

MEMORANDUM

TO: File

FROM: James R. Burns
Counsel to Chairman Schapiro

DATE: November 14, 2010

SUBJECT: Meeting with Meredith Whitney

On November 10, Chairman Schapiro, Didem Nisanci, Robert Cook, Ricardo Delfin, and James Burns met with Meredith Whitney of Whitney Advisory Group to discuss matters germane to the referenced file number, including the requirements for registration of a firm as a nationally recognized statistical rating organization.



Presentation to Chairman Mary L. Schapiro

November 10th, 2010

MEREDITH WHITNEY

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Key Points

- Current construct of rating agencies has little to no credibility, is not trusted, and ineffective.
- Litany of lawsuits against S&P and Moody's reflects lack of effective oversight and due diligence.
- Current system enshrines duopoly/oligopoly.
- Smaller players too specialized and lack broader track record.

MWAG has 18 years of experience with financial institutions.

- Well-respected and established coverage and analysis on consumer finance products, mortgage, credit card, auto loan, student loan (Structured Products ~36% of ratable market).
 - Financial institutions and corporate coverage (~12% of ratable market).
 - Recent launch of top U.S. states (Public, Project, Infrastructure Finance ~22% ratable market).
- MWAG currently covers over 2/3^{rds} of U.S. ratable market.

Nationally Recognized Statistical Rating Organization

Why we want to be an NRSRO?

- An NRSRO is a credit rating agency that issues credit ratings that the SEC permits other financial firms to use for certain regulatory purposes. As of 9/25/2008, there were 10 organizations:
- Many pension funds, banks, etc. demand that ratings be from an NRSRO.
- Often-times, large CRAs receive non-public information from issues (SEC Regulation Fair Disclosure states a CRA may only use such information if their ratings are made to the public for free).

1. Moody's Investor Service (1975)
2. Standard & Poor's (1975)
3. Fitch Ratings (1975)
4. Dominion Bond Rating Service, Ltd
 - Canadian top CRA, 2003
5. A.M. Best Company (insurance, 2005)
6. Japan Credit Rating Agency, Ltd (2007)
7. R&I, Inc. (Japanese, 2007)
8. Egan-Jones Rating Company (2007 after 9yrs)
9. LACE Financial (2008) – also investor paid biz
(Acquired 9/10)
10. Realpoint LLC (2008) *(Morningstar acquired 3/10)*

Competitive Landscape

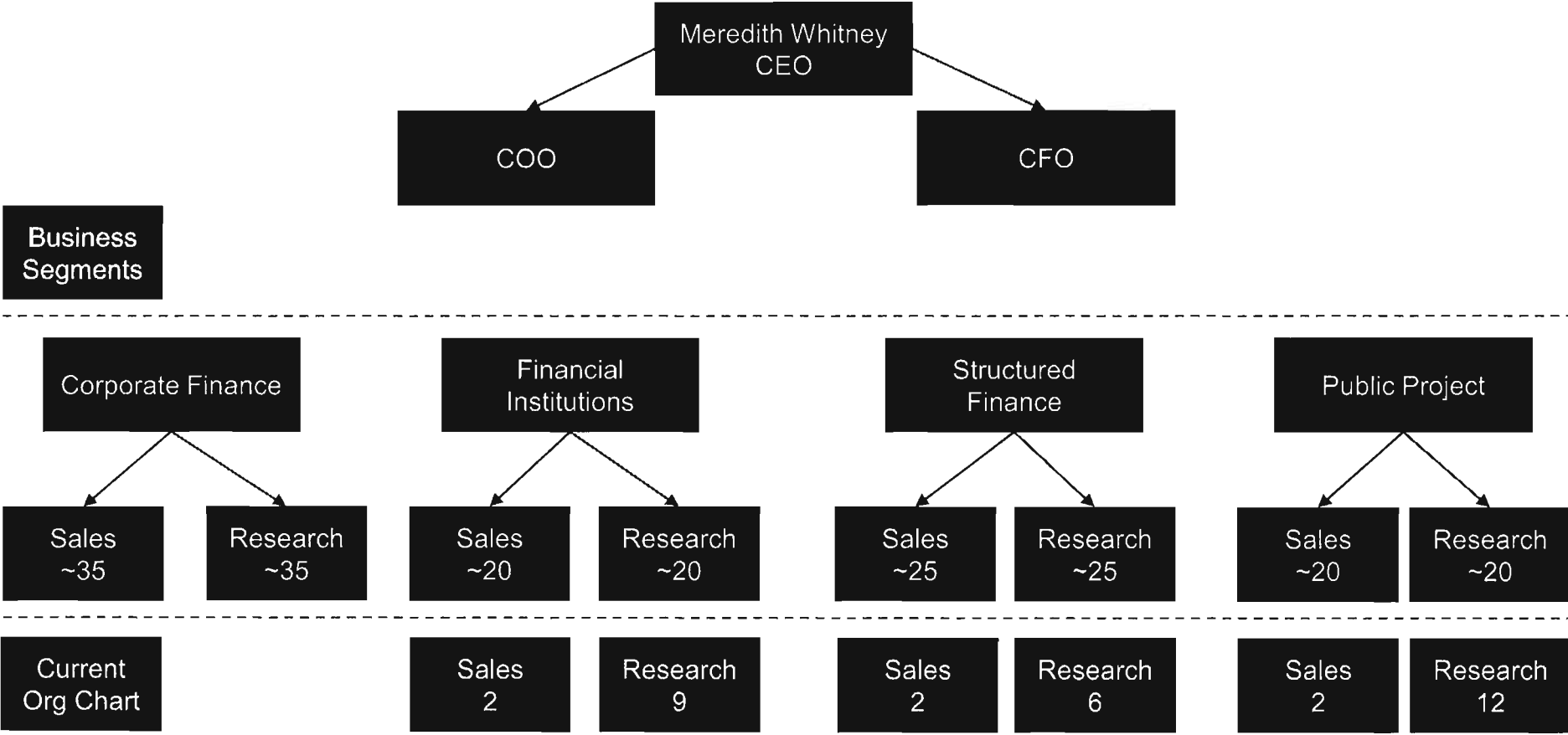
NRSRO's – Competitive Landscape

- Moody's Investor Service, Standard & Poor's, & Fitch Ratings are top players, 90-95% market share.
- A.M. Best Company (insurance): 450+ employees
 - Roles include accounting, computer programmers and technicians, customers service/order entry, data entry/statisticians, editors and journalists, financial analysts, IT, marketing & sales, and web designers.
- Dominion Bond Rating Service, Ltd: 201-500 employees, most frequently move to Moody's after
 - Family owned business, Canadian focused.
- Japan Credit Rating Agency, Ltd: 90 employees, Paid-in Capital = JPY 584 mil (\$6.8M)
 - Main biz areas: rating of LT and ST debt (MTNs and ABS); research on domestic and foreign financial markets and on industry trends; research on foreign political and economic conditions; publication and info service relating to ratings and research activities.
 - Also rates Sovereigns & Supranationals, Medical Institutions and Educational Institutions.
- R&I, Inc. (Japanese)
 - Credit ratings (evaluation of loans and securities such as bonds and other obligations).
 - Research and analysis of financial and capital markets and overall business trends.
 - Research and analysis of asset management.
 - Performance evaluation and consultation regarding pension fund management.
 - Analysis and evaluation of finances and creditworthiness.
 - Information services and publications related to the above.
- Egan-Jones Rating Company (only 12 credit analysts, 3 head/supervisory analysts).
 - Subscription-model only: Clients are fiduciaries, money market funds, hedge funds, and the sell side.
- Realpoint LLC (Morningstar acquired 3/19/2010), specializes in structured finance.

MW Credit Ratings – Org Chart

Key Assumptions/Drivers:

- Used Moody's revenues per segment as drivers of divisions' headcount
- Used DBRS' total headcount ~200 as base model for initial build-out (they are #5 player)



Methodology

MW CRA Projections

Expenses – used ~Moody's per employee cost of \$212K, with slight raise to \$225K for higher compensation costs.

- Included \$20M start-up cost (HR, rent, software/hardware, etc.).
- Largest driver of expenses is headcount, which ramps up from 200 in Year 1 to 650 heads target in Year 3 (~coincides with revenue growth).

Revenues – Achieve over 25% penetration of issuance in Year 3.

- Split segment revenues by ~same percentages as Moody's.
- Growing revenues significantly in Year 3, as Franken Amendment will open up opportunities for smaller credit rating agencies.

Operating Structure

Just 30% of Moody's employee base is in research: ~1,200 Analysts and ~2,800 support.

We put a premium on research.

Starting from scratch, we will have a lower operating expense structure without legacy infrastructure costs.

With lower infrastructure operating costs, we can be more competitive with compensation, and therefore attract better quality talent.

Reputations Lost/Reputations Preserved

Competition Plays Defense While We Build Our Offense

Since the onset of the credit crisis, Moody's and S&P have struggled to improve their heavily tarnished images.

-In fact, both have taken restructuring charges and have guided to higher expense bases going forward resulting from efforts to build out compliance, disclosure, and more analysts.

Herein lies our opportunity: We have been dealing with extensive compliance efforts in equity research for well over a decade.

-Our reputation has not been tarnished by the credit crisis.

-In fact, our brand is associated as being early to identify risks and protecting investors.

Our Approach Focuses on Both Macro and Micro Issues

- Our thesis on homeownership led us to be early when predicting Problems With the Banks.
- Our thesis on tepid HAMP results shapes our thesis on a Double Dip in Housing.
- Our Research on regulatory analysis led us to be early when predicting capital raises caused by rating agency downgrades summer 2007-late 2008.

Sources

<http://www.dbrs.com/>

<http://www.ambest.com>

<http://www.jcr.co.jp/english/>

<http://www.r-i.co.jp/eng/>

<http://www.egan-jones.com/assets/docs/CFA%20Institute%20-%20Solving%20the%20Credit%20Crisis.pdf>

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