more money in interest payments than it is required to pay out. Part of the excess spread pays administrative expenses of the trust such as loan servicing fees. The excess spread also can be used to build up reserves or pay off delinquent interest payments due to a debt tranche. Any amount that is not used to pay expenses or paid over to the debt tranches is retained by the equity tranche.

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, over-collateralization and excess spread. 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 engages in the following steps when rating a RMBS. First, upon receiving a range of data on a pool of mortgage loans from an investment bank or some other arranger, S&P assigns a lead analyst to the transaction. Information provided to the lead analyst about the transaction includes principal amount, 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 is 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 is for the S&P analyst to use S&P's rating methodologies and quantitative 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. The purpose of this 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 runs the most severe stress test to determine the credit enhancement required for a RMBS tranche to receive its highest "AAA" rating. The next most severe stress test is run to determine the amount of credit enhancement required of the next highest tranche, and so on down the capital structure.

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

37. Upon analyzing the proposed capital structure, if S&P determines that the issuer's proposal does not allow for sufficient credit enhancement to receive a "AAA," then S&P is supposed to let the issuer know that the most senior class of securities could only receive a "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.

38. S&P's next step in the process is to conduct a cash flow analysis on the interest and principal expected to be received by the trust from the collateral pool to determine whether it is sufficient to pay the interest and principal due on each tranche of the trust. Ultimately, the monthly principal and interest payments derived from the loan pool needs to be enough to satisfy the monthly payments of principal and interest due by the trust to the investors in the RMBS tranches, as well as to cover the administrative expenses of the trust. Assuming that the proposed structure allows for sufficient cash flow, S&P develops a recommendation for a final credit rating for each tranche of RMBS, which is presented to an internal S&P ratings committee for final approval.

39. Similarly, the steps that S&P follows for assigning ratings to CDOs involves a review of the creditworthiness of each tranche of CDO. The process centers on an examination of the pool of assets held by the trust and, through the use of rating methodologies 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, the analysis is based primarily on the credit rating of each RMBS (or other structured finance security) in the underlying pool and does not include an analysis of the underlying loan pools collateralizing the RMBS.

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, 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 Connecticut.

42. In order for an issuer to successfully market and sell a structured finance security such as an RMBS or a CDO to a buyer / investor, the security must receive a credit rating. Moreover, due to SEC regulations limiting the type of investments that certain institutional investors can purchase, often ratings from multiple credit rating agencies are required for issuers to successfully market and sell a structured finance security to the broadest group of potential buyers / investors.

43. There are few credit rating agencies that assign ratings on 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.

44. The market for rating structured finance securities is also very lucrative. S&P charges three or four times as much for a rating on a structured finance security as it does for a rating on a corporate bond. In 2006, S&P's revenues rose approximately 15% to $12.7 billion, with approximately one half of that growth derived from S&P's increased sale of structured finance security ratings. Industry publications also estimate that as much as 40% of S&P's total revenue is derived from its ratings of structured finance securities.

45. 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, CDOs and other ABS. Accordingly, there are a relatively small group of banks that hire S&P to rate their products on a regular basis.

46. 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 . . . The 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

47. 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, financial obligations as they become due. Thus, S&P is a gatekeeper on whom investors and other market participants necessarily rely.

48. As Professor Coffee noted in his Congressional testimony: "Gatekeepers are reputation intermediaries who provide verification and certification services to investors. . . . [T]he professional gatekeeper essentially assesses or vouches for the corporate clients own

statements about itself or a specific transaction. This duplication is necessary because the market recognizes that the gatekeeper has a lesser incentive to lie than does its client and thus regards the gatekeeper's assurance or evaluation as more credible."

49. S&P's role as a "gatekeeper" takes on special importance in the market for structured finance securities because its investment grade rating is a necessary condition before many institutional investors are permitted under SEC regulations to buy debt securities. In this sense, S&P's rating also acts as a defacto regulatory license that expands the universe of potential buyers / investors capable of purchasing a particular structured finance security. S&P knows this fact.

50. S&P's role as a "gatekeeper" is also affected by the fact that structured finance securities are fundamentally different from other debt investments (*i.e.*, corporate and public bonds). For example, the issuing entity of a corporate bond has some independent existence and measurable value in and of itself that usually can be verified, at least in part, by reference to publicly available materials. This characteristic does not exist in the world of structured finance.

51. As a former senior managing director at a competing credit rating agency has publicly noted, "[s]omewhat unique to the structured finance [security] market is the opacity of the rated securities. In certain situations, the details of the underlying asset pool and often the structure of the transaction are not publicly available for external scrutiny. . . . Moreover, the tools to analyze credit risk, even with transparent assets, are beyond the grasp of many investors. Rating methods are quite technical, often relying on advanced statistical techniques.

Documentation supporting a transaction can be equally daunting, reading more like a legal brief than helpful financial guidance. In turn, a solid understanding of how to value structured [finance] securities remains elusive."

52. In light of the opaque nature of structured finance securities as an investment, buyers / investors in Connecticut (and elsewhere), issuers of structured finance securities, and other market participants are dependent on the ratings assigned by S&P to obtain some relative assessment of the credit risk associated with the various RMBS, CDOs and other ABS tranches that are issued. Indeed, S&P intends that buyers / investors of structured finance securities be the primary recipients of the information that an S&P credit rating is meant to provide, and issuers obtain a credit rating from S&P for the specific purpose of making the risk characteristics of the structured finance security understandable to investors.

53. 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 to purchase a structured finance security. S&P is well aware of buyers' / investors' and other market participants' use and reliance on S&P's credit ratings in this manner.

54. For example, in its Code of Conduct, S&P explains that it "fully supports . . . promot[ing] investor protection by safeguarding the integrity of the rating process." Additionally, 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."

55. Similarly, in its 2007 Annual Report, McGraw-Hill acknowledged 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 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 evaluation and comparing creditworthiness across all sectors in both mature and developing global markets."

56. There are many buyers / investors of structured finance securities in Connecticut, including, banks, mutual funds, insurance companies, hedge funds, and pension funds, as well as individual persons whose investment strategies are affected by the performance of these entities' structured finance security portfolios, 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

57. S&P represents that its ratings are on one uniform scale and can be compared to one another even when used for different asset types, such as corporate bonds and structured finance securities. For example, S&P's Chief Credit Officer publicly stated in 2008 that "[S&P] uses the same credit rating scale across the structured finance, corporate, and government sectors" and that S&P's credit ratings are designed to "provide a common language for evaluating and comparing creditworthiness." Simply put, S&P represents that an "A" or

similarly rated structured finance security has the same credit risk as an "A" or similarly rated corporate bond.

58. S&P's ratings for structured finance securities are expressed in the form of a letter grade. 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.

59. S&P can also modify its ratings from "AA" to "CCC" by attaching a plus (+) or minus (-) sign to show the relative standing within the major rating categories.

60. Structured finance securities bearing an S&P rating of "BBB" or above are also described as "investment grade."

61. A higher S&P credit rating on a particular tranche of a structured finance security corresponds to a lower coupon (*i.e.*, interest) rate that the issuer becomes obligated to pay the buyer / investor. Thus, a tranche rated "AAA" by S&P generally carries a lower coupon rate than a tranche rated "AA" by S&P because it is assumed that there is a lower level of credit risk to the investor. Similarly, a structured finance security rated "AA" by S&P generally carries a lower coupon rate than a structured finance security rated "A" by S&P, and so on down S&P's letter rating scale.

E. The Issuer Pays Business Model

62. S&P is compensated by the same entities that issue the structured finance securities that S&P is tasked with evaluating. Specifically, in exchange for providing its credit ratings on structured finance securities, S&P charges the issuer a fee based on the complexity and size of the structured finance security being rated. 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."

63. Unfortunately, the financial incentives inevitably linked to the Issuer Pays business model, where S&P's desire for additional revenue and market share can only be realized by pleasing the issuers of the securities it is rating, have improperly influenced S&P's analysis when rating structured finance securities.

64. Specifically, by at least 2001, the pressures of S&P's Issuer Pays business model on its rating of structured finance securities became particularly acute. For example, 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.

65. S&P's ability to please issuers of structured finance securities is dependent on its rating models and rating committees requiring the smallest amount of additional credit enhancement to achieve the issuer's desired AAA rating. The smaller or lower the credit enhancement, the more profitable the security is to the issuer.

66. Issuers of structured finance securities are well aware of the incentives built into the Issuer Pays business model and use it to their advantage to get higher ratings from S&P. Specifically, an issuer typically requests ratings from not only S&P but also from S&P's main competitors, Moody's and Fitch, Inc. ("Fitch.") If the issuer is unhappy with the credit enhancement levels proposed by S&P after it conducts its analysis, the issuer can inform S&P of the credit enhancement levels proposed by either Moody's or Fitch in order to influence the outcome of S&P's analysis. In such a situation, S&P is faced with the dilemma of either adjusting its analysis to win the business, and therefore realize additional revenue, or staying true to its original assessment and potentially losing the business.

67. This practice is most commonly known as "ratings shopping" because issuers offer the business of rating their structured finance security to competing rating agencies and usually give the business to the firm (or firms) that find the least amount of credit enhancement necessary to achieve the rating levels desired by the issuer.

68. A current high ranking S&P managing director confirmed the inherent dangers of the Issuer Pays business model in September of 2007 when he testified before Congress as follows: "Another aspect of conflict of interest . . . is that . . . rating agencies can come under

pressure to loosen their standards for a whole sector. And this can happen from behavior from the issuers called ratings shopping, where . . . an issuer . . . shows a deal to multiple rating agencies and then picks one or two that have the easiest standards to rate the deal. Then the other rating agencies that had tougher standards become invisible, and, once more, they don't make any money, because the way you make money . . . is you rate the deal and charge the issuer. So it puts pressure on the rating agencies to loosen their standards . . . . [W]e call this competitive laxity."

IV. S&P REPRESENTS ITSELF TO THE PUBLIC AS AN INDEPENDENT AND OBJECTIVE EVALUATOR OF STRUCTURED FINANCE SECURITIES

A. S&P's Pledge to Safeguard the Integrity of the Rating's Process

69. S&P represents to investors and other participants in the financial markets, including those in Connecticut, that its credit ratings, including those of structured finance securities, are independent, objective and free from outside influence. S&P repeatedly, consistently, and publicly emphasizes its independence and objectivity to investors and other market participants in a variety of public statements.

70. For example, S&P's current web site states: "[S&P's] mission is to provide high quality, objective, independent, and rigorous analytical information to the marketplace" and explains that S&P "endeavors to conduct the rating and surveillance processes in a manner that is transparent and credible and that also maintains the integrity and independence of such processes

in order to avoid any compromise by conflicts of interest, abuse of confidential information, or other undue influences."

71. Harold McGraw III, the Chairman, President and Chief Executive Officer of McGraw-Hill, described S&P in the company's 2002 Annual Report as "the world's leading provider of independent opinions and analysis on the debt and equity markets," and noted that "securitization, disintermediation and privatization create a growing demand for our independent ratings and analysis."

72. In McGraw-Hill's 2003 Annual Report, Mr. McGraw further emphasized that "[S&P] enjoys a preeminent position in the world's financial architecture" and the company's "ongoing commitment to improving transparency facilitates the global capital-formation process." Similarly, Mr. McGraw noted that S&P is responding to the new challenges created by the structured finance market "by building on its market leadership as the world's foremost provider of independent credit ratings and risk evaluation."

73. 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 further stated that "[S&P] provides investors with the independent benchmarks they need to feel more confident about their investment and financial decisions."

74. S&P's vow of independence, objectivity and integrity were codified in October of 2005, when it adopted a Code of Professional Conduct ("S&P's Code" or 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."

75. 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"

76. 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.

77. 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 obligations to issuers are designed to improve the quality of credit ratings and their usefulness to investors."

78. 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."

79. 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 its independence and avoids conflicts of interest with issuers. The most important of these representations are found in sections 1.12, 2.1 – 2.4, and 1.9 of the Code, which currently remain in effect as purported limitations on the factors that S&P considers when rating structured finance securities.

80. Specifically, Section 1.12 of S&P's Code states: "[S&P] and its employees shall deal fairly and honestly with issuers, investors, other market participants, and the public."

81. Section 2.1 of S&P's Code states: "[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."

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

83. Section 2.3 of S&P's Code states: "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."

84. Section 2.4 of S&P's Code states: "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."

85. Section 1.9 of S&P's Code states: "[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."

86. S&P's Code is available on its web site and the requirements of Sections 1.12, 2.1 through 2.4, and 1.9 have continued to be referenced in several public statements by S&P since the Code's adoption in October of 2005.

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

87. McGraw Hill's 2006 Annual Report picked up on the same themes and once again reiterated its 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."

88. 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 further stated 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."

89. 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, Ms. Barnes stated 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."

90. In her testimony before Congress, Ms. Barnes underscored that S&P's credit ratings are "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."

91. Similarly, Mr. McGraw stated in the company's 2008 Annual Report that "[i]t is 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."

92. These themes were reiterated by Deven Sharma, the President of Standard & Poor's Financial Services LLC, in October 2008 testimony before the House Committee on Oversight and Government Reform. Mr. Sharma testified that "[t]he 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."

93. Mr. 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."

94. In sum, the statements made by S&P in its Code 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 market participants. First, that S&P's ratings of structured finance securities have been, and continue to be, independent, objective and free from consideration of S&P's desire for revenue or winning additional business from issuers.

95. Second, recognizing that S&P holds a position of trust in the marketplace, S&P represents that it deals fairly and honestly with the public, including the buyers / investors of the structured finance securities that it rates.

96. Third, that S&P agrees with and has implemented the principles set forth in the IOSCO Code of Conduct by maintaining independence, objectivity and integrity of its ratings of structured finance securities.

97. Fourth, that S&P understands the Issuer Pays business model creates conflicts of interest, but that these conflicts have been adequately managed by the company as demonstrated by the principles set forth in S&P's Code so as to ensure that its credit ratings are purely a function of credit analytics. Investors and other market participants depend on S&P to properly

manage this conflict and reasonably interpret S&P's representations to understand that S&P does so.

98. Fifth, that S&P dedicates the resources necessary and does in fact conduct timely and thorough surveillance on its ratings of structured finance securities to ensure that the rating assigned by S&P continues to reflect S&P's assessment of the credit risk associated with the obligation.

99. The above representations made by S&P are material to buyers / investors of structured finance securities, as well as other market participants located in Connecticut, and also have been reasonably interpreted by those same individuals and entities in light of the circumstances in which the representations have been made.

100. None of the above representations made by S&P were true. S&P knows of this fact and yet S&P continues to make the same misrepresentations to this day with this full knowledge.

V. S&P'S EVALUATION OF STRUCTURED FINANCE SECURITIES WAS NOT INDEPENDENT AND OBJECTIVE

101. Rather than maintaining independence and objectivity when rating structured finance securities as its public statements promised, S&P was focused on pleasing the relatively small group of repeat issuers that pay its lucrative fees, thereby maintaining its already high market share and its revenue. As a result, S&P's credit analytics when rating structured finance

securities were influenced by the very business and revenue considerations that its public statements consistently and explicitly disavow and its Code of Conduct prohibits.

102. S&P's sacrifice of its independence and objectivity due to its desire to please issuers of structured finance securities has manifested itself in several ways. Although not an exhaustive recitation, some examples of this conduct are set forth below.

A. Ratings Shopping Corrupts the Integrity of the Process

103. "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.

104. 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."

105. Between at least 2004 and 2007, when the markets for RMBS and CDOs were particularly active, S&P experienced this pressure on a daily basis. Upon information and belief, the pressure did in fact influence the ratings that S&P assigned to structured finance securities, the recommendations that S&P's analysts made to their superiors, and the feedback that S&P provided to issuers.

106. The fact that these outside influences did in fact affect S&P's ratings of structured finance securities was not disclosed by S&P in its public statements. To the contrary, S&P represented quite the opposite by repeatedly stating that its ratings are not influenced by its business relationships.

B. S&P's Quest for Profits Influenced its Rating Methodology

107. S&P's desire for more fees also influenced the rating methodology that S&P developed, or in some cases, intentionally failed to develop, for rating structured finance securities.

108. By at least 2001, 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 rating methodologies that S&P developed and implemented for rating RMBS and other structured finance securities.

109. S&P believed that the only way for it to successfully compete for an issuer's structured finance business was to make sure that its 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 uninfluenced by either S&P or its clients' financial interests.

110. The role that these pressures played in S&P's analytics was confirmed in a May 2004 communication between a senior S&P executive and managing directors in S&P's residential mortgage backed securities group. "We just lost a huge . . . RMBS deal to Moody's

due to a huge difference in the required credit support level . . . [which] was at least 10% higher than Moody's . . . . I had a discussion with the team leads here and we think that the only way to compete is to have a paradigm shift in thinking, especially with the interest rate risk."

111. Unfortunately, this type of analytical adjustment based on revenue concerns was prevalent at S&P well before 2004.

112. For example, beginning in approximately 1996, S&P used a rating model it developed called "*LEVELs*" to estimate the likelihood of default and expected loss associated with a pool of residential mortgages used as collateral for a RMBS. As described in section III.A, the loss estimate for a pool of loans determines how much, or the "level," of credit enhancement necessary for S&P to issue AAA rated securities backed by the identified collateral.

113. S&P's *LEVELs* model uses a statistically based methodology to estimate the default and loss of residential home loans and loan pools based in part on historical loan performance data. Put simply, based on how other loans have performed over time, S&P's *LEVELs* model estimates the default probability and expected loss for a particular pool of loans and structure proposed by an issuer of a RMBS.

114. The first *LEVELs* model implemented by S&P in 1996 for rating RMBS used a database that aggregated loan performance data going back five or more years for approximately 500,000 residential loans across the United States. Upon implementing *LEVELs* and publicizing its use to market participants, S&P's original intention was to refine and improve the model by

making at least annual updates to *LEVELs* by adding additional loan performance data, thus increasing the size of its databases. This plan was a function of the fact that S&P knew that the predictive quality of its *LEVELs* model was only as accurate as the quality of the data underlying the model.

115. Consistent with this principle, S&P updated its *LEVELs* model in early 1999 by adding loan performance data going back six to eight years for approximately 900,000 loans. As acknowledged by a former senior S&P executive responsible for rating RMBS, these updates were critical to the *LEVELs* model's success because each new version was built with growing data on both traditional and new mortgage products, particularly with respect to the growing subprime mortgage market.

116. Beginning in 2001, as the number of RMBS transactions in the United States increased and, therefore, the number of opportunities for S&P to earn lucrative fees for rating structured finance securities also greatly increased, S&P's upper level management stopped refining S&P's *LEVELs* model by adding new loan data. S&P adopted this new approach despite the fact that its senior managers in the residential mortgage backed securities group repeatedly emphasized the importance of keeping the model up to date given the constantly changing nature of the residential mortgages issuers sought to securitize.

117. For example, at the insistence of the managing director responsible for rating RMBS, S&P's *LEVELs* development team continued to collect data on historical loan performance. Based on this work, in 2001 S&P developed a new version of its *LEVELs* model

based on significant performance data for 2.5 million loans. Unfortunately, S&P did not implement this updated model.

118. Similarly, in early 2004, S&P's residential mortgage backed securities unit completed another update of the *LEVELs* model based on performance data from approximately 9.5 million loans covering the full spectrum of new mortgage products, particularly those in the area of sub-prime lending, which was the fastest growing segment of residential lending. Despite the urgings of the managing director in charge of rating RMBS, S&P did not implement this more comprehensive model for rating RMBS upon its completion in 2004.

119. Furthermore, as one former senior S&P managing director testified before Congress, although S&P still maintained a trove of additional residential loan data, as of October of 2008, it still had not implemented any meaningful updates to its *LEVELs* model based on the much more comprehensive database developed by its analysts.

120. S&P's conscious decision between at least 2001 and 2008 to use an outdated version of its *LEVELs* model for rating RMBS was motivated by S&P's desire to continue to assign the AAA ratings with minimal credit enhancement that issuers coveted, thus preserving its market share and earning much more revenue for the company.

121. In the words of one former senior S&P managing director in charge of rating RMBS, a primary factor in S&P's break down in ratings standards and lack of interest in keeping the *LEVELs* 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." To the contrary, the perverse set of incentives embedded in the Issuer Pays business model guaranteed that the more accurate S&P's ratings became at predicting credit risk, the less money it stood to make because issuers would simply bring their business elsewhere.

122. 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.

123. As stated by a former senior S&P executive, between at least 2001 and 2008, when rating structured finance securities S&P's internal business strategy valued revenues over ratings quality, while at the same time promising independence and objectivity in its public statements.

> Well, profits were what drove it starting in about 2001 at [S&P]. It was the growth in the market and the growth – profits were running the show. In a nutshell, that was the simple answer. And the business managers that were in charge just wanted to get as much of the [revenue] as they saw like this, growing out in the street, into their coffers . . . .
>
> I believe that [S&P] at this time, there was a raging debate between the business managers and the analysts. The analysts were in the trenches. We saw the transactions coming in. We could see the shifts that were taking place in the collateral. And we were asking for more staff and more investment in being able to build the databases and the models that would allow us to track what was going on. The corporation, on the other hand was interested in trying to maximize the money that was being sent up to McGraw-

> Hill, and the requests were routinely denied. So, by 2005 . . . we did have two very excellent models that were developed but not implemented. And it's my opinion that had we built the databases and been allowed to run those models and continually populated that base and do the analysis on a monthly quarterly basis, we could have identified the problems as they occurred.

124. In sum, S&P's desire to earn more fees and maintain its market share at the expense of ratings quality, was not consistent with S&P's representations in its Code of Conduct and its public commitment to maintain the highest level of independence, objectivity and integrity in its ratings for structured finance securities. To the contrary, as of at least 2008, S&P's "cornerstone principles" of independence and objectivity were eroded and compromised by the very business considerations – revenue generation, catering to the preferences of issuers, and market share – that its senior executive publicly disavowed.

125. S&P's desire for more fees and maintenance of its high market share also affected the manner in which it evaluated CDOs.

126. For example, in 2001, S&P was asked to provide a credit estimate by a leading investment bank and frequent customer of S&P's on a structured finance security called *Pinstripe I CDO* that was collateralized by RMBS. A credit estimate is not an official rating, but a private statement made by S&P for a fee regarding how it likely would have rated the transaction.

127. S&P had not previously rated the RMBS underlying the *Pinstripe I CDO* and, therefore, did not independently have access to the underlying loan level data. The managing

director responsible for performing the credit estimate stated that to conduct an appropriate analysis his team would need to obtain the loan level data and then run that data through S&P's *LEVELs* model. A less rigorous alternative to this approach was to simply estimate the CDO's credit risk based on ratings assigned to the underlying collateral by S&P's competitor, Fitch. However, this method was prohibited by S&P's internal policies.

128. In response to the managing director's request for access to the loan level data to carry out a proper credit estimate, the S&P managing director was chastised by the co-head of S&P's CDO group and member of its Executive Committee, as follows:

> Any request for loan level tapes is TOTALLY UNREASONABLE!!! Most investors don't have it and can't provide it. Nevertheless we MUST produce a credit estimate . . . .
>
> It is your responsibility to provide those credit estimates and your responsibility to devise some method for doing so. Please provide the credit estimates requested! (Emphasis in original.)

129. In short, rather than directing the managing director to adhere to S&P's internal policy by actually obtaining the appropriate data and carrying out the necessary analysis (albeit using the *LEVELs* model that S&P knew had already become out of date), upper level S&P management instructed him to ignore the "robust safeguards" S&P had in place and estimate the transaction's credit risk without access to even the most basic information about the deal. In the view of the managing director, he was essentially being asked to "provide a guess."

130. Despite the managing director's objections and refusal to provide a credit estimate without having rated the underlying RMBS or gaining access to the loan level data, S&P went

forward with grading the transaction and assigned its highest credit estimate of AAA to a significant portion of the *Pinstripe I CDO's* securities. S&P disregarded the safeguards that its internal policies were designed to ensure and the recommendation of one of its most senior managers, because it wanted to meet the demands of one of its best customers and it did not want to forego revenue that would otherwise be captured by one of its competitors.

131. By at least late 2004, S&P's unstated willingness to cater to the demands of issuers intruded on the entire rating methodology that S&P developed for rating certain 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 matched that of its competitors.

132. For example, in August of 2004, one of S&P's managing directors noticed that S&P was not rating as many CDOs backed by CMBS as it had in previous quarters. To address the loss of business, she informed her colleagues as follows: "We are meeting with your group this week to discuss adjusting criteria for rating CDOs of real estate assets . . . because of the ongoing threat of losing deals." The head of S&P's CDO unit and a member of its Executive Committee endorsed lessening the standards by noting: "Ok with me to revise criteria." Although not revealed publicly, S&P engaged in this conduct for the specific purpose of not losing deals to Moody's or Fitch, increasing its revenue, and making its ratings no more conservative than that of its closest competitors.

133. Just as is the case with respect to the models used to rate RMBS, inappropriate business considerations such as revenue generation, catering to the preference of issuers, and market share influenced the manner in which S&P rated CDOs. None of these objectives were consistent with S&P's Code of Conduct or its public commitment to maintaining the highest level of independence, objectivity and integrity in its ratings for structured finance securities.

C. S&P's Surveillance Practices Were Designed to Fail

134. S&P's focus on business considerations such as revenue enhancement and maintaining its market share also influenced the manner in which it monitored, or conducted surveillance, on the structured finance securities that it had already rated.

135. For example, 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, including the managing director of RMBS, 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.

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

> [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 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.

137. 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 had already been paid its fee and issuers continued to want only AAA ratings. Indeed, proper surveillance could actually lead to S&P earning less revenue because there was a real business risk that as the volatility of S&P's ratings increased investors would perceive S&P's ratings as less accurate, thus leading issuers to stop using S&P to rate structured finance securities.

138. 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. Just as was the case with respect to its decision to not keep its *LEVELs* model up to date, S&P's decision to deemphasize its surveillance responsibility

was directly influenced by the company's overriding emphasis on revenue and market share goals.

139. Put simply, S&P failed to dedicate the appropriate resources to responsibly conduct surveillance, did not implement the more up to date version of *LEVELs* developed by its analysts, and did not use its *LEVELs* model to continually monitor its ratings of RMBS because it knew that doing so would have revealed that many of the structured finance securities that it had previously rated AAA were not deserving of such a high rating.

140. Given this reality, S&P feared that the volatility and downgrades in its RMBS ratings that would have ensued would have damaged its business franchise because investors and other market participants would inevitably have questioned the validity of S&P's RMBS ratings in the first place, as well as S&P's representation that structured finance securities rated AAA contained no more credit risk than a AAA rated corporate bond.

141. Rather than expose itself to the negative ramifications of these difficult questions, S&P decided to simply avoid the issue entirely by using ineffective and insufficient safeguards to both initially rate and also monitor its RMBS ratings. As a result, much of the credit risk contained in RMBS that received S&P's highest ratings remained hidden from the marketplace for much longer than it would have if S&P had treated surveillance as the "robust safeguard" that its public statements promised, by adequately staffing its surveillance group, implementing the already developed updates to its *LEVELs* model, and using the model to conduct surveillance on its RMBS ratings.

142. Once again, S&P's internal business decisions – motivated primarily by its self interested desire to achieve or maintain revenue and market share goals – directly contradicted S&P's Code of Conduct and its public representations regarding its robust surveillance, as well as maintaining independence and objectivity in its ratings of structured finance securities.

VI. CAUSES OF ACTION

First Count: Violation of the Connecticut Unfair Trade Practices Act (Conn. Gen. Stat. § 42-110a, et seq.)

1-142. Paragraphs 1 through 142 of the Complaint are hereby repeated and realleged as Paragraphs 1 through 142 of this First Count as if fully set forth herein.

143. At all times relevant to this Complaint, S&P was engaged in the trade or commerce of providing credit ratings to issuers located in Connecticut and providing credit ratings for use by investors and other market participants within the State of Connecticut.

144. By engaging in the acts and practices alleged herein, S&P made or caused to be made to Connecticut consumers, 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 ratings of structured finance securities are 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, including the buyers / investors of the structured finance securities that it rates;

c. that S&P understands that the Issuer Pays business 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 ratings of structured finance securities; and

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

145. By engaging in the acts and practices alleged herein, S&P made omissions to Connecticut consumers that it had a duty to disclose by virtue of S&P's other representations to Connecticut consumers, including, but not limited to, the following

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

b. that S&P does not deal fairly and honestly with buyers / investors of structured finance securities or other market participants;

c. that S&P allowed business and revenue considerations to influence the rating methodologies it developed to rate structured finance securities;

d. that S&P's surveillance of its ratings on RMBS was influenced by business concerns such as revenue enhancement and maintaining market share;

e. 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;

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

g. that S&P's structured finance ratings were based in part on a desire to promote S&P's own economic interests.

146. S&P's acts and practices regarding Connecticut consumers as alleged herein are unfair, oppressive or unscrupulous and violated the public policy of the State of Connecticut, including, but not limited to the public policy against:

a. misrepresenting the nature and extent of your services in business; and

b. abusing and unfairly profiting from a dominant position in the market.

147. S&P's acts and practices as alleged herein have directly and proximately caused substantial injury to consumers within the State of Connecticut.

148. S&P knew or should have known that its conduct alleged herein violated Conn. Gen. Stat. § 42-110b.

149. S&P's acts or practices alleged herein constitute unfair or deceptive acts or practices in violation of Conn. Gen. Stat. § 42-110b.

PRAYER FOR RELIEF

WHEREFORE, the State of Connecticut requests the following relief:

1. A finding that by the acts alleged herein, S&P engaged in unfair and deceptive acts and practices in the course of engaging in the trade or commerce of a credit rating agency within the State of Connecticut in violation of the Connecticut Unfair Trade Practices Act;

2. An injunction pursuant to Conn. Gen. Stat. § 42-110m enjoining S&P from engaging in any acts that violate the Connecticut Unfair Trade Practices Act, including, but not limited to, the unfair and deceptive acts and practices alleged herein;

3. An order pursuant to Conn. Gen. Stat. § 42-110m requiring that S&P submit to an accounting to determine the amount of improper fees and revenue paid to S&P as a result of its unfair and deceptive acts and practices;

4. An order pursuant to Conn. Gen. Stat. § 42-110o directing S&P to pay a civil penalty of $5,000 for each and every willful violation of the Connecticut Unfair Trade Practices Act;

5. An order pursuant to Conn. Gen. Stat. § 42-110m directing S&P to pay restitution;

6. An order pursuant to Conn. Gen. Stat. § 42-110m directing S&P to disgorge all revenues, profits, and gains achieved in whole or in part through the unfair acts or practices complained of herein;

7. An order pursuant to Conn. Gen. Stat. § 42-110m directing S&P to pay reasonable attorneys' fees to the State of Connecticut;

8. Costs of suit; and

9. Such other relief as this Court deems just and equitable.

Plaintiff State of Connecticut hereby demands a trial by jury on all issues and causes of action so triable.

Dated at Hartford, Connecticut, this 10th day of March, 2010.

PLAINTIFF
STATE OF CONNECTICUT

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RETURN DATE: MARCH 30, 2010

STATE OF CONNECTICUT	:	SUPERIOR COURT
	:	
	:	JUDICIAL DISTRICT OF
Plaintiff,	:	OF HARTFORD
	:	
v.	:	AT HARTFORD
	:	
THE MCGRAW-HILL COMPANIES, INC. and STANDARD & POOR'S FINANCIAL SERVICES LLC	:	
	:	
Defendants.	:	MARCH 10, 2010

AMOUNT IN DEMAND

The amount, legal interest or property in demand is $15,000.00 or more, exclusive of interest and costs.

PLAINTIFF
STATE OF CONNECTICUT

RICHARD BLUMENTHAL
ATTORNEY GENERAL

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