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Rating Agency Used by Bryan Administration for SPV Bond Rating Charged by S.E.C. With Failure to Implement Internal Controls

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Kroll Bond Rating Agency Inc., the firm used by the Bryan administration to rate the Internal Revenue Matching Fund (I.R.M.F.) bond through a so-called special purpose vehicle (SPV), was recently charged by the U.S. Securities and Exchange Commission on two matters relating to the rating of commercial mortgage-backed securities (CMBS), and of collateralized loan obligation combination notes (CLO Combo Notes). Kroll agreed to pay the S.E.C. more than \$2 million to settle the charges.

According to the order pertaining to CMBS ratings, Kroll allowed analysts to make adjustments that had material effects on the final ratings but did not require any analytical method for determining when and how those adjustments should be made. The charges were [published in](#)

[September](#) by the News File Corporation (NFC), a newswire firm offering broad access to media houses such as Thomson Reuters, Bloomberg, Dow Jones and Yahoo! Finance. Reuters also covered the story.

The revelation was one of the main culprits of the Senate's [decision to reject](#) Mr. Bryan's debt refinancing plan during a Tuesday session. It was the third time the governor had summoned the Legislature into session as he sought ratification of the agreement.

The charges were filed on Tues., Sept. 29, and though the Senate was called into session [a second time regarding the same bill on Dec. 3](#), there was no mention of the S.E.C. charges against Kroll. Mr. Bryan had touted the BBB rating Kroll provided to the SPV as a good sign the territory would be able to secure a more favorable interest rate on I.R.M.F. bonds using the SPV.

The S.E.C.'s order relating to CLO Combo Notes contended that Kroll's policies and procedures were not adequately designed to ensure that it rated CLO Combo Notes in accordance with the terms of those securities. According to the order, the CLO Combo Notes included a defined "Rated Balance" amount and also directed that noteholders were entitled to receive cash flows from the underlying components of the CLO Combo Note after the Rated Balance was reduced to zero, said the News File Corporation. However, "ratings of CLO Combo Notes were limited to repayment of the Rated Balance amount of each CLO Combo Note and did not reflect the risk associated with any cash flows payable to holders of the CLO Combo Note over and above the Rated Balance, even though such amounts could materialize, and would be payable to the holders of the CLO Combo Note."

"Ratings agencies play a crucial gatekeeping role in the securities market. With that responsibility comes the requirement that they establish and enforce policies and controls to ensure the consistency and integrity of credit ratings," said the S.E.C.'s Daniel Michael, chief of the Enforcement Division's Complex Financial Instruments Unit. "We will continue to hold rating agencies accountable for failing to ensure the integrity of the ratings process."

According to the News File Corporation, the S.E.C.'s orders found that, in connection with rating CMBS, Kroll violated Section 15E(c)(3)(A) of the Securities Exchange Act of 1934 and, in connection with rating CLO Combo Notes, the firm violated Rule 17g-8(b)(1) of the Exchange Act.

Kroll agreed to pay a civil penalty of \$1.25 million, and in the CLO Combo Notes case to pay a \$600,000 civil penalty and more than \$160,000 in disgorgement and prejudgment interest, according to NFC.

Kroll also agreed to establish a Fair Fund for the benefit of victims, and agreed in both actions to review and correct its internal policies and procedures relating to the charged violations.