

Frequently Asked Questions

Morningstar Credit Ratings, LLC Position Paper

February 17, 2021

What are the allegations to which MCR is responding?

On Feb. 16, 2021, the Securities and Exchange Commission (SEC) filed a [complaint](#) against Morningstar's former credit rating agency, Morningstar Credit Ratings, LLC (MCR), alleging that MCR violated some technical rules that applied to MCR when it was a credit rating agency. MCR is litigating this case because it complied with the relevant rules, and the SEC is overreaching its regulatory authority and infringing on the analytical independence of credit ratings. MCR published a position paper in response to the complaint, available [here](#).

How are independent credit rating agencies protected under federal law?

Under the federal securities laws, credit rating agencies provide opinions on the creditworthiness of securities, such as commercial mortgage-backed securities (CMBS). It is vital to investors and the capital markets that credit ratings represent an independent assessment of credit risk. For that reason, the Credit Rating Agency Reform Act of 2006 prohibits the SEC from regulating the substance of credit ratings or the procedures and methodologies used to determine credit ratings. This statutory limitation protects the analytical independence of credit rating agencies. While the SEC can regulate credit rating agencies, it may never regulate the substance of credit ratings or credit rating methodologies.

What is Morningstar Credit Ratings (MCR)?

MCR is the former credit rating business of Morningstar, Inc. In July 2019, Morningstar acquired DBRS, another credit rating agency, and it integrated the operations of MCR and DBRS under the name "DBRS Morningstar." MCR withdrew its registration with the SEC in December 2019. It no longer operates as a credit rating agency, and all of its outstanding credit ratings were withdrawn in October 2020. The SEC's enforcement action relates solely to legacy MCR—prior to the acquisition of DBRS—and is unrelated to the current DBRS Morningstar credit rating business.

What is this case about?

The SEC's case against MCR relates to a legacy credit rating methodology that MCR last used to rate CMBS in early 2017. The SEC's principal allegation is that MCR failed to provide a general description of its legacy methodology, even though MCR published its narrative methodology document on its website. In so doing,

MCR went above and beyond what is actually required by the relevant SEC rule. The SEC's real objection is that MCR's legacy methodology permitted the use of certain qualitative adjustments, based on the analytical judgment and experience of MCR's independent analysts. The SEC's position violates the statutory protection afforded to the substance of credit rating methodologies. The SEC's position is contrary to the relevant SEC rules and the SEC's authoritative policy statements. The SEC's case is impermissible regulation by enforcement.

Does MCR admit or deny the SEC's allegations?

At all times, MCR complied with the applicable regulatory requirements. The SEC's complaint insinuates that MCR's previous credit ratings should have been different, but it does not actually allege any substantive issue with those ratings. In fact, MCR acted with integrity in rating CMBS transactions, and the SEC's complaints make no allegations to the contrary. Further, the SEC has not alleged any harm to investors from MCR's use of its legacy methodology. The methodology at issue in this case was last used to determine a CMBS credit rating in March 2017, and no credit ratings determined using the legacy methodology remain outstanding.

What happens next?

MCR looks forward to vindicating the integrity and independence of its legacy ratings processes in federal court. At the appropriate time, MCR will explain in court the numerous regulatory, statutory, and constitutional defects in the SEC's case.

What is the analytical judgment used during the credit rating process?

Generally speaking, the SEC's allegations seem to call into question certain qualitative adjustments, based on the analytical judgment and experience of credit rating analysts, that are inherent and permitted in virtually all NRSRO (nationally recognized statistical rating organization) rating methodologies. Although there is no statute or rule that prohibits an NRSRO from using a qualitative methodology or a methodology that has some qualitative components, the SEC's complaint suggests that the use of such qualitative adjustments by credit rating analysts is impermissible. This amounts to an attempt by the SEC to regulate

the substance of credit rating methodologies, thereby infringing on the independence of credit ratings.

Did the SEC find any evidence that previous MCR credit ratings harmed investors?

No. Despite some insinuations in the complaint that are wholly unsupported by any evidence, the SEC’s complaint makes no actual allegations that call into question the integrity of previous MCR credit ratings. The SEC has not alleged any harm to investors from MCR’s use of its legacy methodology.

The legacy methodology at issue in this case was last used to determine a CMBS credit rating in March 2017. No credit ratings determined using the legacy methodology remain outstanding.

Is the methodology in question still in use today?

No. Nationally recognized statistical rating organizations, or NRSROs, review and update their credit rating methodologies periodically in the ordinary course of business. From time to time, as part of that process, NRSROs may retire certain credit rating methodologies. MCR, a former credit rating agency, voluntarily retired the legacy MCR CMBS methodology referenced in the SEC’s allegations in 2018 in the ordinary course.

Have internal policy and disclosures in question changed since this methodology was in place?

The SEC’s complaint relates to activities in 2015-16. There have been numerous policy and disclosure changes since that time, as credit rating agencies routinely review and update their methodologies and procedures. The methodology at issue in this case was last used to determine a CMBS credit rating in March 2017. MCR voluntarily retired the legacy rating methodology referenced in the SEC’s allegations in 2018 in the ordinary course. No credit ratings determined using the legacy methodology remain outstanding.

Is the methodology in question related to Morningstar’s fund and equity research ratings?

No. Morningstar’s research and ratings on funds and stocks are separate from and unrelated to the credit rating business.

Is the litigation related to DBRS Morningstar?

No. The SEC’s enforcement action relates solely to legacy Morningstar credit rating business—prior to the [acquisition](#) of DBRS—and has nothing to do with the current DBRS Morningstar credit rating business.

Are these allegations related to the settlement Morningstar Credit Ratings and the SEC agreed to in May 2020 regarding an investigation of MCR’s sales and marketing activities?

This enforcement action by the SEC relates solely to legacy MCR’s CMBS methodology and is unrelated to the prior settlement [announced](#) on May 15, 2020.