

**July 15, 2009**

Calpers Sues Over Ratings of Securities

By [LESLIE WAYNE](#)

SACRAMENTO — The nation's largest public pension fund has filed suit in California state court in connection with \$1 billion in losses that it says were caused by "wildly inaccurate" credit ratings from the three leading ratings agencies.

The suit from the [California Public Employees Retirement System](#), or Calpers, a public fund known for its shareholder activism, is the latest sign of renewed scrutiny over the role that credit ratings agencies played in providing positive reports about risky securities issued during the subprime boom that have lost nearly all of their value.

The lawsuit, filed late last week in California Superior Court in San Francisco, is focused on a form of debt called structured investment vehicles, highly complex packages of securities made up of a variety of assets, including subprime mortgages. Calpers bought \$1.3 billion of them in 2006; they collapsed in 2007 and 2008.

Calpers maintains that in giving these packages of securities the agencies' highest credit rating, the three top ratings agencies — [Moody's Investors Service](#), [Standard & Poor's](#) and [Fitch](#) — "made negligent misrepresentation" to the pension fund, which provides retirement benefits to 1.6 million public employees in California.

The AAA ratings given by the agencies "proved to be wildly inaccurate and unreasonably high," according to the suit, which also said that the methods used by the rating agencies to assess these packages of securities "were seriously flawed in conception and incompetently applied."

Calpers is seeking damages, but did not specify an amount. Steven Weiss, a spokesman for McGraw Hill, the parent company of Standard and Poor's, said the company could not comment until it had been served and

seen the complaint. [Moody's](#) and Fitch did not respond to a request for comment.

As the Obama administration considers an overhaul of the [financial regulatory system](#), credit rating agencies have come in for their share of the blame in the recent market collapse. Critics contend that, rather than being watchdogs, the agencies stamped high ratings on many securities linked to subprime mortgages and other forms of risky debt.

Their approval helped fuel a boom on Wall Street, which issued billions of dollars in these securities to investors who were unaware of their inherent risk. Lawmakers have conducted hearings and debated whether to impose stricter regulations on the agencies.

While the lawsuit is not the first against the credit rating agencies, some of which face litigation not only from investors in the securities they rated but from their own shareholders, too, it does lay out how an investor as sophisticated as Calpers, which has \$173 billion in assets, could be led astray.

The security packages were so opaque that only the hedge funds that put them together — Sigma S.I.V. and Cheyne Capital Management in London, and Stanfield Capital Partners in New York — and the ratings agencies knew what the packages contained. Information about the securities in these packages was considered proprietary and not provided to the investors who bought them.

Calpers also criticized what contends are conflicts of interest by the rating agencies, which are paid by the companies issuing the securities — an arrangement that has come under fire as a disincentive for the agencies to be vigilant on behalf of investors.

In the case of these structured investment vehicles, the agencies went one step further: All three received lucrative fees for helping to structure the deals and then issued ratings on the deals they helped create.

Calpers said that the three agencies were “actively involved” in the creation of the Cheyne, Stanfield and Sigma securitized packages that they then gave their top credit ratings. Fees received by the ratings agencies for helping to construct these packages would typically range from \$300,000 to \$500,000 and up to \$1 million for each deal.

These fees were on top of the revenue generated by the agencies for their more traditional work of issuing credit ratings, which in the case of complex securities like structured investment vehicles generated higher fees than for rating simpler securities.

“The ratings agencies no longer played a passive role but would help the arrangers structure their deals so that they could rate them as highly as possible,” according to the Calpers suit.

The suit also contends that the ratings agencies continued to publicly promote structured investment vehicles even while beginning to downgrade them. Ten days after Moody’s had downgraded some securitized packages in 2007, it issued a report titled “Structured Investment Vehicles: An Oasis of Calm in the Subprime Maelstrom.”

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