

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 83966 / August 28, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18689

In the Matter of

**MOODY'S INVESTORS SERVICE,
INC.**

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Moody's Investors Service, Inc. ("Moody's" or "Respondent").

II.

In anticipation of the institution of these proceedings, Moody's has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Moody's consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Moody's Offer, the Commission finds that:

Summary

1. This matter concerns Moody's failure to establish, maintain, enforce and document policies and procedures reasonably designed to clearly define and consistently apply credit rating symbols as required by the Exchange Act.

Respondent

2. Moody's is a Nationally Recognized Statistical Rating Organization ("NRSRO") headquartered in New York, New York. Moody's is a wholly-owned subsidiary of Moody's Corporation, a publicly-traded company with common stock listed on the New York Stock Exchange.

Facts

Universal Ratings Symbols

3. In the wake of the most recent financial crisis, Congress mandated that the Commission prescribe rules to improve the regulation of NRSROs. *See* "Improvements to the Regulation of Credit Rating Agencies," Title IX, Subtitle C of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, H.R. 4173 (July 21, 2010) ("Dodd-Frank Act"). Congress explained in relevant part that the "systemic importance" of credit ratings and the critical "gatekeeper" role played by NRSROs justified public oversight and accountability. *See* "Findings," Section 931 of the Dodd-Frank Act, Pub. L. No. 11-203, 931 (1) & (2).

4. Section 938 of the Dodd-Frank Act, entitled "Universal Ratings Symbols," provided that the Commission shall require, by rule, each NRSRO to establish, maintain, enforce and document policies and procedures that, in relevant part, "(2) clearly define and disclose the meaning of any symbol used by the [NRSRO] to denote a credit rating; and (3) apply any symbol described in item (2) in a manner that is consistent for all types of securities and money market instruments for which the symbol is used." *See* Dodd-Frank Act, Pub. L. No. 111-203, 938(a)(2) and (3). As Congress explained, "an NRSRO's credit rating symbol should have the same meaning about creditworthiness when it is applied to any issuer – the same symbol should not have a different meaning dependent on the issuer." The Restoring Financial Stability Act of 2010, Committee on Banking, Housing and Urban Affairs, S Rep. No. 111-176, at 124 (2010).

5. The Commission implemented Section 938(a) by adopting Rule 17g-8(b) of the Exchange Act. The language of Rule 17g-8(b) was modelled closely on the statutory text. *See* NRSRO Adopting Release, 17 CFR Parts 232, 240 and 249, Rel. No. 34-72936, at 454-66

(effective Nov. 14, 2014). The Commission rejected criticisms that it was impermissibly regulating NRSROs' methodologies, explaining that "paragraph (b) of Rule 17g-8, as adopted, implements Section 938(a) of the Dodd-Frank Act in a manner that appropriately balances relevant concerns." *Id.* at 463. With respect to the requirement of consistency, the Commission explained that: "Rule 17g-8, as adopted, requires an NRSRO to have policies and procedures reasonably designed to achieve the objective of consistency without specifically mandating how a NRSRO's credit ratings and ratings methodologies must be designed to achieve this consistency." *Id.* at 463-64. Rule 17g-8(b) became effective as of June 15, 2015. *Id.* at 2.

Moody's Policies And Procedures

6. From at least June 15, 2015, Moody's publicly-facing documents made it appear as if it was in compliance with Rules 17g-8(b)(2) and (3). These included a document entitled "Ratings Symbols and Definitions" in which Moody's stated that its ratings "reflect both on the likelihood of default on contractually promised payments and the expected financial loss suffered in the event of default." Additionally, that document – like every Moody's publication -- defined "credit risk" as the "risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default."

7. Moody's included in that document a chart entitled "Global Long-Term Rating Scale" which described the meaning of its alphanumeric credit ratings; for example, "Obligations rated A are judged to be upper-medium grade and are subject to low credit risk" and "Obligations rated Baa are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics." That chart thus appeared consistent with the requirement of Rule 17g-8(b)(2) that Moody's have policies and procedures reasonably designed to define and disclose the meaning of credit rating symbols.

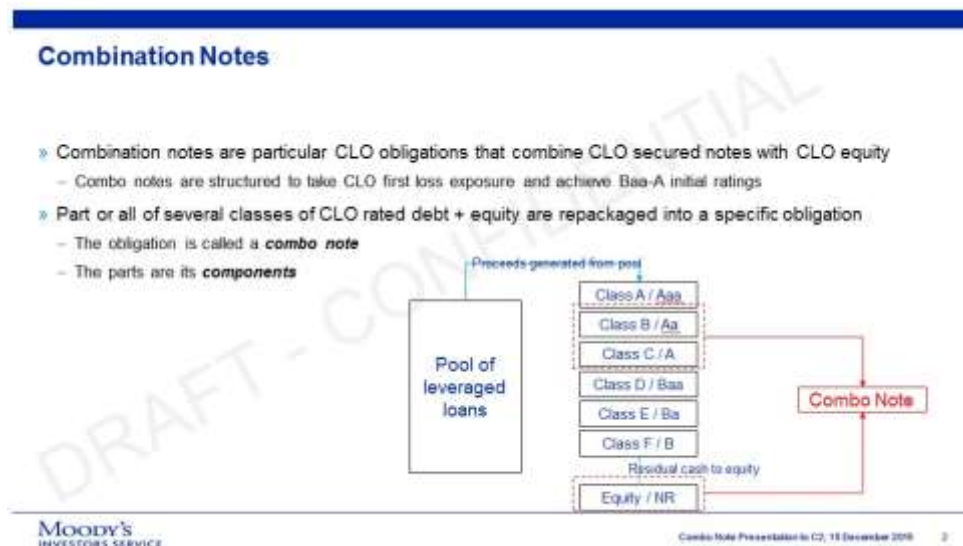
8. Moody's used the set of alphanumeric credit rating symbols in its Global Long-Term Rating Scale across a variety of asset classes including "non-financial corporates, financial institutions, structured finance vehicles, project finance vehicles, and public sector entities," and defined other rating scales and symbols for other asset types where the assets had characteristics different from those to which the Global scale was applicable, *e.g.* probability of default ratings, and demand obligation ratings. This appeared consistent with the requirement of Rule 17g-8(b)(3) that Moody's have policies and procedures reasonably designed to ensure consistent application of its rating symbols across all securities for which the symbols are used.

9. Despite those public assurances, Moody's was not in full compliance with Rules 17g-8(b)(2) and (3). Moody's failed to establish, maintain, enforce and document internal policies and procedures that were reasonably designed to clearly define and consistently apply its credit rating symbols. With respect to structured finance securities called "Combo Notes," Moody's definition of credit risk did not adequately inform the users of Moody's ratings about what the rating addressed, and what it did not address. As described further below, the unrated risk associated with a Combo Note was not limited to a discrete, non-credit feature.

Combo Notes

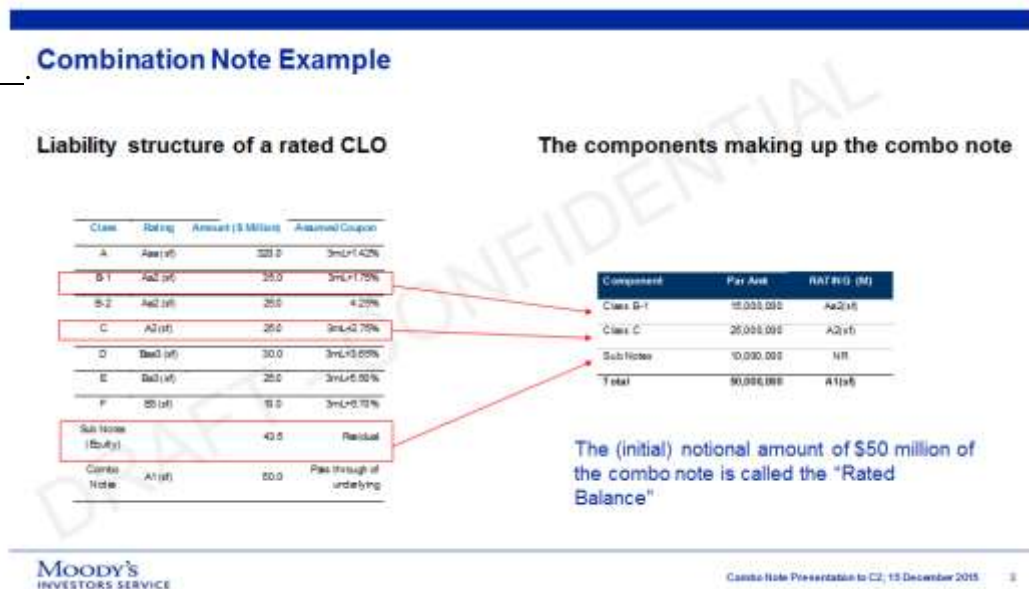
10. As a consequence of its failure to establish, maintain, enforce and document the required policies and procedures in a way that encompassed all of its ratings issued under the Global Long-Term Rating Scale, Moody's issued and maintained ratings of Combo Notes in a way that departed from the objectives set forth in Rules 17g- 8(b)(2) and (3). Specifically, Moody's failed to clearly define the meaning of ratings symbols assigned to Combo Notes and to assign ratings to Combo Notes in a manner that was consistent with other types of securities that used the same rating symbols. The ratings Moody's assigned to Combo Notes addressed only a portion of otherwise undifferentiated cash flows payable to the holder of the Combo Note. The only line of demarcation between cash flows addressed by Moody's rating, and cash flows not addressed by Moody's rating was a "rated balance" feature unique to Combo Notes, the amount of which was set by the issuer and disclosed in the transaction documents.

11. Combo Notes are a type of re-securitization of collateralized loan obligations ("CLOs"). CLOs are structured finance vehicles backed by portfolios of corporate loans. Combo Notes combine the unrated equity tranche and one or more rated debt tranches of a given CLO. Combo Notes are pass-through securities without any credit enhancements. As a result, the cash flows payable to a Combo Note holder are the same as the cash flows payable to the holder of the underlying CLO tranches. Moody's illustrated the basic structure of Combo Notes in the following slide from an internal power point presentation dated December 15, 2015:



12. Moody's rating press releases disclosed that its ratings of Combo Notes addressed only the payment of what Moody's referred to as the "rated balance." The rated balance was not, however, necessarily coextensive with the "contractually promised payments" payable to the holder of the Combo Note as referenced in Moody's definition of credit risk. Purchasers of Combo

Notes were entitled to all of the cash flows from the underlying components regardless of the rated balance. Moody's rating did not reflect the risk associated with cash flows payable to the Combo Notes over and above the rated balance, even though such amounts could materialize depending on performance, and would be payable to the holder of the Combo Note. Moody's definition of credit risk did not make clear that certain "contractually promised payments" did not, in its view, present credit risk, and therefore were not addressed by the rating. Moody's illustrated the rated balance approach in the following slide from the December 15, 2015 internal power point presentation:



13. Moody's announced on April 21, 2016 that it was considering whether to continue rating Combo Notes. On October 7, 2016, Moody's issued a press release announcing a revised methodology for rating CLOs which press release stated in relevant part that, "Moody's will no longer assign new ratings to combination securities backed by both CLO secured debt and equity tranches that have a rated balance that differs from the entire contractual promise of these securities."

14. Between June 15, 2015, when Rule 17g-8(b) became effective, and April 21, 2016, when it stopped rating new issues of Combo Notes, Moody's rated approximately 26 Combo Notes with a total notional value of approximately \$2 billion.

15. As a result of the conduct described above, Moody's violated Rules 17g-8(b)(2) and (3) of the Exchange Act which require NRSROs to establish, maintain, enforce and document policies and procedures reasonably designed to achieve transparency and consistency over the assignment of credit ratings.

IV.

Undertakings

Moody's has undertaken to do the following within 180 days of the entry of this Order:

A. Moody's shall complete a comprehensive review of its policies, procedures, and internal controls that relate to the findings in this Order in consultation with the Office of Credit Ratings.

B. Moody's shall submit a written report certifying its compliance with the undertakings set forth above. The report shall describe the revised or new policies and procedures established and documented under Rules 17g-8(b)(2) and (3), and the actions taken to maintain and enforce the revised or new policies and procedures as required by the rule. The report shall be supported by exhibits sufficient to demonstrate compliance, including but not limited to Moody's revised or newly established policies and procedures. The Staff may make reasonable requests for further evidence of compliance and Moody's agrees to provide such evidence. The report shall be submitted no later than sixty days from the date of completion of the undertakings to Jessica Kane, Director, Office of Credit Ratings and Reid Muoio, Deputy Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549, with a copy to the Office of the Chief Counsel of the Enforcement Division.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Moody's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Moody's cease and desist from committing or causing any violations and any future violations Rules 17g-8(b)(2) and (3) of the Exchange Act.

B. Moody's shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$1,250,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Moody's may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Moody's may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

- (3) Moody's may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Moody's as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Reid A. Muoio, Deputy Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Moody's agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Moody's agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Moody's by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

- D. Moody's shall comply with the undertakings enumerated in Section IV above.

By the Commission.

Brent J. Fields
Secretary