MEMORANDUM

TO: File No. 4-610

FROM: Alicia F. Goldin
Division of Trading and Markets

DATE: May 17, 2011

RE: Meeting with Representatives of Moody's Corporation (Moody's) Regarding Municipal Securities

On April 12, 2011, representatives of Moody's (Tom Keller, Managing Director, Global Public Finance; Robert Kurtter, Managing Director, U.S. Public Finance; Janet Holmes, Vice President-Senior Regulatory Officer (Americas); Kathyanne Cohen, Vice President, Regulatory Affairs (Americas); and David Martin, Partner, Covington & Burling LLP) met with Commissioner Elisse B. Walter; Cyndi Rodriguez from the Office of Commissioner Walter; Martha Haines, John McWilliams, Randall Roy and Alicia Goldin from the Division of Trading and Markets; and Michael Popper from the Division of Corporation Finance, to discuss issues related to the municipal securities market. The participants discussed, among other things: rating methodologies, policies and practices; the impact of bond insurance on credit ratings; conflicts of interest; and the MSRB's initiative to provide real-time municipal securities ratings information available to the public through EMMA. Moody's provided the attached presentation.

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Presentation to the SEC

April 12, 2011

Thomas Keller, Managing Director, Global Public Finance
Robert Kurtter, Managing Director, U.S. Public Finance
Janet Holmes, Vice President-Senior Regulatory Officer
Kathyanne Cohen, Vice President, Regulatory Affairs

Overview

1. Role of Credit Ratings in Capital Markets
2. Municipal Bond Market
3. Rating Practices & Protocols
4. Management of Potential Conflicts of Interest
5. Use of Ratings in Regulation

Role of Credit Ratings in Capital Markets

Role of credit ratings in capital markets

1. Over time, credit ratings have developed important attributes
   - Insight and robust analysis
   - Symbols that succinctly communicate opinions
   - Broad coverage across markets and industries, enabling comparability
   - Public availability of opinions
2. These attributes have made credit ratings a spoken and understood language of credit
   - A point of reference easily understood by market professionals
   - Promote dialogue and debate
   - Market commentary that helps flow of relevant information
   - Improve understanding of credit risk, which promotes market integrity and efficiency
   - A supplement, not a substitute for, market participants' own credit analysis

Role of credit ratings in capital markets (cont'd)

3. What credit ratings are:
   - Opinions about the future
   - All Moody's credit ratings are probabilistic opinions
   - The relative likelihood of an issuer to meet its obligation over the medium term horizon
   - Supported by insightful and robust analysis, based on an assessment of the information gathered
   - In light of the agency's experience in rating other securities and issuers

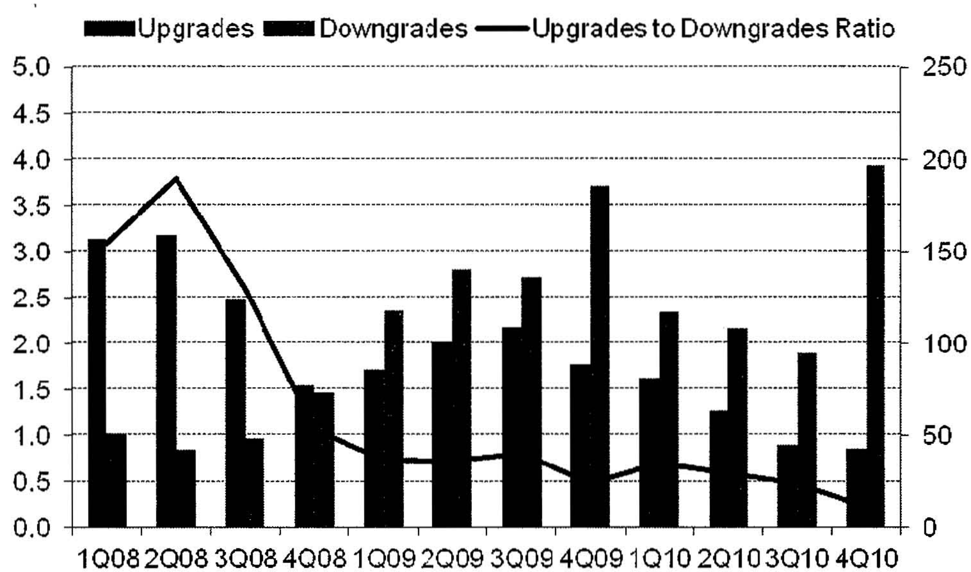
4. What credit ratings are not:
   - Statements of absolute fact
   - Guarantee of securities performance
   - Recommendation to buy, sell or hold a security
   - Price indicators
   - Liquidity indicators

Municipal Bond Market

There is unprecedented financial stress across sectors

- Municipal market is broad and has a varying risk profile
- Recession is over, but economic recovery is tepid
- State and local governments are lagging in recovery
- End of federal stimulus will make 2011 an even more stressful year for state and local governments
- Moody's has had negative sector outlooks on state and local governments for 3 years
- Downgrades have outpaced upgrades for 8 consecutive quarters

Rating Downgrades-to-Upgrades, by Number of Issuers



2011 U.S. states outlook

- Negative outlook for states: third consecutive year
- States face a revenue and spending problem, not a debt problem
- States will not be able to grow their way out of budget gaps
- Low revenue + fragile recovery = challenges
  - State reserves are half of pre-recession levels
- States face difficult choices
- Pensions are a growing but still relatively small burden for states
- Downgrades likely to outpace upgrades, but no state defaults expected
- Yet still have inherent credit strengths

2011 U.S. local governments outlook

- Toughest year yet for local governments since the Great Depression
  - Local governments expected to underperform states
- States can transfer certain costs to their cities
- Recession hitting property taxes now
- Revenue will vary with tax and assessment practices
- Fewer options remain
- Other risks loom
- Yet, like states, local governments still have strengths/options

What are we watching? What could change?

- **States:** Revenues remain weak, but most will manage via spending cuts, use of reserves
  - Risks:
    - Expiration of federal stimulus funds in June 2011 creates large gaps
    - Entitlement spending for pension, OPEBs, Medicaid continues to grow
    - Economic recovery is fragile
    - Material shift in market confidence

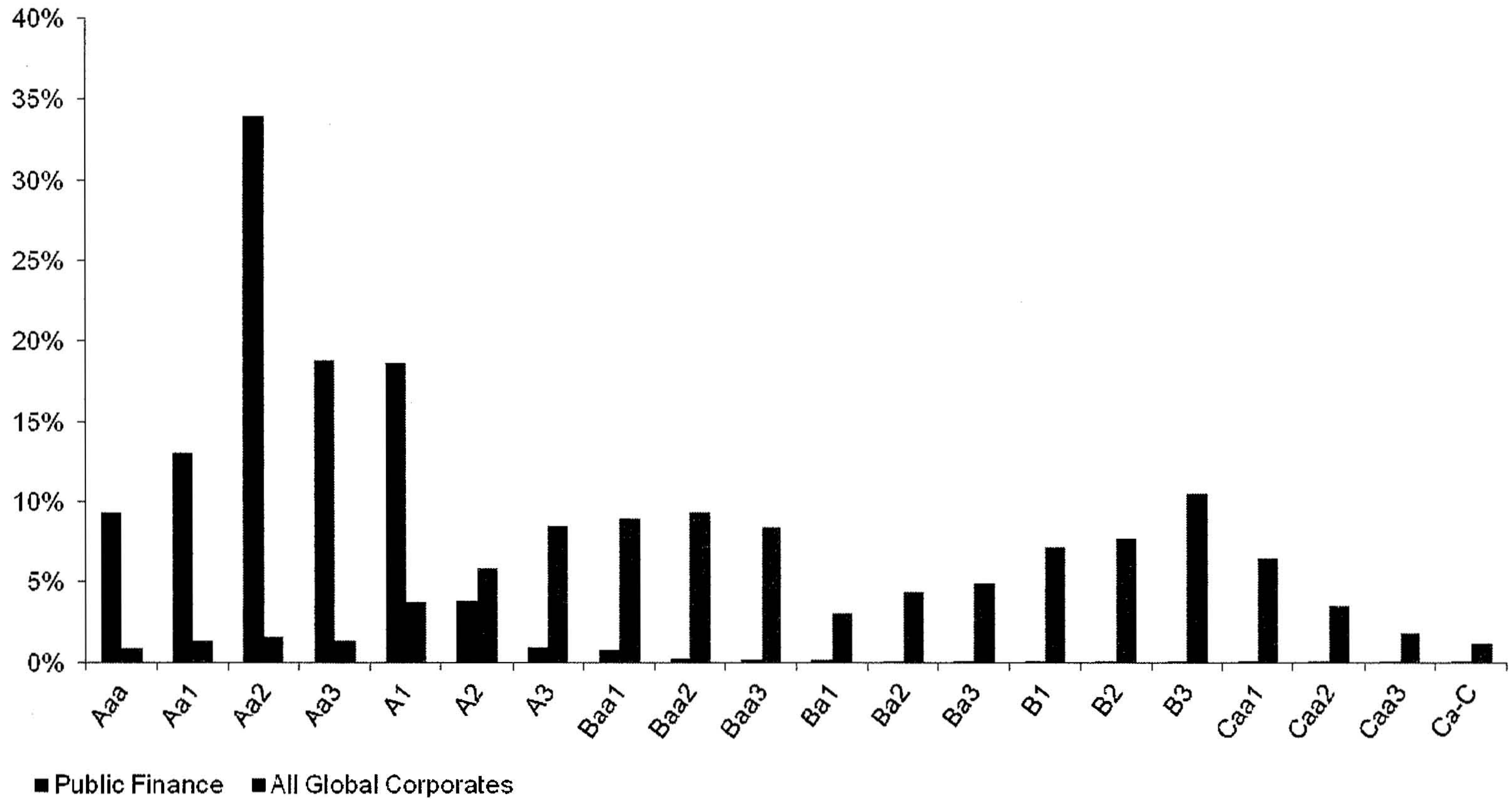
- **Local Governments:** Small, weaker issuers will be most stressed, some distressed
  - Risks:
    - Further state aid cuts
    - Some have exposure to enterprise risk with outsized debt levels
    - Exposure to financial institutions, liquidity and credit facilities expiring
    - Breakdown in political process that results in failure to pay debt, bankruptcy filing

Moody's views are based on certain assumptions, including:

- State and local governments will:
  - honor their contractual obligations to make bond payments because of strong incentives to do so
  - be able to continue accessing financial markets on roughly the same terms currently available
  - continue to have sufficient budget flexibility to meet the contractual obligations associated with their bonds (e.g., cutting costs and/or increasing revenues)
- Bankruptcy laws will not change
- The economic recovery will not be derailed by, e.g., an oil price shock

Ratings Distribution

Municipal vs. Global Corporate Ratings



Moody's rated defaults expected to increase in 2011

- Historically, very few rated municipal bonds have defaulted
  - From 1970 to 2010, 55 Moody's rated municipal issuers defaulted
  - Nearly 80% were in non-profit hospital or housing project sectors
- In 2011, however, rated defaults expected to increase
  - Could be 2-3x 2008 levels
  - But not expecting any states to default
  - Consistent with defaults implied by our rating distribution
  - Depends on willingness to make tough choices

Defaults are higher among unrated bonds

Recent US Municipal Defaults

	2008	2009	2010
Issuers (#)			
Rated by Moody's	5	1	1
Unrated and Rated by Moody's	167	207	82
Volume ($millions)			
Rated by Moody's	$ 3,678	$ 24	$ 25
Unrated and Rated by Moody's	$ 8,518	$ 7,330	$ 2,713

Source: Moody's and Income Securities Advisor, Inc.

Rating Practices & Protocols

Moody's Five Part Rating Process:

Each credit rating -- whether a municipal rating or a corporate rating -- reflects the opinion of a rating committee

1. **Gathering Information**
   - Assigned analyst begins credit analysis process by assembling relevant information.
2. **Credit Analysis**
   - Assigned analyst analyzes the issuer or obligation based on Moody's published methodology and formulates his or her view for the rating committee to consider.
3. **Rating Committee**
   - Critical mechanism in promoting the quality, consistency, independence and integrity of the Moody's rating process.
   - Rating committee includes assigned analyst. Composition of remainder of committee depends on the industries or sectors that are relevant to the credit rating being assigned.
   - Moody's credit rating opinions are determined by a majority vote of the members of a rating committee, and not by an individual analyst.
4. **Dissemination of Credit Rating Announcements**
   - Public dissemination through press release and news wires.
5. **Monitoring**
   - Once a credit rating is published, it is monitored. Every credit is reviewed at least once every twelve months and modified if appropriate to respond to changes in Moody's view of the relative creditworthiness of the issuer or obligation.

Management of Potential Conflicts of Interest

Management of conflicts of interest - general

1. Certain conflicts of interest are prohibited, *e.g.*
   - No one on analytical side can participate in fee discussions with issuers
   - Stricter gift ban
   - Securities trading policy
   - Prohibition on CRA employees providing consulting or advisory services
2. Certain conflicts of interest are permitted but must be managed appropriately and disclosed, *e.g.*
   - Issuer-pays and investors-pays business models
   - Fundamental one member/one vote policy for rating committees protects against potential conflicts of interest or individual bias influencing rating decision

In recent years, we have reinforced measures to manage potential conflicts of interest

1. Bolstering operational segregation of credit rating and credit policy functions from commercial functions
2. Prohibiting fee discussions by ratings managers (analysts were already subject to such a prohibition)
3. Strengthening the prohibition on the provision of recommendations or advice
4. Enhancing gift ban
5. Reinforcing independence and objectivity through changes to rating committee composition
6. Conducting “look-back” reviews
7. Reinforcing independence and objectivity through analyst and management compensation policies
8. Reviewing and retaining complaints about analysts made by third parties

Use of Ratings in Regulation

Legislative and regulatory support for removing ratings from regulation

1. Federal agencies currently studying and overhauling regulations as a result of Dodd-Frank Act
2. Moody's has long-supported removing references to ratings.
3. Using credit ratings as a substitute for issuer disclosure raises similar issues

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For more information, please contact:

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