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Banks Find S.&P. More Favorable in Bond Ratings

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The Wall Street ratings game is back.

Five years after inflated credit ratings helped touch off the financial crisis, the nation's largest ratings agency, Standard & Poor's, is winning business again by offering more favorable ratings.

S.& P. has been giving higher grades than its big rivals to certain mortgage-backed securities just as Wall Street is eagerly trying to revive the market for these investments, according to an analysis conducted for The New York Times by Commercial Mortgage Alert, which collects data on the industry. S.& P.'s chase for business is notable because it is fighting a government lawsuit accusing it of similar action before the financial crisis.

As the company battles those accusations, industry participants say it has once again been moving to capture business by offering Wall Street underwriters higher ratings than other agencies will offer. And it has apparently worked. Banks have shown a new willingness to hire S.& P. to rate their bonds, tripling its market share in the first half of 2013. Its biggest rivals have been much less likely to give higher ratings.

"The general consensus was that these changes have let them get their market share back," said Darrell Wheeler, a bond analyst at Amherst Securities.

Standard & Poor's said the "methodology used and the conclusions drawn by The New York Times are flawed," though it declined to elaborate on what those flaws were.

In its response to the government lawsuit, the company said that its ratings had always been "uninfluenced by conflicts of interest."

But David Jacob, who ran the S.& P. division that rated mortgage-backed bonds until 2011, said that in his time at the company, after the financial crisis, he saw employees adjusting criteria in response to business pressure.

"It's silly to say that the market share doesn't matter," said Mr. Jacob, who is now retired. "This is not God's holy work. It's a business."

Along with its chief rivals — Moody's Investors Service and Fitch — S.& P. was criticized for offering top-flight ratings to subprime mortgage securities, which made those bonds appear more attractive to investors before the crisis. The agencies had an incentive to offer higher ratings because banks choose which ratings agency grades each bond. The flaws in the system became apparent when many bonds with the highest ratings ended up plunging in value, inflicting enormous damage on the economy.

The government, though, chose in February to file suit against only S.& P., accusing it of relaxing its rating methodology before the crisis to win business.

The methodology and motivation of the ratings agencies are important because they play such a vital role in the financial system. Many investors are allowed to buy only bonds that have been rated AAA by S.& P. or one its two largest competitors, Moody's and Fitch. Banks often adjust the riskiness of their investment products to satisfy the agencies.

But the agencies have long been accused of tailoring their ratings to the banks to win more business. Before the crisis, the biggest problems involved ratings of bonds tied to subprime residential mortgages. More recent concerns have come about since S.& P. made an apparently benign change last September to the criteria it uses to rate bonds backed by commercial real estate mortgages, which is now the hottest portion of the mortgage bond market.

The company said at the time that the change was not designed to win more business. Before the change, though, S.& P. was lagging, in part because of tougher standards it put in place immediately after the crisis.

Since the change, the company has been much more likely than its big rivals to offer higher ratings on the commercial real estate bonds, according to the analysis for The Times. On half of the deals that it rated since last September, S.& P. has given at least a portion of the deal a higher rating than the other agencies rating the same deals. Before the change in standards, it rarely offered higher ratings.

Some investors buying the bonds worry that the willingness of some agencies to give better ratings is encouraging banks to issue lower-quality bonds.

"When one agency loosens up on something, it forces others to as well," said Edward Shugrue, the chief executive of the bond investing firm Talmage.

Immediately after the crisis, the agencies themselves moved to tighten their standards. S.& P. offered top positions to Mr. Jacob and his partner, Mark Adelson, from the consulting firm Adelson & Jacob, both of whom had called for more scrutiny of bonds.

The two quickly pushed inside the company for tougher standards for the bonds that were at the root of the financial crisis. This alienated many banks, and the agency was rarely chosen to rate the mortgage-backed bonds. The company rated only 22 percent of the bonds issued in 2011, down from 80 percent in 2006.

Inside the company, Mr. Jacob said, "People weren't happy with losing market share."

A spokesman for the company said it rejected Mr. Jacob's assertions and noted that he did not raise his concerns when he was at the company.

S.& P. ran into particular trouble in August 2011 after it backed out of rating a bond being issued by Goldman Sachs and Citigroup because of internal disagreements about how to rate the bonds. It was in the months after that episode, when no banks would hire S.& P., that the company pushed out many of the employees who had been instituting tougher standards, including Mr. Jacob and Mr. Adelson.

At the same time, the company began working on new criteria for rating bonds tied to commercial real estate.

When S.& P. released the new standards in September 2012 it was not immediately clear if they would result in higher ratings. The document describing the changes left many of the specifics vague.

But the company quickly managed to win the job of rating a number of smaller bonds. And in each of the first five deals where it was chosen, Standard & Poor's offered higher grades than its competitors to at least a portion of the multilayered deals, according to the data from Commercial Mortgage Alert. The pattern has not slowed down more recently. On each of the five most recent deals that Standard & Poor's rated, it gave better ratings than the other agencies.

The company's numbers stand in particular contrast to Moody's, which has not given the highest ratings to any deal it rated over the last two years. Fitch, the third big ratings agency, gave higher ratings on only 8 percent of the bonds it rated over the last year.

S.& P.'s willingness to give higher ratings makes it look more like the three smaller ratings agencies that work on bonds tied to commercial real estate: Kroll, DBRS and Morningstar. They were all more likely to give higher ratings than Fitch and Moody's. Even among those three, though, only Morningstar was more likely to give higher ratings than S.& P., according to the Commercial Mortgage Alert data. Morningstar gave higher ratings than competitors on 52 percent of the deals it graded.

Joseph Petro, an executive with Morningstar's ratings business, said that it won fewer overall contracts than other agencies because it applied tougher standards in the preliminary phases of the process, which are not publicly visible.

Several bond investors said that ratings mattered less than they did in the past because the financial crisis taught them to do their own analysis before putting their money down. That is particularly true for bonds backed by commercial mortgages, which are popular with more sophisticated investors.

But Mr. Shugrue said that the little things being allowed could turn into steps toward much bigger problems.

"You can see that we are slipping our way back to 2007," he said.