

Credit Rating Failures in the Aftermath of the Mortgage Meltdown

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What Do These Movies Have in Common?



Citizen Kane



Fight Club

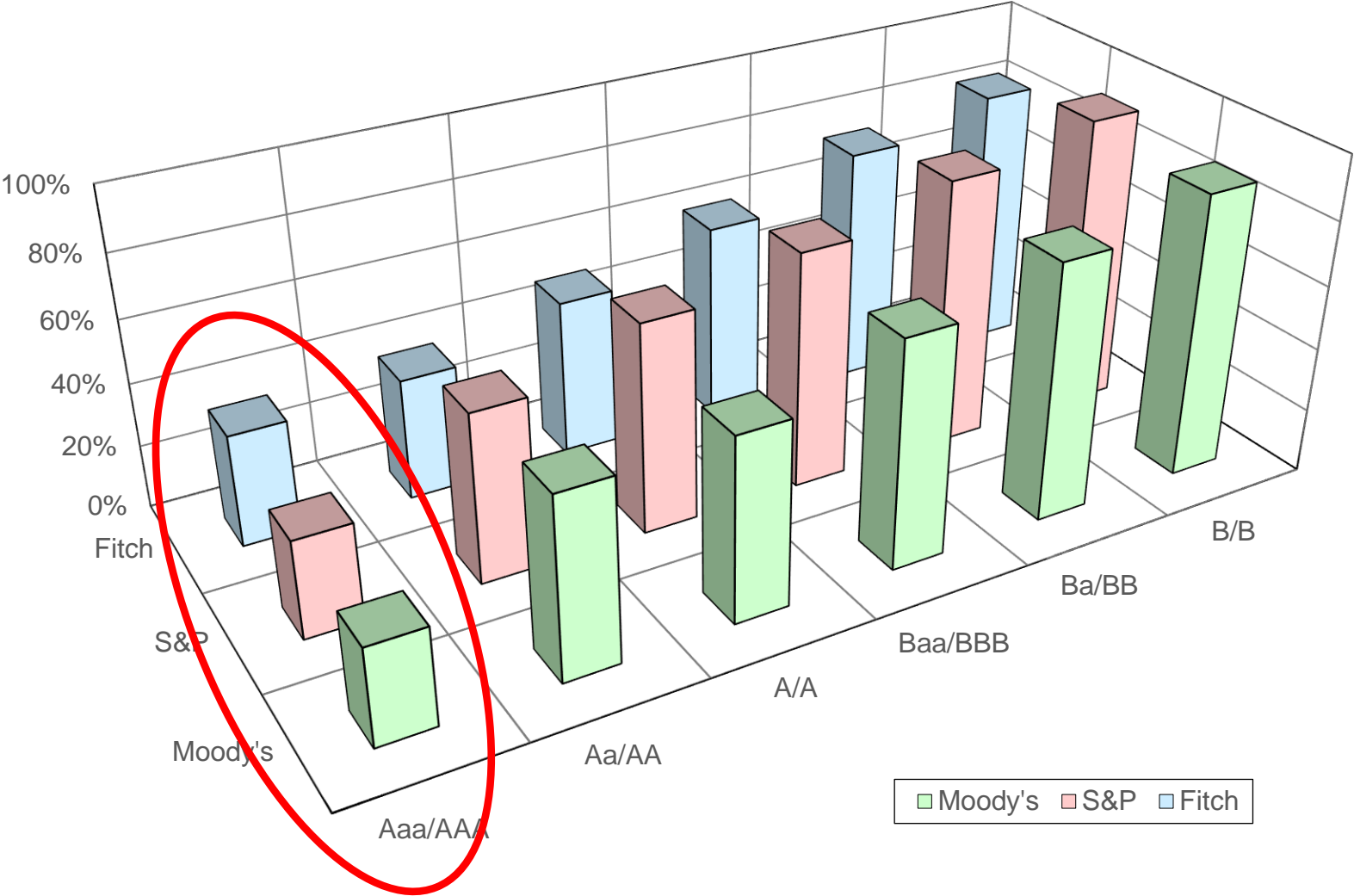


Pulp Fiction



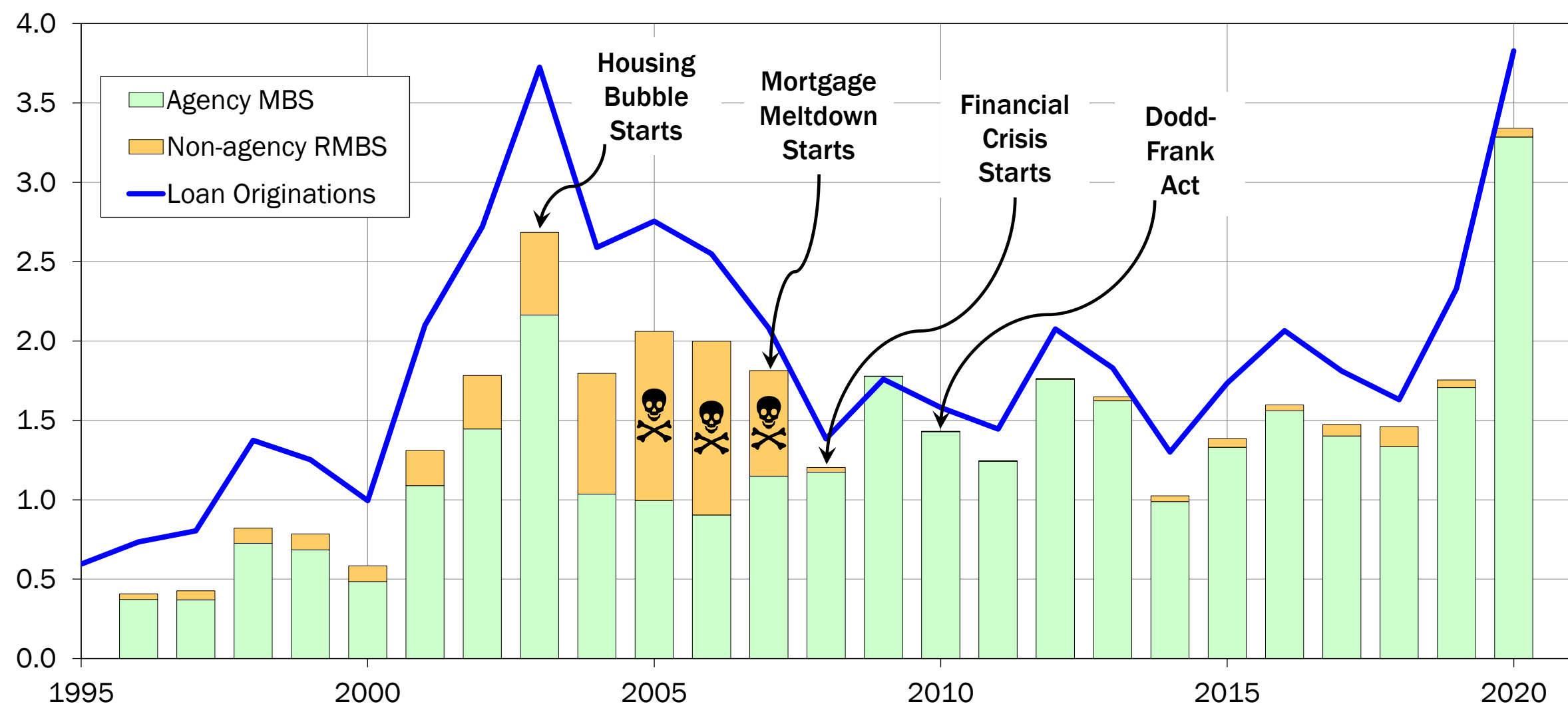
Forrest Gump

RMBS 10-Year Rate of Defaults (as of December 31, 2017)



	Moody's	S&P	Fitch
Aaa/AAA	30%	31%	35%
Aa/AA	56%	53%	38%
A/A	57%	66%	50%
Baa/BBB	71%	75%	62%
Ba/BB	81%	85%	75%
B/B	89%	93%	84%

U.S. MBS Issuance and Loan Originations (\$ trillions)



Source: SIFMA, Inside Mortgage Finance

2010 Three-way Stand-off: SEC vs. Rating Agencies vs. Issuers

- **1981:** Proposal. *Disclosure of Securities Ratings in Registration Statements*, Rel. Nos. 33-6336, 34-18012, [46 Fed. Reg. 42024](#) (18 Aug. 1981)
- **1982:** Ratings not considered part of a registration statement, which would otherwise trigger potential liability. [SEC Rule 436\(g\)](#), [17 C.F.R. § 230.436\(g\)](#); *Adoption of Integrated Disclosure System*, Rel. Nos. 3-6383, 34-18524, [47 Fed. Reg. 11380, 11441](#) (16 Mar. 1982)
- **2010:** [Dodd-Frank Act](#) § 939G nullifies Rule 436(g), intending to impose liability on rating agencies by requiring consent to liability
- **2010:** Rating agencies refuse to provide consents
- **2010:** [SEC no-action letter re **Ford Motor Credit**](#) dodges DFA § 939G by allowing issuers to omit ratings from prospectuses

Mortgage Meltdown — The Aftermath

- \$1 trillion ($\pm 20\%$) of losses on mortgage loans from 2007 through roughly 2016
- Industry-wide breakdown of loan origination and securitization practices
- Loans did not conform to the descriptions in the securities offering materials or comply with contractual representations and warranties
- Huge failure of investor protection because of short limitations periods
- Servicing violations
- Investors and the government have recovered less than 25%
- Horrible performance of credit ratings

How Do We Know What Happened & Why?

- Early reports did not cover the full magnitude of the wrongdoing
 - [FCIC](#) (2009) and [U.S. Senate](#) (2011)
- DOJ investigations/settlements found much more (2013-2019)
- [FHFA v. Nomura](#) trial and decision (2015)
- Trials in private cases ([Assured](#) 2013 and [MBIA](#) 2020)
- **Rating agency cases**
 - U.S.: [S&P](#) (2015), [Moody's](#) (2017), & SEC enforcement
 - Australia: [S&P](#) (2018), [Fitch](#) (2019)

Selected Settlements of DOJ MBS Cases (\$ billions)

Date	Total Amount	Cash Penalty	Consumer Relief	Defendant	Plaintiff(s)	Admissions
11/19/2013	13.0	9.0	4.0	JP Morgan Chase	DOJ + states ¹	✓
7/14/2014	7.0	4.5	2.5	Citigroup	DOJ + states	✓
8/21/2014	16.65	9.65	7.0	Bank of America	DOJ + states	✓
2/25/2015	2.6	2.6	0	Morgan Stanley	DOJ	✓
2/11/2016	3.173	2.773	0.4	Morgan Stanley	DOJ + states ²	✓
4/11/2016	5.06	3.26	1.8	Goldman Sachs	DOJ + states	✓
1/17/2017	7.2	3.1	4.1	Deutsche Bank	DOJ	✓
1/18/2017	5.28	2.48	2.8	Credit Suisse	DOJ	✓
3/29/2018	2.0	2.0	0	Barclays	DOJ	✗
8/1/2018	2.09	2.09	0	Wells Fargo	DOJ	✗ ³
8/14/2018	4.9	4.9	0	Royal Bank of Scotland	DOJ	✗ ³
10/9/2018	0.765	0.765	0	HSBC	DOJ	✗
10/16/2018	0.48	0.48	0	Nomura	DOJ	✗ ³
4/12/2019	1.5	1.5	0	General Electric	DOJ	✗

¹ Includes \$4 billion of a previously announced settlement with the FHFA.

² Reported as \$3.2 billion but includes \$2.6 billion of a previously announced settlement with DOJ.

³ Settlement details DOJ's findings but defendant did not admit to them.

Selected Settlements of FHFA & GSE MBS Cases (\$ millions)

Date	Amount	Defendant	Plaintiff	Date	Amount	Defendant	Plaintiff
12/31/2010	1,520	Bank of America	Fannie	2/27/2014	122	Société Générale	FHFA
12/31/2010	1,350	Bank of America	Freddie	3/21/2014	885	Credit Suisse	FHFA
5/28/2013	250	Citigroup	FHFA	3/26/2014	9,300	Bank of America, Countrywide, and Merrill Lynch	FHFA
7/25/2013	885	UBS	FHFA				
10/25/2013	5,100	JP Morgan Chase	FHFA	4/24/2014	280	Barclays	FHFA
11/6/2013	335	Wells Fargo	FHFA	4/29/2014	110	First Horizon	FHFA
12/2/2013	404	Bank of America	Freddie	6/19/2014	100	RBS	FHFA
12/20/2013	1,925	Deutsche Bank	FHFA	8/22/2014	3,150	Goldman Sachs	FHFA
12/31/2013	475	Ally Financial	FHFA	9/12/2014	550	HSBC	FHFA
1/7/2014	10,300	Bank of America	Fannie	7/12/2017	5,500	RBS	FHFA
2/7/2014	1,250	Morgan Stanley	FHFA	6/25/2018	847	Nomura	FHFA*

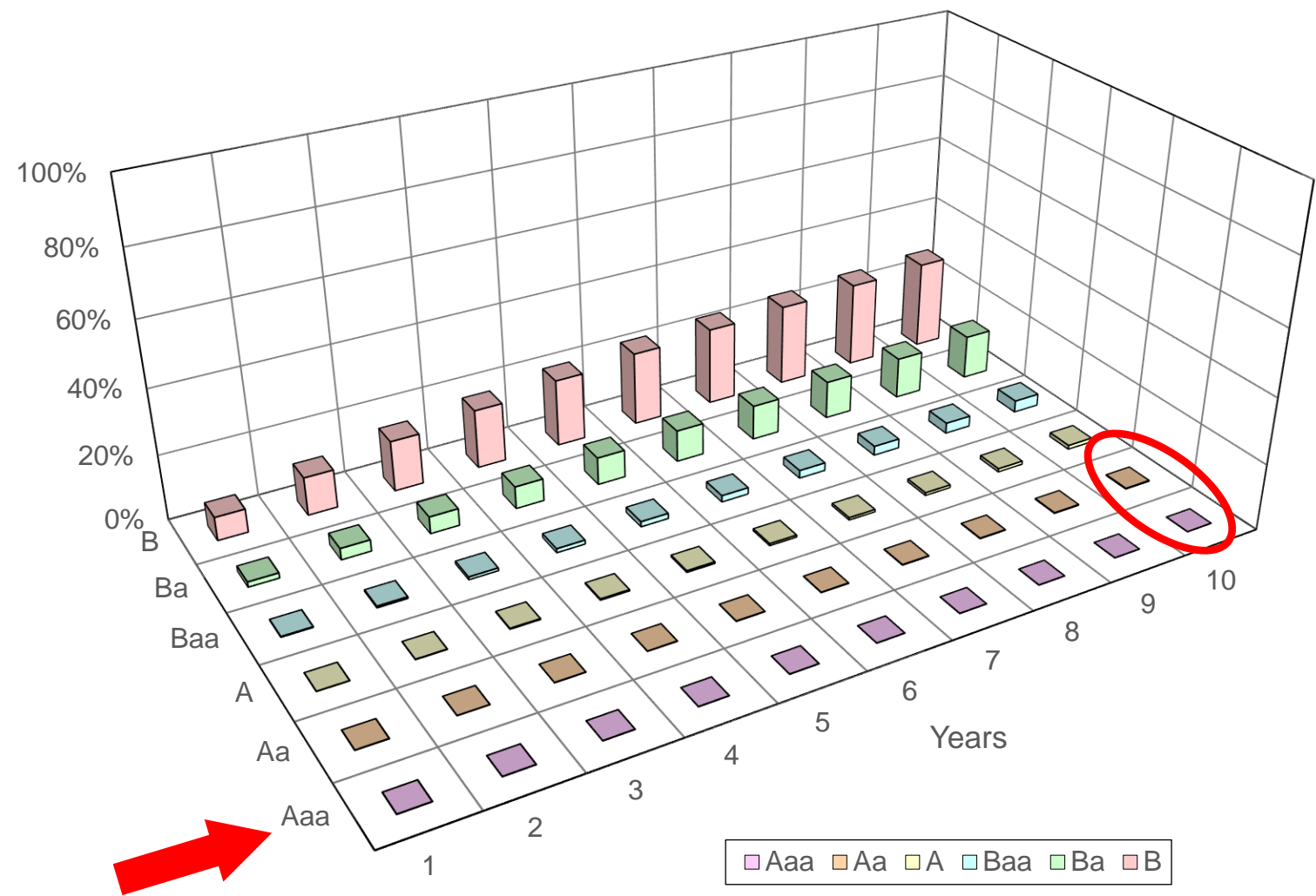
* Case was tried and affirmed on appeal. [Federal Housing Finance Agency v. Nomura Holdings America](#), [104 F. Supp. 3d 441](#) (S.D.N.Y. 2015), aff'd. [873 F.3d 85](#) (2d Cir. 2017), cert. denied 585 U.S. ____ (No. 17 1302, 25 Jun 2018). **Note:** Links to the complaints in the FHFA cases are available at <https://www.fhfa.gov/SupervisionRegulation/LegalDocuments/Pages/Litigation.aspx> and a list of the FHFA settlements appears at <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Final-Update-on-Private-Label-Securities-Actions-9172018.aspx>.

Rating Agency Litigation

- [S&P 2015 settlement](#): \$1.375 billion
- [Moody's 2017 settlement](#): \$864 million
- [S&P 2018 Australian settlement](#): A\$215 million
- [Fitch 2019 Australian settlement](#): A\$27 million

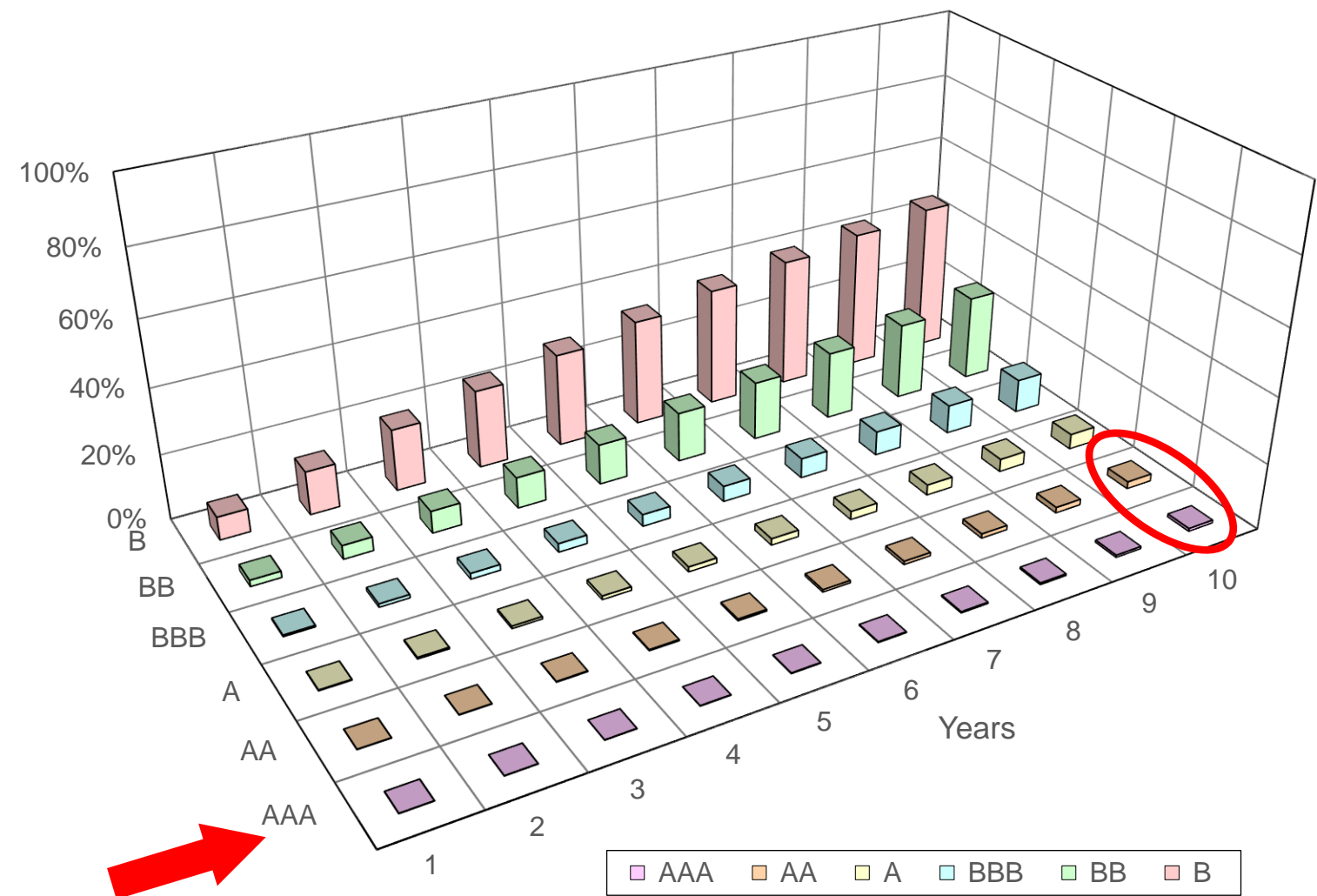
But Nobody Went to Jail.

Moody's “Idealized” Default Rates



Years	Aaa	Aa	A	Baa	Ba	B
1	0.0%	0.0%	0.0%	0.2%	1.6%	7.2%
2	0.0%	0.0%	0.1%	0.5%	3.5%	11.7%
3	0.0%	0.0%	0.2%	0.8%	5.2%	15.6%
4	0.0%	0.0%	0.3%	1.2%	6.8%	18.1%
5	0.0%	0.1%	0.5%	1.6%	8.4%	20.7%
6	0.0%	0.1%	0.6%	2.0%	9.8%	22.7%
7	0.0%	0.1%	0.7%	2.4%	10.7%	24.0%
8	0.0%	0.1%	0.8%	2.9%	11.7%	25.2%
9	0.0%	0.2%	1.0%	3.2%	12.7%	26.2%
10	0.0%	0.2%	1.2%	3.6%	13.5%	27.2%

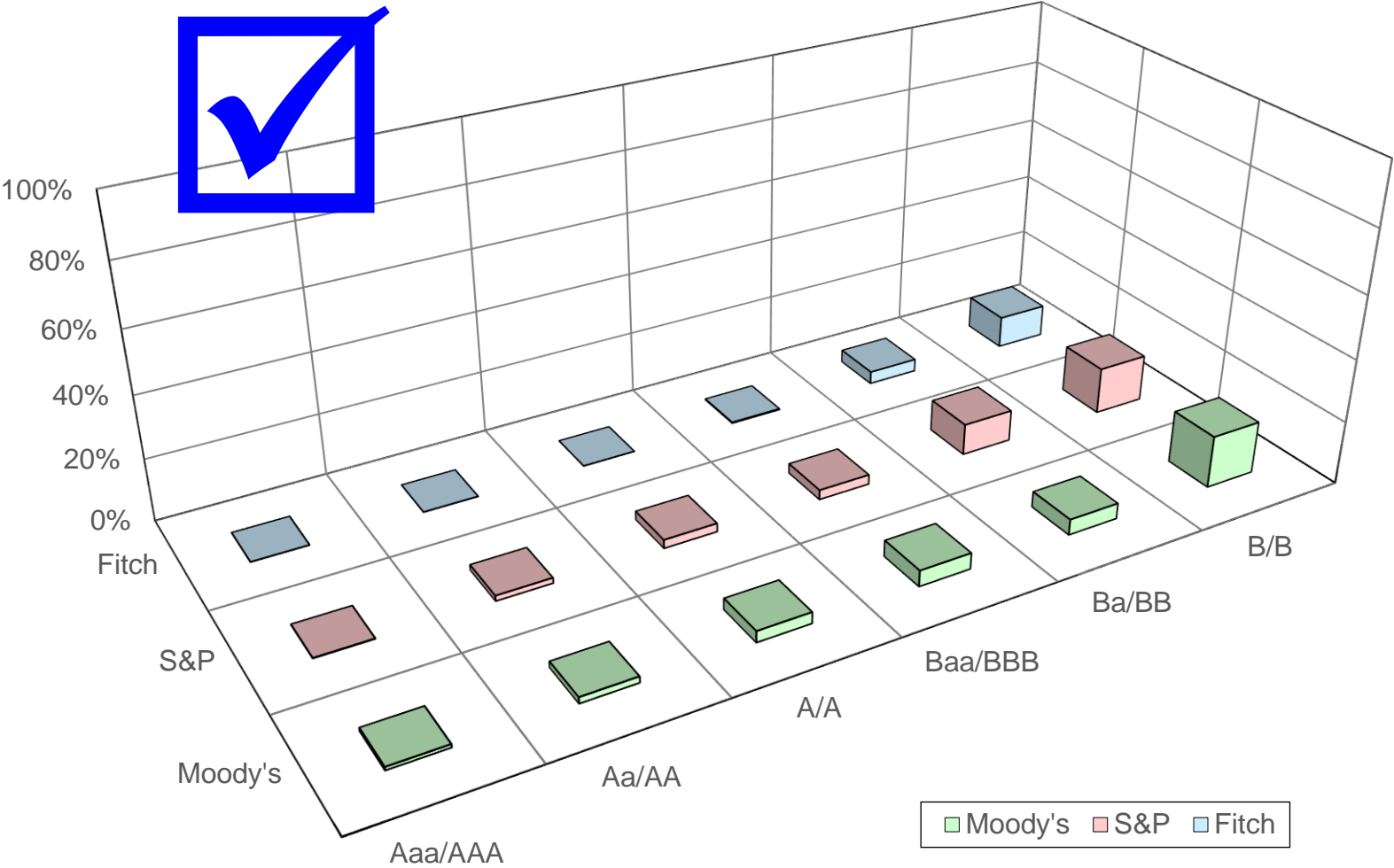
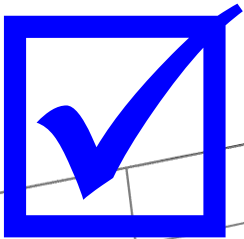
S&P Assumed Default Rates



Years	Aaa	Aa	A	Baa	Ba	B
1	0.0%	0.0%	0.2%	0.4%	1.9%	7.1%
2	0.0%	0.1%	0.4%	1.0%	4.2%	13.4%
3	0.0%	0.2%	0.7%	1.7%	6.8%	19.0%
4	0.1%	0.3%	1.0%	2.6%	9.5%	24.1%
5	0.1%	0.5%	1.5%	3.6%	12.3%	28.6%
6	0.2%	0.7%	2.0%	4.8%	15.2%	32.7%
7	0.3%	1.0%	2.5%	6.0%	18.1%	36.3%
8	0.5%	1.3%	3.2%	7.4%	20.8%	39.7%
9	0.6%	1.7%	3.9%	8.8%	23.6%	42.7%
10	0.8%	2.1%	4.6%	10.3%	26.2%	45.4%

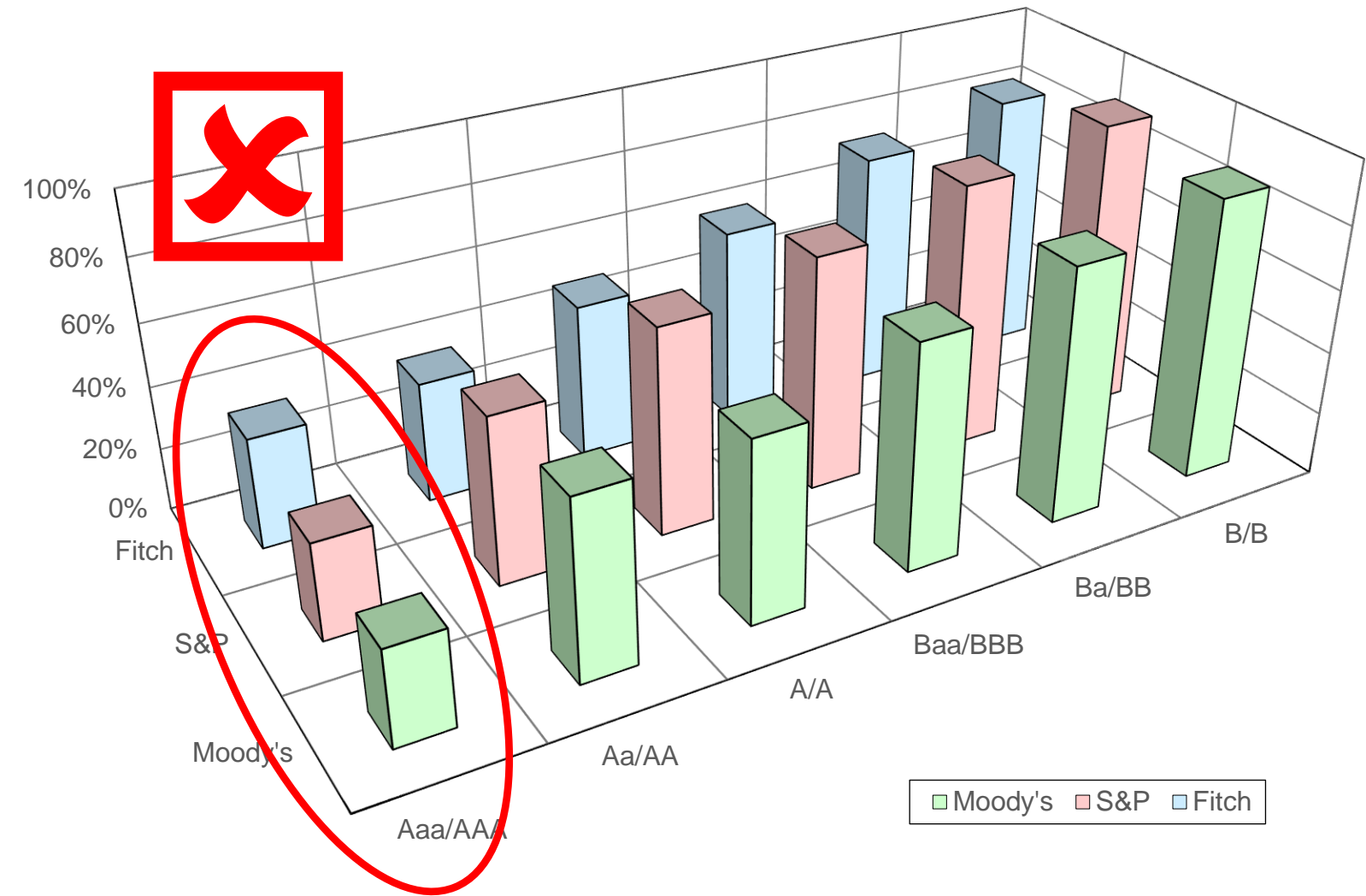
Source: S&P CDO Criteria, June 2019.

ABS 10-Year Rate of Defaults (as of December 31, 2017)



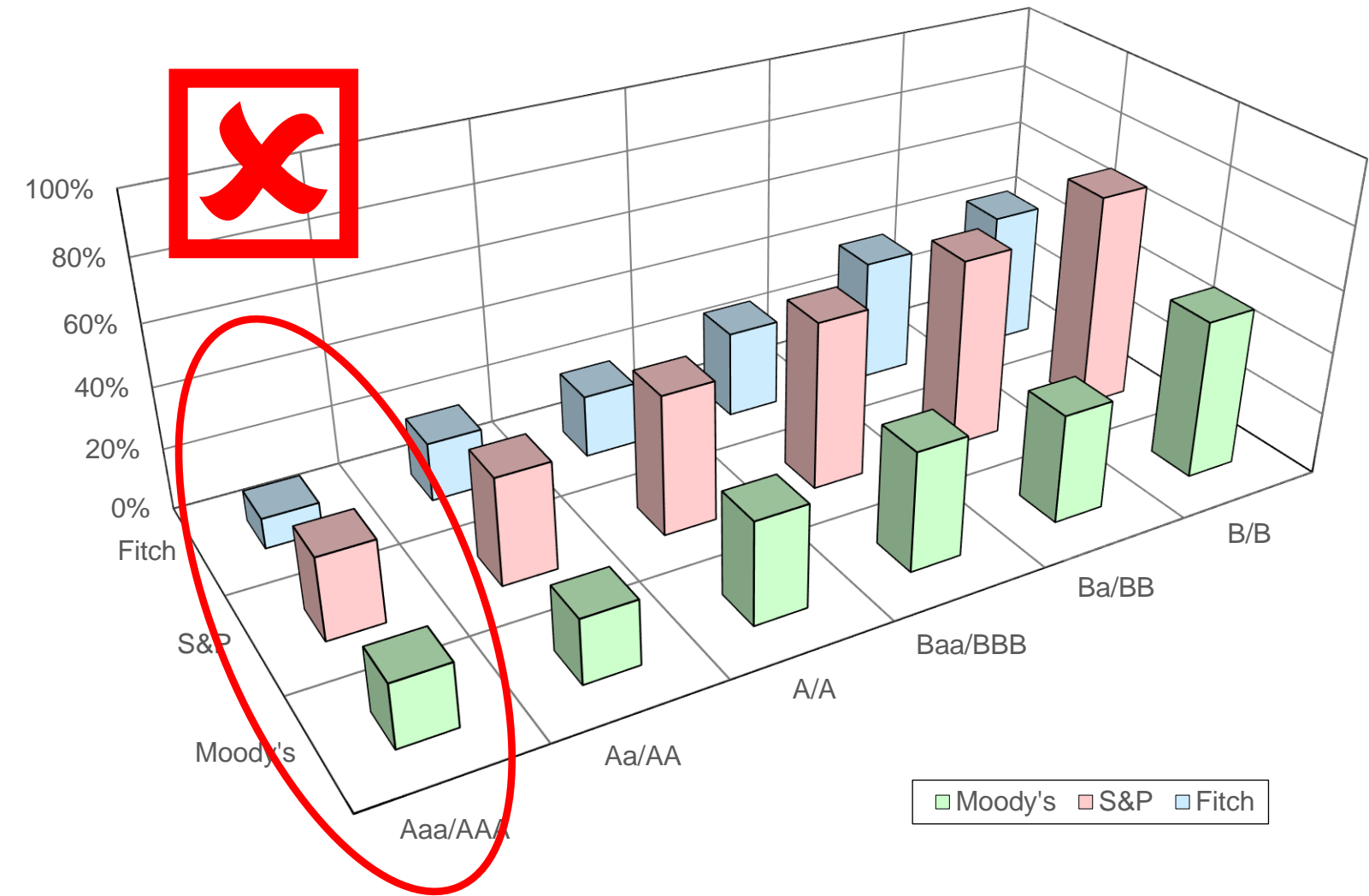
	Moody's	S&P	Fitch
Aaa/ AAA	1%	0%	0%
Aa/AA	2%	2%	0%
A/A	4%	3%	0%
Baa/BBB	5%	3%	0%
Ba/BB	5%	10%	4%
B/B	17%	15%	10%

RMBS 10-Year Rate of Defaults (as of December 31, 2017)



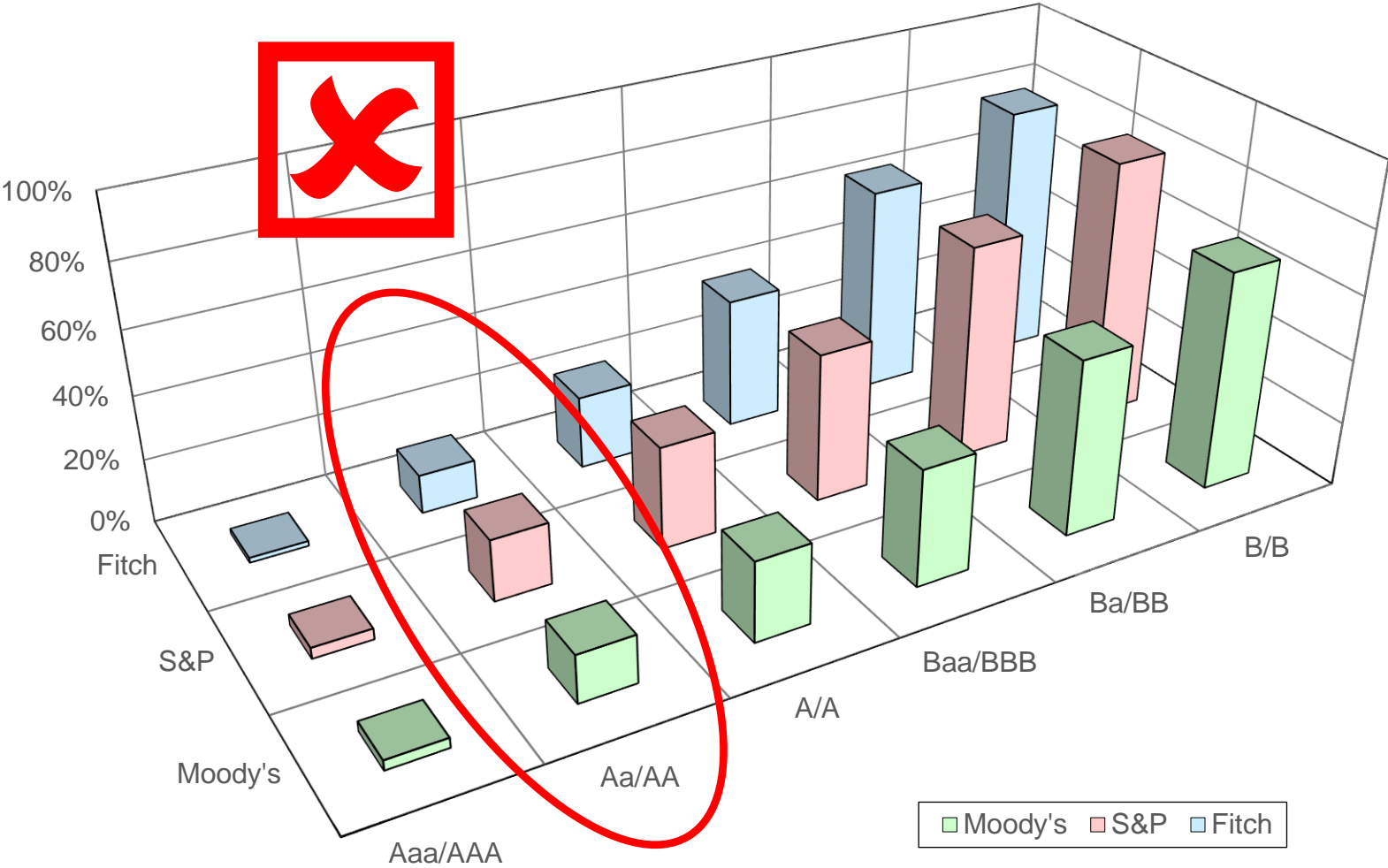
	Moody's	S&P	Fitch
Aaa/ AAA	30%	31%	35%
Aa/AA	56%	53%	38%
A/A	57%	66%	50%
Baa/BBB	71%	75%	62%
Ba/BB	81%	85%	75%
B/B	89%	93%	84%

CDOs 10-Year Rate of Defaults (as of December 31, 2017)



	Moody's	S&P	Fitch
Aaa/ AAA	20%	26%	10%
Aa/AA	21%	35%	19%
A/A	33%	45%	20%
Baa/BBB	38%	54%	28%
Ba/BB	35%	62%	40%
B/B	51%	71%	44%

CMBS 10-Year Rate of Defaults (as of December 31, 2017)



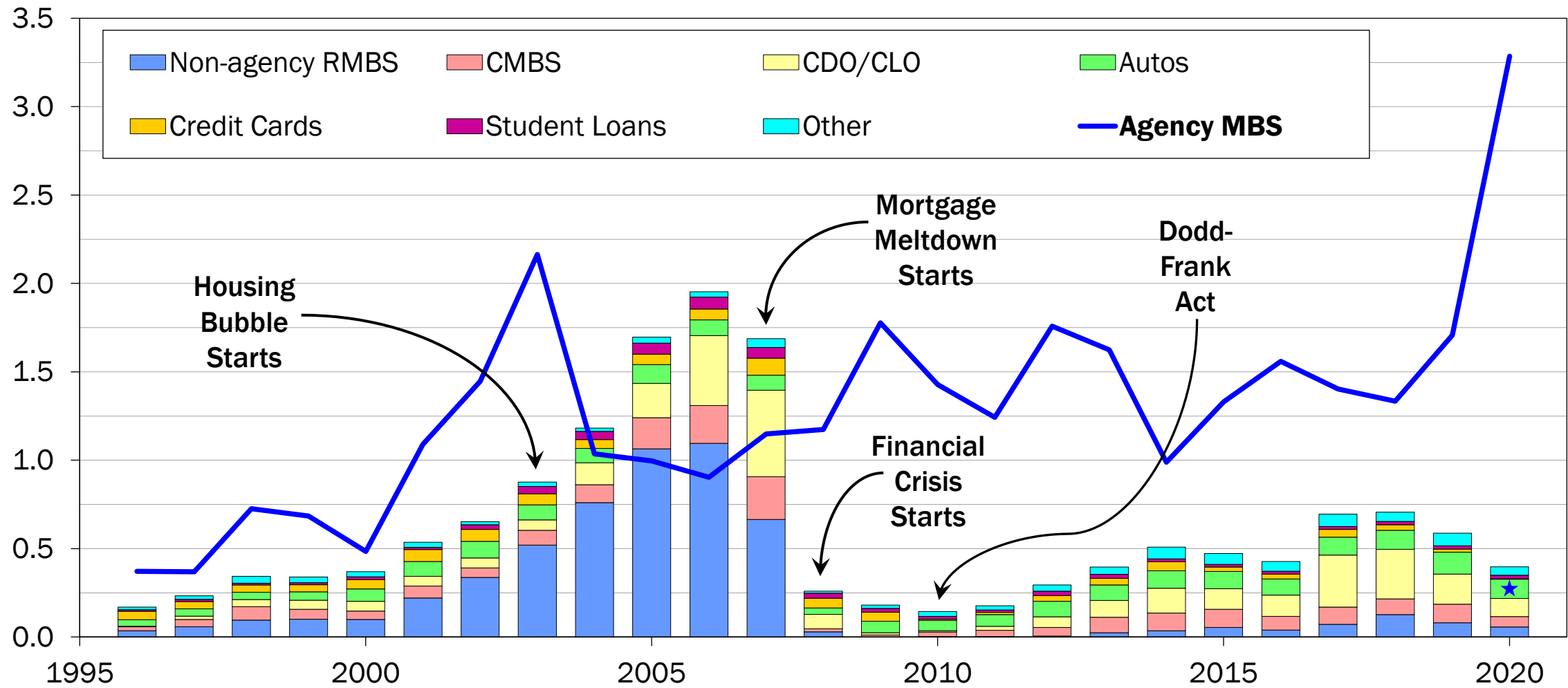
	Moody's	S&P	Fitch
Aaa/ AAA	3%	3%	2%
Aa/AA	15%	19%	12%
A/A	25%	32%	23%
Baa/BBB	36%	47%	41%
Ba/BB	55%	67%	65%
B/B	68%	82%	80%

Fitting “Ford Motor Credit” into the High-Level View

- Laws and regulations
 - Trade and commerce
 - Financial regulation
 - Securities regulation
 - » Investor protection
 - Government enforcement (civil and criminal)
 - Private right of action (e.g., 1933 Act § 11)
 - **Whom to sue** ← ← ←
 - **Why to sue** ← ← ←
 - When to sue
 - Remedies

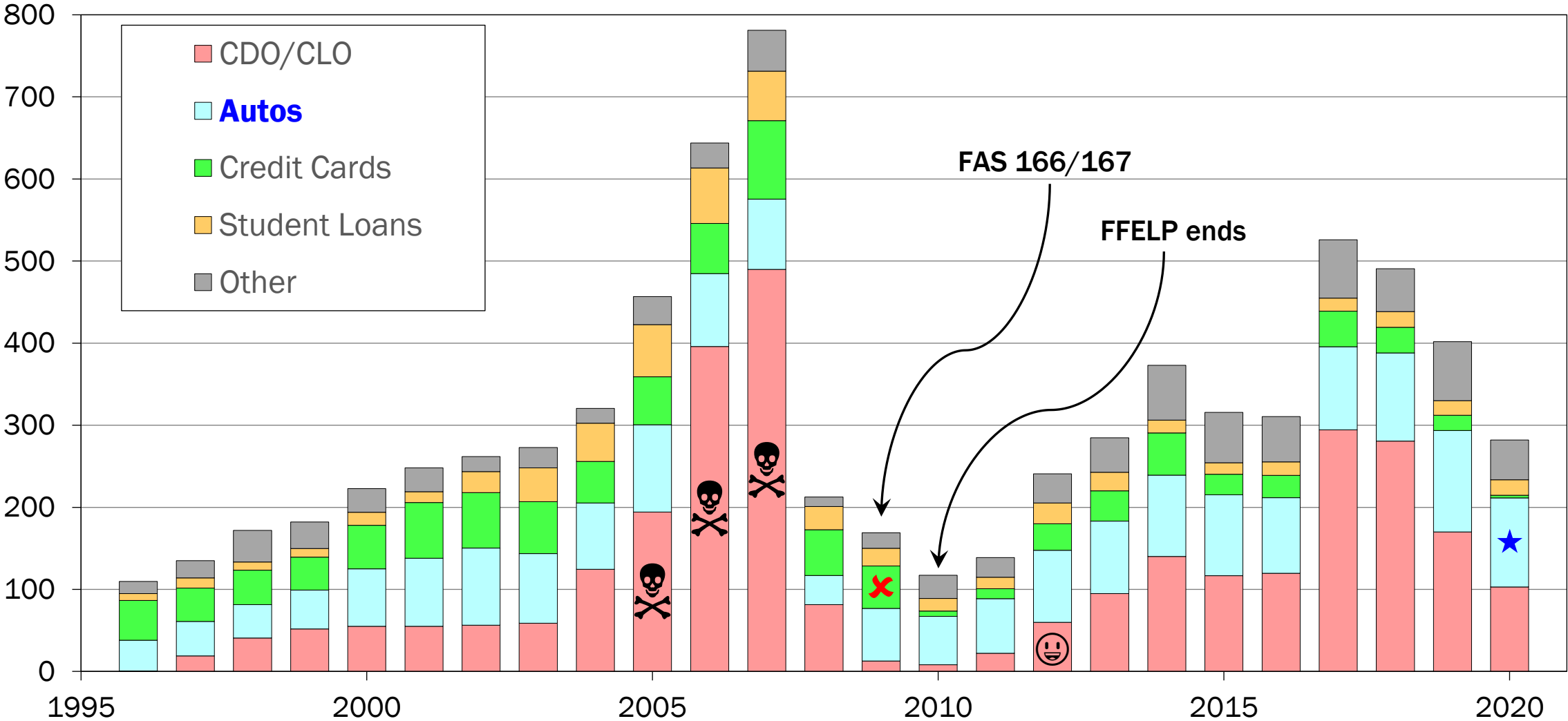
Appendix

U.S. Securitization Issuance Volume (\$ trillions)



Source: SIFMA

U.S. Non-mortgage Securitization Issuance Volume (\$ billions)



Source: SIFMA

Additional Resources

- [*The Mortgage Meltdown and the Failure of Investor Protection*](#) (2020)
- [*The Deeper Causes of the Financial Crisis: Mortgages Alone Cannot Explain It*](#) (2013)
- [Handbook of Mortgage-Backed Securities](#) (2016)
- SIFMA [MBS statistics](#)
- SIFMA [ABS statistics](#)
- S&P-DOJ case: [complaint](#) (2013), [order](#) (2013), [settlement](#) (2015)