Comment on SEC Proposed Rules for Nationally Recognized Statistical Rating Organizations

File Number S7-18-11
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William J. Harrington

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A. Introduction to the Members of the Security and Exchange Commission

My name is William J. Harrington. I was employed by Moody's Investors Services ("Moody's) as an analyst in the Derivatives Group from June 1999 until my resignation in July 2010. In 2006, I was promoted to Senior Vice President, the highest title that one could attain while performing purely analytical tasks. I am extremely proud of my work at Moody's, which I memorialized in detailed committee memos, in Moody's methodologies and in other Moody's publications. A summary of my responsibilities at Moody's and at prior employers and a list of my publications are included in an appendix to this Comment.

During my 11-year tenure at Moody's, I was a lead analyst for many Derivative Product Companies ("DPCs"), for a collateralized swap program and for several Credit Derivative Product Companies ("CDPCs"). From 2006 onward, I was Team Co-Leader for these types of counterparty vehicles, collectively known as Structured Finance Operating Companies ("SFOCs").

Beginning in 2003, I spearheaded the multi-year development of a methodology to treat interest-rate and currency swaps in all types of cash-flow securitizations rated worldwide by Moody's. In the U.S., these types of cash-flow securitizations include Residential Mortgage-Backed Securities ("RMBS"), Commercial Mortgage-Backed Securities ("CMBS"), Collateralized Bond Obligations ("CBOs"), Collateralized Loan Obligations ("CLOs" and, collectively with CBOs, "CDOs") and Student Loans, among others.

During the first seven years of my tenure, I was also a lead analyst for approximately 50 CDOs. Upon my promotion to Senior Vice President in spring 2006, I relinquished my responsibilities for CDOs to focus entirely on SFOCs.

In 2009 and 2010, I participated in 20+ sovereign committees as one of two required senior members from outside of the Sovereign Group. My prior experience as an International Economist at The WEFA Group served me well in this capacity.

Thank you for providing this opportunity to comment on the Proposed Rules for Nationally Recognized Statistical Rating Organizations (Proposed Rules").

My comments refer only to Moody's Investors Services.

I am at your disposal.

Sincerely yours,

William J. Harrington

Comment on SEC Proposed Rules for Nationally Recognized Statistical Rating Organizations

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Former Moody's Analyst Assesses the Proposed Rules for NRSROs for Application to Moody's

I am offering the views of a career analyst at Moody's, a viewpoint that has been wholly ignored to date in inquiries relating to the dismal quality of opinions formed by Moody's in so many sectors.

My approach is that of a lead analyst in a properly conducted Moody's committee. I don't seek to sway, but rather to recommend; to marshal materials in support of my recommendation; to present the materials cogently; and to do all of this in a manner that advances the deliberations of the Commission.

1. **Would Moody's Have Formed Durable Opinions Had the Proposed Rules Been Implemented in 2002?**

In assessing the Proposed Rules and in suggesting additional ones, I asked what their subsequent impact would have been on Moody's opinions had they been implemented in 2002.

Would the management of Moody's and its parent Moody's Corporation have engaged in a multi-year effort to stoke the RMBS ratings machine and to acquiesce to all proposed opinions for RMBS and CDO issuances?

Would Moody's have rated Special Investment Vehicles ("SIVs")?

Would Moody's have assigned pass-through rating factors to credit default swaps in the PARCS/PYXIS program from the outset? (PARCS/PYXIS is a type of shelf program for credit default swaps that Merrill Lynch used to distribute credit default swaps to its own CDOs of Asset-Backed Securities ("CDOs of ABS"). Moody's analysts and outside observers alike have characterized PARCS/PYXIS as a self-referencing hall of mirrors that created a web of interconnectedness among Merrill Lynch CDOs that was nearly impossible to trace.)

As the notional of credit default swaps in PARCS/PYXIS program exceeded $5 billion, $6 billion, $7 billion, $8 billion, $? billion, would Moody's have continued to assign pass-through rating factors? Would the Derivatives Group and the Banking Group have continued to ignore the growing impact of this program on the others' opinions? Would Moody's have waited to address the systemic implications of the program until very late in the game?

Would Moody's have issued the same ratings in 2004 to Athilon Asset Acceptance Corp. and Athilon Capital Corp., a CDPC that formed my ongoing touchstone as to why Moody's management must not be allowed again to co-opt committee proceedings in the SFOC sector?

Would the Compliance Department have sought twice in 2009 to reverse opinions regarding Merrill Lynch Derivative Products AG, a DPC? Would Moody's have undertaken in 2009 and 2010 to waive through proposals by AIG to transfer 50+ interest rate swaps with CDOs to Merrill Lynch Derivative Products AG? Would Moody's have assigned proposed ratings to those CDOs that borrowed money under from AIG via the interest rate swaps?

2. Old Habits Die Hard: Moody's Public Rationale Belied by its Private Opinions and Actions

Moody's argues that RMBS committees could not have factored the collapse of real estate prices into their opinions, given that the scale of the collapse was both unprecedented and unforeseeable. This rationale is as unconvincing as it is disingenuous, for it pretends that Moody's and other financial players were not designing and operating the conveyances that carried real estate prices to unsustainable levels in the first place. A roller coaster inexorably chugs up to stomach-turning heights before it hurtles downward, and both a carnival operator and a thrill seeker understand the nature of the ride's operations.

The rationale of "who could know?" is wholly undone through even a cursory examination of the actions of Moody's and other financial players in the structured finance sector. Moody's and other financial players took care to protect their earning should the real estate bubble that they were ushering into the world subsequently collapse.

The major financial institutions that dominate the workings of the International Swaps and Derivatives Association ("ISDA") designed template confirmations for credit default swaps on several types of structured finance. The individual templates that were introduced for the RMBS, CMBS and CDO sectors each had a credit event should the specified tranche be downgraded to Caa1 or lower. On the one hand, structured finance groups in these institutions were extracting ever poorer Moody's opinions and being rewarded for doing so. At the same time, these very same groups turned around and protected themselves against the downgrades that they foresaw for the time when the impoverished nature of Moody's opinions would inevitably become apparent.

For its part, Moody's management insisted that its quarterly monitoring fees and all other amounts owed by a structured finance issuance be paid at a very senior level in its priority of payments, ahead of payments of interest and principal to rated notes, including those rated Aaa at issuance. Moody's is paid the vast majority of its monitoring fees on structured finance issuances that it continues to rate, no matter how little remains for distribution to rated notes and no matter how far the notes have been downgraded.

Mark Zandi, my former colleague at The WEFA Group, related that he endured harsh criticism after Moody's Corp. acquired his economic forecasting firm in 2005. In Mark's view, some of the criticism rose to the level of "personal attacks" on him. Management was offended by his forecasts for the U.S. economy and the housing market that did not support the RMBS modeling assumption that housing prices would rise 4.00% per annum ad infinitum.

Brian Clarkson related his view of the real estate market to me in the summer of 2006. With respect to the primary market, Mr. Clarkson mulled that, well, the primary market would be okay. However, he was emphatic that everyone knew it was not the time to buy a second house. He then asked if he should call my partner to relate this gangbusters outlook. (Such offer immediately and emphatically declined).

Moody's management is also on record as having known what it was embarking on when it decided to race S&P and Fitch to the bottom of the ratings heap. In a 2009 group meeting, Doug Lucas and Andy Kimball presented data that showed that external constituents had regarded analysts at Moody's, S&P and Fitch in declining respect from 2004 onwards. Management had tracked this ongoing erosion since 2004 without taking remedial action and without reflecting this view in annual evaluations.

These incidences are discussed near the end of the Comment. Please see "*J.35. Pre-2008: External Paymeisters Come First, Last and Always. Analysts Are Seen, Not Heard."*

3. Financial Institutions Mismanaged Risk All By Themselves, Can't Pin That on NRSROs

Commissioner Shapiro is not entirely correct that rating agencies contributed "significantly to the mismanagement of risks by financial institutions." The financial institutions that issued structured finance transactions mismanaged their risks entirely on their own. On one hand these large financial institutions rewarded employees (and outside counsel) to obtain ever more worthless opinions from the rating agencies and, on the other hand, their treasury and risk management functions treated the same worthless opinions at full face value. The CEO of a bank holding company did not need deep knowledge of synthetic CDOs to discern this tendency.

4. Canvass Analysts Regarding Best Practices for the "Credit Rating Process", i.e. Opinion Formation

The Contributor strongly suggests that the SEC seek the views of Moody's analysts themselves as to the best practices for opinion formation that they would like to see safeguarded.

Neither Moody's nor any other entity has polled current and former Derivatives analysts as to their views regarding the committee proceedings that formed such degraded opinions on CDOs. These analysts are the most valuable sources of insight that the SEC can consult. The analysts should be de-briefed extensively, both singly and, over time, in increasingly larger groups to identify those persistent views that an individual analyst or group of analysts insist be considered in shaping remedial policies to be implemented at Moody's.

Moody's management continues to maintain that "the past is the past" and blocks any inquisitiveness on the parts of analysts themselves. Someone else was responsible (very likely the same inquisitive analysts) for all that occurred and management bears responsibility for nothing. It's time to look forward and get that stock price (i.e. that for Moody's Corp.) back up!

Derivatives analysts were scornful of much of the testimony offered at the two hearings of the Financial Crisis Inquiry Commission ("FCIC") devoted to the rating agencies. One who had been the lead analyst in 2006-2007 for many CDOs mulled "What *did* happen in those CDO committees? I always recommend that the senior-most tranche be rated Aa1 (i.e. a weaker opinion than that proposed by a banker.) But, somehow, the committee always voted Aaa (i.e. the opinion that had been proposed by a banker.)"

Whether Moody's issued an opinion of Aaa or Aa1 regarding the senior-most tranche of a CDO may seem to be more a philosophical distinction than a practical one. After all, the two opinions are only one notch apart on Moody's scale. Rating agencies can be very "ivory tower," *n'est-ce pas*?

Yet the two opinions were worlds apart in commercial terms and the distinction between the two was entirely practical. The senior-most tranche of a CDO could not be sold with an opinion of anything but Aaa. Aa1 may as well have been Caa1 (and over the course of time, Aa1 became exactly that.)

If the senior-most tranche of a CDO could not be sold, neither could any other tranches of the CDO. In this hypothetical case, a banker would either pull the CDO from the market or, more likely, issue the CDO without any Moody's opinions. Moody's might still be paid a break-up fee, but would forfeit its much larger rating fee and future monitoring fees. If Moody's was to maintain 90% profit margins with respect to CDOs, it couldn't afford to leave any fees on the table.

B. Summary of the Comment and its Rationale

5. The Proposed Rules Will Be Downright Dangerous If Applied to Moody's

The Proposed Rules for Nationally Recognized Statistical Rating Organizations ("Proposed Rules") must be largely reconsidered as they relate to Moody's. They do not address the ongoing conflict of interest that impairs opinion formation in Moody's committees.

Additional rules that promote the independence of analysts in committees should be considered and those Proposed Rules that strengthen management oversight of analysts should be greatly scaled back, if not scrapped altogether. The Comment suggests rules of the former type and identifies the most misguided rules of the latter type.

The suggested changes to the Proposed Rules with respect to Moody's may not be applicable in their entirety to other rating agencies of comparable size, most notably Standard & Poor's ("S&P) and Fitch Ratings Ltd. ("Fitch), owing to differences in corporate organization

6. If There Be Only One Additional Rule, Let It Be This

A single additional rule would improve the formation of Moody's opinions immediately, and would be costless to implement. The Board of Moody's Corporation, the parent company of Moody's, should report the status of each analyst who has filed a complaint with the Compliance Department, has filed a complaint against the Compliance Department or has commented on Moody's website with respect to a methodology on an annual basis for five ensuing years.

7. Does the Commission Really Want to Abet Moody's Management in Debasing Moody's Opinions?

Most of the Proposed Rules fail the acid test that had they been implemented in 2002, Moody's would have developed durable opinions, particularly in the RMBS, CDO and SIV sectors, in the ensuing years. Rather, the opposite is true. Many of the Proposed Rules give still more license to the management of Moody's to step-up its long-standing intimidation and harassment of analysts, to the detriment of opinion formation. The rationale seems to be that, as the fox did so well in guarding the previous henhouse, why not commission it to design a new one, enlist it to take the daily beak count and designate it Hen's Delegate to the U.S. Poultry Association?

The management of Moody's, the management of Moody's Corporation and the board of Moody's Corporation are squarely responsible for the poor quality of previous Moody's opinions that ushered in the financial crisis and should not be given first shot at debasing future opinions as well. Seriously, dudes, not for nothing, but something is way wrong with this picture. The phrase "bass ackwards" recurs. Please re-calibrate.

Analysts are best positioned to police the "credit rating process" (in the parlance of the Dodd-Frank Act) which flourishes or withers with each formation of a Moody's opinion at the conclusion of a committee. Currently there are no incentives for an analyst to police a committee other than self-respect, but there are serious disincentives for her to challenge management in any way. Moody's has no quality control function with respect to ongoing performance of committee members, with performance defined as preparation, willingness to challenge the recommended opinion and the views of others in a respectful manner, independent voting and ongoing self-evaluation. Yet, a committee is the "plant" that forms a Moody's opinion, which, in turn, is the sole product for which Moody's is paid.

8. Moody's Management Debases Moody's Opinions Pretty Well on Its Own

Management, in contrast, has repeatedly shown that it intends to retain its outsized influence in committees even though doing so degrades the quality of Moody's opinions, with devastating consequences for both the reputation of Moody's and the broader financial system. Management influence on "the credit rating process" is not restricted to overbearing participation in committees, but is exercised in all areas of daily operations, including the allocation of analyst responsibilities, annual reviews, compensation, promotion, group meetings, internal communications and informal conversations. Additionally, the internal control functions of Credit Policy and Compliance dictate and enforce the macro-mood of management, which filters downward into committees.

The goal of management is to mold analysts into pliable corporate citizens who cast their committee votes in line with the unchanging corporate credo of maximizing earnings of the largely captive franchise. Implementation of the credo is impressively flexible – in laying the groundwork for the financial crisis, management rewarded lenient voting with respect to all asset classes. In the immediate aftermath of the crisis, management advocated voting in a uniformly harsh manner with respect to all asset classes and as time has passed, management has encouraged each type of voting, based on its varying strategies for individual asset classes.

As examples, Moody's is broaching an easing of rating criteria with respect to CLOs, which is the only sector within the larger one of CDOs where a revival of issuance might plausibly occur. Moody's has also publicly glossed over several challenges that have emerged regarding the provision of interest rate swaps and currency swaps to all manner of asset-backed securities rated worldwide. Recognition of these challenges will result in higher costs to issue these types of securities and thus is not constructive to the earnings of the franchise.

Two internal control functions of Credit Policy and Compliance develop and enforce the marching orders du jour. Credit Policy has the last word on changes to methodology as well as freedom to contest the outcome of any committee simply because one of its staff believes the opinion to be "wrong". The Compliance Department has implemented several complicated policies that impact each Moody's analyst and special additional ones that impact only analysts in the Derivatives Group. Collectively, the Compliance policies serve the sole purpose of constructing a virtual Potemkin village for regulators to admire.

The Compliance Department is also an enforcer that actively harasses analysts viewed as "troublesome", i.e. independent, and is well-experienced in doing so. Several of its prominent officers trained for the Compliance Department (and Credit Policy) by managing the issuing and monitoring of RMBS opinions. The contributor can attest to harassment meted out by the Compliance Department while employed at Moody's as well as ongoing harassment that has stopped only recently.

Management regularly intoned that "Compliance doesn't retaliate" but offered no corroborating evidence. Would Moody's rate a senior-most RMBS tranche "Aaa" simply because output from a management-specified model shows that the tranche is always paid in full?

The board of Moody's Corporation, the parent of Moody's, exercises no oversight regarding analyst independence nor is there an incentive for it to do so. Moody's has recorded positive earnings in every quarter since going public in 2000. Earnings fell as the financial crisis unfolded, but they remained positive.

The lesson learned to-date by the management of Moody's and that of Moody's Corporation with respect to their roles in the financial crisis and its aftermath is that they can brazen out anything and are untouchable. Implementation of many of the Proposed Rules will be yet another validation that this is the case.

C. Moody's Enshrines Management Conflict of Interest in Opinion Formation

The salient conflict of interest confronting Moody's employees is that which arises simply from being employed by Moody's. This conflict of interest permeates all levels of employment, from entry-level analyst to the Chairman and Chief Executive Officer of Moody's Corporation.

However, the nature of the conflict-of-interest differs by levels of employment. An entry level analyst balances conducting her committee responsibilities with integrity while staying on sides of management. The Chairman and Chief Executive of Moody's Corporation balances preserving the independence of committee proceedings at Moody's with receiving increased remuneration as Moody's business grows. Analysts and managers at the intervening levels confront both conflicts of interest each time that they participate in a committee or evaluate an analyst.

The ongoing, unresolved conflict of interest plays out in the formation of Moody's opinions. These public opinions of Moody's are often at odds with its private opinions. In some cases, the distinction between public and private opinion is an explicit one. Much more often, the distinction between the two is unknown even to Moody's. Members of committees vote one opinion for publication and keep their private opinions to themselves. A committee member who votes differently, i.e. one who votes the same opinion for publication as she holds privately, earns her own self-respect. She also courts retaliation from management.

In either case, the public opinion fails its only purpose – a tool for external parties to categorize bonds.

9. Opinion Factory Gets By Without Quality Control Function

A committee is the "plant" at which a Moody's opinion is formed. In the parlance of the Dodd-Frank Act, the "credit rating process" flourishes or withers at Moody's each time that a committee forms an opinion. Preliminary steps in the "credit rating process" of each issuance, such as identifying the applicable methodology, determining modeling treatment, analyzing model output, reviewing documentation and drawing comparisons with similar issues all inform a committee but none ordain its opinion. Nor do these preliminary steps taken as a whole ensure a flourishing "credit rating process" even when each such step on its own is executed robustly.

A flourishing "credit rating process" is evidenced in a committee that is experienced by each committee member as both a "talking shop" and a "voting shop," where the only pressure that is exerted on a committee member is to use all possible rigor in forming an opinion and in voting that same opinion. In such a committee, there is no discrepancy between the opinion that is privately held by Moody's and that which is publicly expressed by Moody's. Any individual (not simply a member of a Moody's committee) who forms and expresses an opinion in this manner honors herself by doing so. Likewise, every Moody's opinion formed in this fashion honors the committee and also honors Moody's. There should be no other type of Moody's opinion.

Where a committee degenerates into merely a "talking shop" where a committee member forms a private opinion rigorously but does not vote in accord with this private opinion, Moody's forms a degraded public opinion that is at odds with the one that it holds privately. While any individual (not simply a Moody's analyst) may withhold many such private opinions over the course of her life as a means of getting along, Moody's should hold no opinions of this type. Still worse is a committee that is not even a "talking shop," but rather a perfunctory approval of a recommended opinion where a committee member forms no opinion on her own. In this instance, Moody's has no opinion, yet still publishes a hollow one as if it did.

10. CDO Plant Pumped-Out Public Opinions, Dumped Private Ones on the Factory Floor

In the experience of the contributor, the committees that issued opinions on "CDOs" from 2005 to the middle of 2006 degenerated increasingly into "talking shops." In these instances, members felt free to discuss the negative aspects of the CDO but also felt pressure by management to overlook these aspects when voting. The contributor ceased rating CDOs in Spring 2006, but in the ensuing year discerned a further deterioration of CDO committees into what seemed to be "commiseration shops", based on the widespread demoralization that he repeatedly observed as members emerged from such committees.

Moody's management was solely responsible for the degradation of opinions formed in CDO committees from 2005 onwards and possibly earlier. From the Managing Directors of the Derivatives Group upward to the CEO of Moody's Corporation Ray McDaniel and for every intervening management level, Moody's management undercut analyst attempts to produce informed Moody's opinions regarding CDOs. The means employed by management were various, but a manager either supported the increasingly transparent mission of obliging each banker and arranger in all matters and disrupting no scheduled steps of a scheduled CDO issuance or she ceased managing. Surviving management at all levels both protected their jobs and prospered for doing so as compensation grew and payouts from annual option grants skyrocketed along with the stock price of Moody's Corporation. The stock hit a high of $75 in early 2007 from an initial level of $14 in 2000.

11. As Before, Analyst Self-Respect Only Mitigation for Conflict of Interest

The senior management of Moody's and Moody's Corporation is largely intact despite having decimated the quality of Moody's opinions and the Moody's brand. Unlike its close competitors S&P and Fitch, Moody's did not have a large-scale purge of management in response to the dismal quality of its opinions. The two competitors each have a corporate parent and boards which held all levels of management of the ratings business accountable for their comparable rating debacles. In the future, management at S&P or Fitch may weigh this precedent in contemplating whether to lean on committees to dilute their opinions.

In contrast, the management of Moody's and the board of Moody's Corporation are well-entrenched and the board conducts no oversight of management. In essence, both the board of Moody's Corporation and Moody's management flout the only material conflicts of interest that confront Moody's employees and managers, working at Moody's itself. For this reason, the additional rules proposed later may apply only to Moody's.

Moody's management has implemented many new policies that serve to placate regulators, including a special set that applies only to those in the Derivatives Group, but which would not have prevented the ratings debacle had they been in place by 2002. These proposals were designed with no input from analysts in any sector of structured finance and left these analysts unconvinced as to the utility of the proposals in producing informed opinions. Moreover, the former RMBS managers in the Compliance Department sought to intimidate analysts who voiced this view and, in some cases, did so successfully. This intimidation has been sanctioned by senior-most management of Moody's and Moody's Corporation and the board of Moody's Corporation. Lastly, Moody's management has drawn no cogent relation between the new policies and the wrong that they are intended to right.

The contributor believes that the post-debacle policies implemented by Moody's through July 2010 serve only to centralize management control of the "credit rating process," most notably committees, so that the floodgates may be easily opened for arrangers in those sectors that take off in the future. Most dispiritingly, even a top-to-bottom removal of implicated management and a complete replacement of the board of Moody's Corporation would not have a lasting impact as it would leave in place the distorted incentive system for management that is the only material conflict of interest at Moody's. Moody's management is cannot be reformed.

12. Moody's Stock Options Exacerbate Conflict of Interest, Particularly for Senior Management

Managers in all areas of Moody's (not simply structured finance) are benefiting on a personal level as Moody's brazens out attempts to hold it accountable. Judging from widespread chagrin as the price of Moody's Corp. ("MCO") collapsed in 2008, most managers had not exercised their options when MCO hit highs in 2006-2007.

Managers who had exercised their options would have been in a position to walk away from Moody's, or at least would have had less reason to keep close tabs on MCO. But why cash out when every month's brokerage statement showed impressive paper gains. Wasn't the upside limitless? MCO rose 600% from 2000 to 2007, couldn't it climb by that amount again?

Paper gains can be more compelling than realized profits; witness the country's excitement when real estate prices were climbing. Many felt well-off without having to sell property. Paper gains are not taxed. Paper gains do not have to be reinvested. Paper gains seem unlimited. Paper gains do not incentivize one to investigate their source.

Having been seduced by paper gains and then dumped as the gains evaporated, managers are incentivized to root for MCO to climb. Most MCO options that have not been exercised remain outstanding. While options ceased to be granted in 2008, most options typically have a ten-year expiry from grant date.

MCO options issued early on have the lowest strikes and now have value. As an example, MCO options issued in 2001 were struck at $14 and can be exercised before December of this year (2011). MCO options issued in 2002 are struck at $19 and may be exercised up to December 2012. MCO options issued in 2003 are struck at $22 and may be exercised up until December 2013.

These options may be exercised at a gain to their holders. And the gain will grow if Moody's stock climbs. Last June, the stock hit a low of $17 and the options had little-to-no value. By comparison, MCO options granted prior to 2003 are doing well. They'll do even better if the stock climbs on. And senior management has the largest potential gains to extract from exercising MCO options. As one senior manager cajoled a group of Senior Vice Presidents in 2009, "Forget the past. Get that stock price up!"

D. The "Credit Rating Process," Committees and the Distinction Between a Private and a Public Opinion

Moody's forms opinions, publishes them and is paid for doing so. A Moody's opinion is expressed by an individual rating symbol that is one in a set of rating symbols, each of which is associated with a discrete range of expected loss as set forth by Moody's. In most cases, Moody's publishes an opinion soon after having formed it.

Each Moody's opinion emerges from a committee, which is a formal meeting that is convened for the purpose of determining which rating symbol within the standardized set represents the opinion of the committee. A committee chair presides over a committee in accordance with the procedures that have been established by Moody's.

Committee procedures govern all aspects of a committee, including the prior distribution of a comprehensive committee memo, the determination of which attendees will vote to form the Moody's opinion, the presentation of a recommended opinion by the lead analyst with reference to the committee memo and the subsequent deliberation by all attendees of issues to consider in forming the Moody's opinion. Upon conclusion of the deliberations, the committee chair polls each voting member in reverse order of title for her opinion as to which individual rating symbol is appropriate for the issue at hand. All such opinions are weighted equally and tallied with the Moody's opinion determined by a simple majority.

External parties use Moody's opinions to classify bonds. For the classification to offer utility in this purpose, each Moody's opinion should at the time of issuance be as informed as possible, reflect the private opinion of Moody's and be expected to be durable.

13. Published Methodologies Do Not Ordain a Moody's Opinion

The committee memo, recommended opinion and committee deliberations each take the Moody's methodology that is applicable to the opinion under consideration as a starting point. It is important to repeat, however, that a methodology ordains neither the recommended opinion presented by the lead analyst, nor the individual opinion of any committee member, nor the resulting Moody's opinion. Rather, the lead analyst and each other voting member is expected to use only her own judgment in forming her opinion and to vote this same opinion. In this way, the private opinion of Moody's accords exactly with its published opinion and is as informed as possible.

Only an opinion formed in this manner has the sole trait that is of utility to an external party in classifying bonds – at the time of its formation, the opinion is expected to be durable. New information in the future may prompt a reconsideration of the opinion. But all information available at time that the opinion is formed is reflected in it.

The importance of fostering the independence of the lead analyst and each other committee member both in contributing to the deliberations of a committee and in offering her individual opinion cannot be overstated. Issues arise in each committee on which the applicable methodology is silent. In some cases, the applicable methodology is a statement of general principles with implementation left to the external party seeking a Moody's opinion. In other instances, the applicable methodology is prescriptive on many points but is also augmented by permutations that have arisen subsequent to its publication. Moreover, each augmentation is re-considered by subsequent committees and, as with individual components of the published methodology, may be built upon, deemed not material or repudiated in any individual committee. The world simply moves too quickly for all pertinent issues to be full encapsulated in a published methodology.

Lastly, subjective elements considered in forming each opinion may lead separate committees to form different opinions on issues that otherwise appear similar and that share the same methodology. For all these reasons, a voting committee member is invited to offer a rationale to accompany her vote. In fact, a non-voting attendee is also asked for her opinion and rationale, although this latter opinion is not tallied with those of committee members in forming a Moody's opinion.

14. Moody's Committees Differs Markedly in Purpose from Corporate Meetings Elsewhere

Every corporation convenes meetings every day that have characteristics that are superficially similar to that of a Moody's committee. The difference between a routine corporate meeting and a Moody's committee lies in the purpose of each. Routine corporate meetings may or may not have an impact on the goods produced and sold by the corporation and rarely are determinative on a stand-alone basis. Moreover, routine corporate meetings reinforce the standing hierarchy and serve as jousting grounds for those who wish to advance in it.

Much of the behavior that is tolerated or even encouraged in routine corporate meetings defeats the purpose of a Moody's committee. Examples of these types of corporate behavior include senior managers imposing their views on subordinates, members communicating electronically with others inside the meeting and outside of it, peers competing with each other to impress senior managers rather than drawing out others' views respectfully, participants shutting out the meeting as irrelevant and concluding a meeting without resolution.

15. Management Routinely Co-opts Committees to Form Desired Public Opinion

In contrast, Moody's forms a valuable opinion only in a committee where the proceedings are observed in both form and spirit. Each member enters the committee having already briefed herself using the committee memo prepared by the lead analyst. After certain preliminaries the lead analyst takes the floor to recommend an opinion that is cogently reflected in her rationale and supported by materials in the committee memo. Each committee member probes the lead analyst regarding her rationale and other members regarding their views until satisfied for her voting needs and then casts a vote based solely on her own view as to the most appropriate opinion that the committee should form. Within a committee, the hierarchy should be as flat as possible, in keeping with its most important characteristic that the opinion of each member has equal weight.

Unfortunately, the contributor participated in numerous committees where management maneuvered for a prescribed result through intimidation of other voting members. Intimidation could be blatant, with managers belittling opposing views, interrupting while others speak, making evident that they didn't consider the committee memo to be relevant or engaging in non-committee activities such as communicating on an electronic device until ready to speak themselves. Managers might also adopt a strictly formulaic approach and seek to have aspects of others' opinions deemed "irrelevant" to the opinion at hand or challenge a member with a possible ramification of her opinion along the lines of "with your view, you should be suggesting that the entire methodology be up for grabs and we're not here to do that.

In short, Moody's management can be trusted only to continue its practice of running roughshod over committee proceedings and continually subjecting analysts to the conflict of interest of preserving their job security.

16. Athilon CDPC Closing Committee – Management Extracts Opinion Demanded by Issuer

The 2004 committee for the initial rating of Athilon Asset Acceptance Corp. and Athilon Capital Corp. (collectively "Athilon CDPC") exhibited a full gamut of actions and reactions as management jockeyed to obtain the desired opinion. The recommended opinion met with such objection from the analyst committee members that deliberations exceeded four hours. The senior-most manager departed at the two hour point, observing that the committee was in fine hands to continue and whispering his vote to one of the two remaining managers. That indicated to one of the analysts that voting for the recommended opinion was exactly what the committee had been convened to do.

A first round of voting on a technical issue met with "no's" from the committee and these several "no's", in turn, met with glares from one of the managers who remained behind and dispirited resignation from the second manager. In the next round of voting, committee members changed their "no's" to "yes", for various reasons unrelated to the credit of Athilon CDPC. One member cited intimidation from the glaring manager and another felt misplaced sympathy for the beaten-down managers who in most other areas was trying to fight the good fight. In this instance, the committee was merely a "talking" shop, where the members developed informed opinions that they could defend robustly but held them privately and did not vote them.

E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Away Management Residue

The additional rules suggested here will hold an analyst to her responsibilities to inform herself as fully as possible in forming a private opinion and to voting her private opinion as the Moody's opinion. Where each analyst does so, all steps in the "credit rating process" will flourish and Moody's will issue an opinion that it believes to be durable.

17. Bears Repeating – If There Be Only One Additional Rule, Let it Be This

A single additional rule would improve the formation of Moody's opinions immediately, and would be costless to implement. The Board of Moody's Corporation, the parent company of Moody's, should report the employment status of each analyst who has filed a complaint with the Compliance Department, has filed a complaint against the Compliance Department or has commented on Moody's website with respect to a methodology on an annual basis for five ensuing years.

Exit interviews of those who have left Moody's would not count toward this requirement. The contributor attributed his own resignation to "personal reasons" but is now very happy to share his observations. Other employees who leave Moody's in the aftermath of filing a complaint may prefer to wait until they obtain new employment before offering their views on Moody's.

The SEC should also interview employees who have made such complaints.

This requirement would go a long way in reviving the "credit rating process" at Moody's and in mitigating the conflict of interest that confronts both analysts and managers. Analysts are more than capable of policing themselves, fellow committee members, committee proceedings and all aspects of opinion formation at Moody's if free from the threat of retaliation by a manager or harassment by the Compliance Department.

Moreover, the analysts themselves serve as the best oversight of the development of methodologies and their ongoing utility over time. Freely operating rating committees can signal when a methodology has lost its relevance or is being subverted.

Most importantly, analysts will be incentivized to preserve committees as both "talking shops" and "voting shops" where the Moody's opinion is reached through highly informed and vigorous deliberations.

18. Annual Interview of Each Employee Who Has Been Disciplined by Compliance Department

Each employee disciplined by the Compliance Department should be interviewed by a board member of Moody's Corporation and also by the SEC annually for as long as they are employed by Moody's. This will obligate the Compliance Department to justify each disciplinary action that it has taken against an employee.

19. Managers Should Not Vote in Forming a Moody's Opinion

Managers should not vote in forming a committee opinion. Rather, they should leverage their experience to foster deliberations that are open and which assist the committee chair both in probing for an airing of all issues of concern to members and in informing the deliberations with their own insights regarding the applicable methodology, its ongoing development and its applications in similar cases.

Systematic shortcomings that led to the dismal opinions formed on CDOs, most notoriously CDOs of Asset-Backed Securities ("ABS"), flowed directly from decisions by Moody's management. As with "Rosemary's Baby", these CDO opinions were corrupted at inception, not at the later times of their multi-notch downgrades.

In one egregious instance of systematic subversion of CDO committees, Moody's management ignored the frequent reporting from two very capable Derivatives analysts who had been seconded to the RMBS rating group to help with its overwhelming deal flow. These analysts repeatedly let Derivatives managers know of the poor quality of opinions that were being churned out by the RMBS machine, opinions which managers insisted be respected in committees for CDOs of ABS. To objections that the RMBS group was known to be pumping out worthless opinions, managers would counter that to do other than respect the RMBS opinions at face value would indicate that Moody's didn't believe its own opinions.

Managers also beat back analyst concerns that the correlations embedded in models for CDO of ABS should be highly stressed in modeling CDOs of RMBS. Had managers not been able to vote an opinion, analysts who were uncovering shortcomings in CDO methodology may have been more successful in sharing their concerns during committee deliberations.

During the heyday of CDO issuance from 2005 to 2006, management also stopped hiring senior analysts and instead hired junior analysts who, while possessing the raw talent to grow into competent analysts, were too inexperienced to perform the tasks to which they were assigned. Critically, a junior analyst asked to lead the rating of a CDO could not possibly possess sufficient confidence, tactical sense or gravitas to challenge a banker, collateral manager or Moody's manager intent on pumping out another debauched CDO. Nor would the junior analyst have known that she could recommend in committee a lower rating than that indicated solely by modeling, to offset, for instance, the poor quality of RMBS opinions embedded in a CDO of ABS.

Management also explicitly threatened the job security of analysts who "impeded deals," as was notoriously done both collectively to the entire legal staff of the Derivatives Group and individually to certain analysts by Brian Clarkson, abetted by his managers in the Derivatives Group. These managers raised no objections to the tactics employed daily by Brian Clarkson to pressure analysts into green-lighting any and all proposals by CDO bankers and issuers. The contributor heard repeatedly from one of these managers that a manager who obstructed the CDO flow would lose her job.

The track record of management influence in committees speaks for itself – it produced hollowed-out CDO opinions that that were at great odds with the private opinions of committees and which were not durable for even a short period after publication. External parties who used the opinions to classify CDO bonds suffered greatly from having done so. The CDO opinions were many times more damaging than had they been merely useless.

20. Train Management in Committee Comportment

Moody's has long tolerated the practice of managers in the Derivatives Group treating a committee opinion as a pre-determined outcome that they are personally responsible for delivering and for which their views carry primary weight. The managers are accustomed to having influenced very, very many committees over very many years, principally for CDOs but also for other asset classes. Their modes of intimidation have encompassed interrupting subordinates, grimacing while opposing views are voiced and voted, belittling both opposing views and members who voice them and inflating the impact of voting an opposing view to indicate that that view is inappropriate to even raise.

When Derivatives managers were not attempting to strong-arm committees, they often ignored the proceedings entirely by losing themselves in their Blackberries. Even more destructively, the contributor was left with the strong impression that Derivatives managers were communicating surreptitiously via Blackberry with each other during committees. This destroys the very core of a committee, which is that all points are made for all to hear. An examination of the Blackberry records of managers to compare with their committee attendance would be highly instructive as to their views of their responsibilities in a committee.

Lastly, Derivatives managers sometimes employed sympathy as a means of constraining the opinions voted by members. The impulse to commiserate with a manager clearly feeling the stress of corralling a bucking committee could be surprisingly effective in prompting members to vote an option different to one that they held.

21. Cite Total Number of Voting Members in Opinion Press Release

Moody's should be required to report the number of voting members that formed a Moody's opinion in its accompanying press release. The tally of opinions will not be cited, simply the total number of voting members who cast an opinions.

The number of committee members is a transparent indicator of the resources devoted by Moody's to form the opinion being cited. The contributor has participated in committees with as few as three members and as many as 20.

The press release should also mention instances in which the committee was convened following a successful appeal of a previous committee and the grounds for the appeal. No reference need be made to the previous opinion itself.

22. Committee Assessment Function -- Analysts Police All Aspects of the "Credit Rating Process"

Moody's should be required to establish a Committee Assessment Function devoted solely to evaluating the committee performance over the course of a year of all members regardless of title. The Committee Assessment Function should bypass management entirely and report directly to a board member tasked with sole responsibility for this function.

By-passing management in forming the assessment will mitigate the oppressive conflict of interest facing analysts, that of how to perform to their peaks in committees without being sidelined by management.

The formation of a Committee Assessment Function will incentivize members of a committee to form opinions in a robust manner as possible with the aim of their proving durable. This function would evaluate all aspects of performance in committees for all members, regardless of title, and this evaluation would form the largest component of the annual review of an analyst or manager.

Cross-evaluations throughout the year by other committee members, except for managers, will form a principal part of this assessment and will be shared with the analyst as part of her review. Committee ross-evaluations will be shared with a committee member at least semi-annually. In the cross-evaluations, equal weight will be given to each voting member, regardless of title.

Analysts will be eager to police the “credit rating process” effectively if they are given incentives to do so and if they are protected from retaliation by Moody’s management for having done so. In the author’s experience, analysts once came to Moody’s solely to do work of which they would be proud, not to kowtow to their superiors and certainly not to prostrate themselves in front of whichever external entity happened to be footing the bill on a given day. Senior analysts of the contributor’s acquaintance were sufficiently experienced, educated and dedicated to deal directly with issuers, to tackle new methodological issues and most importantly, to contribute meaningfully to committees and to vote independently in them. In 11 years at Moody’s, the contributor witnessed no actions by any analyst, senior or junior, that could be remotely attributed to nefarious intent, nor did he hear of any such actions.

For each committee where a member has been lead analyst, she will be evaluated on the completeness of her committee memo with respect to well-reasoned rationale for her recommended opinion with reference to the applicable methodology, to analysis of model results and of documentation features, to presentation of supporting and non-supporting factors for her recommended opinion, and to points whose evolution over time are expected to have an impact on the opinion going forward. The lead analyst will also be evaluated on the timeliness with which she distributed the committee memo so that members had sufficient time to prepare, on her ability to respond to all points raised during the committee deliberations, on her knowledge of opinions formed in previous committees that had considered similar issuances and on her comportment during deliberations and voting.

Where a committee member is not a lead analyst, she will be evaluated both on an outright basis and in relation to peers of similar title and experience. She should have prepared prior to the committee by having reviewed the committee memo thoroughly. Her comments during deliberations will be based on her review of the committee memo, her familiarity with the applicable methodology, her knowledge of opinions from committees for similar issuances and her assessment of the logic of the lead analyst’s rationale for the recommended opinion. A committee member will also be evaluated on her ability to move deliberations forward for the benefit of the entire committee.

A committee chair will be evaluated on her ability to conduct all procedural responsibilities while buttressing the spirit of a committee, which is to ensure that all views held by individual members are expressed during the course of deliberations while also drawing the deliberations to a vote in a timely manner. Critically, the committee chair will ensure that all views are treated respectfully and that managers do not seek to influence the votes of subordinates. In turn, the committee chair will evaluate the lead analysts and other voting members on their abilities to voice all pertinent points without having to be cajoled to do so.

Managers will be evaluated on their ability to aid the committee chair in fostering deliberations with respect to their knowledge of technical issues and their experience with previous opinions on similar issues.

The Committee Assessment Function will use several tools in its evaluation of a member's committee performance. Its staff will attend as many committees as possible as non-voting members and schedule follow-up discussions with individual members throughout the year, both on a scheduled and a surprise basis. The follow-up discussions will allow the control function to understand the member's approach and preparation for individual committees as well as her assessment of committee proceedings generally. The control function will not ask about the opinion voted by the member but will probe as to the evolution of a member's analysis and philosophy over time.

23. Acid Test: Durable Opinions Had Committee Assessment Function Been Implemented in 2002?

Had a Committee Assessment Function been in place as early as 2002, committees in the Derivatives Group would have continued their practice of developing robust, well-informed private opinions that were voted as the public opinion of Moody's. Above all, each analyst would have been given incentives to earn and preserve the respect of her colleagues through her contributions to each committee over the course of a year. Working toward this goal would have aligned with the reasons for becoming a Moody's analyst in the first place.

Each analyst would also be encouraged to hold the feet of other every other analyst to the fire as tough decisions arose, which in turn would have resulted in committee opinions that would indicate when a methodology required adjustment. The nature of the CDO market was such that a complete repudiation by a committee would not have been necessary, nor would it initially have needed to be uniformly applied in all committees. Forming an opinion that a senior CDO tranche deserved a rating of Aa1 rather than Aaa would have been enough to bring the issuance to a halt with respect to Moody's – either because the issuer would have to make adjustments or it would remove Moody's from one or more tranches in the a transaction.

This power would have been necessary because the model-oriented nature of structured finance allowed CDO bankers to continually propose transactions that leveraged elements of the existing methodology beyond recognition, even if their parameters conformed exactly. The most egregious and damaging example of this was the morphing of CDOs of ABS into CDOs of Only One Type of ABS, Namely RMBS ("CDOs of OOTA, NRMBS"). Committees comprised of experienced CDO analysts who were aware that the quality of RMBS opinions had for some time prior to 2006 been hollowed-out through management fiat, could have begun suggesting adjustments to compensate for the suspect RMBS opinions on an initially ad-hoc basis. Standard modeling may have been overridden to incorporate additional stresses. A committee might even have returned a CDO opinion that was weaker than that initially proposed by bankers.

The opinions formed would almost certainly have varied by committee, but each on its own would have had the most important attribute that the public opinion issued by Moody's lined up exactly with the one that it held privately and was expected to be durable.

The Committee Assessment Function also would have rewarded analysts with less seniority in doing their job, i.e. challenging more senior members, including managers, in committees.
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F. Analysts Keep Correlated Collateral Out of Merrill Lynch CDO Hall of Mirrors (PARCS/PYXIS)

An opinion from a Derivatives Group committee regarding an individual credit default swap under the PARCS/PYXIS program in spring 2008 reflected a black hole in the program that had systemic implications. The opinion differed in a small but telling manner from all previous opinions that had been formed on credit default swaps in the $8 billion PARCS/PYXIS program.

Three Moody's analysts, including the contributor, held Merrill Lynch to its obligation to fill the black hole through a process of triangulation. They participated in individual committees that formed opinions for new credit defaults swaps under the program, they worked with the fundamental analysts and met directly with Merrill senior management regarding PARCS/PYXIS and they completed review of the Credit Support Annex in early summer 2008, enabling it to obtain RAC soon thereafter and to be implemented. In this last task, the team repeatedly rebuffed Merrill Lynch until it delivered the necessarily conservative terms that had been implicit in the program since its inception but had not been executed. Mike Connor was the banker at Merrill Lynch with responsibilities for PARCS/PYXIS, including executing a Credit Support Annex.

24. CDOs Had Advanced $8 BN to Merrill Lynch Under Credit Default Swaps with PARCS/PYXIS

PARCS/PYXIS is a Merrill Lynch program that has taken in more than $8 billion upfront from counterparties under credit defaults swaps while funding the amounts to be returned to the counterparties only on a contingency basis. The program documents specify that, in the case of Merrill Lynch being downgraded to a prescribed rating, Merrill Lynch obligations under the program would be collateralized through the mechanism of a Credit Support Annex.

The governing documents of PARCS/PYXIS are largely silent regarding the properties that a Credit Support Annex must possess and, in the absence of a Credit Support Annex, counterparties faced the senior unsecured risk of Merrill Lynch. However, from the inception of the program, the management of the Derivatives Group set the precedent that the obligation of Merrill Lynch to return amounts owed to counterparties under the program would be treated as being free of all credit risk, i.e. better than Aaa, despite no Credit Support Annex being in place.

Where a CDO rated by Moody's was the counterparty under PARCS/PYXIS, it was directed by its governing documents to obtain from Moody's a rating factor to assign to each credit default swap. Naturally, Moody's is paid both to assign each rating factor and to refresh it on an annual basis. And naturally, each CDO makes such payments to Moody's at the top of its waterfall, ahead of all payments to rated notes and pari-passu with the separate -- and substantial -- fee paid annually to Moody's for monitoring the CDO itself.

The rating factors assigned by Moody's ignored payment risk by Merrill Lynch entirely and acknowledged only the credit risk of the reference obligation under a credit default swap. True to the practices of Merrill Lynch at the time, the reference obligation was often another CDO on its own books that it had been unable to distribute. Post-mortems on the program repeatedly described it as a self-referencing, self-dealing hall of mirrors. The contributor has heard a similar indictment of PARCS/PYXIS from people outside of Moody's as corroboration of this view.

In spring 2008, the contributor participated in meetings with the Moody's fundamental analysts for Merrill Lynch regarding general updates from Merrill Lynch Treasury. According to the fundamental analysts, Merrill Lynch Treasury acknowledged that the entirety of its obligations under the PARCS/PYXIS program might soon have to be secured and that credit lines of between $10 billion and $20 billion were earmarked just for this purpose. The contributor had the impression that PARCS/PYXIS was an item upon which the Treasury Department of Merrill Lynch often updated the fundamental analysts of Moody's, whereas the latter and their colleagues in the Derivatives Group rarely if ever discussed the program.

The management of the Derivatives Group did not even report to itself regarding the credit default swaps for which it assigned rating factors under the PARC/PYXIS program. If it had, the practice of Merrill Lynch to nest risk residing with the firm within still bigger nests also residing in the firm would have been impossible to ignore and Moody's may have opted to at least reflect the nested risk in the rating factors assigned to credit default swaps under the program. Moody's might have even ceased to issue such rating factors altogether. An impact from that type of organic reaction by Moody's might have caused the CDO of ABS machine at Merrill Lynch to seize up before it could pump out every last debauched issuance in its pipeline.

25. Analysts Form PARCS/PYXIS Opinions Using Common Sense, Not Published Methodology

The contributor also noted that Merrill Lynch Treasury could earmark billions and billions of dollars of financing until the cows came home, but until these amounts were secured to counterparties under the PARCS/PYXIS program by a Credit Support Annex or some similar mechanism, the counterparties remained unsecured creditors in the event that Merrill Lynch entered bankruptcy. It was for this reason that two analysts had been reviewing iterations of Credit Support Annexes proposed by Merrill Lynch for some period of time. Despite their diligent efforts, Merrill Lynch was completely uncooperative.

As was often the case in the Derivatives Group, no single methodology addressed all aspects of PARCS/PYXIS, despite its size and systemic importance. Rather, committees drew from many methodologies and from the precedent of previous opinions which had largely been led by management. Moreover, had a comprehensive methodology been in place, the committee may have felt hamstrung to form an opinion that conformed fully to the methodology but was far less reflective of opinions that had been evolving in other committees. In times of emergency, as is the case when the financial world is unraveling, action is the preferred course even at the expense of uniformity across all similar opinions.

The opinion that pressed Merrill Lynch to get serious with respect to its Credit Support Annex was formed by a committee of only three members. As precedent with PARCS/PYXIS had been so well established, the committee might have been expected to be a perfunctory one. The lead analyst had performed this same role with respect to several credit default swaps which had previously been assigned rating factors but had developed qualms regarding the ongoing assumption that Merrill Lynch should be ignored in the calculation. The analyst led off by recommending a continuation of this practice but became increasingly uneasy with her recommendation during deliberations and suggested jettisoning precedent and adding the risk of Merrill Lynch into the rating factor. The Managing Director with responsibility for PARCS/PYXIS offered that doing so would be unfair to the issuer but the committee voted to accept the revised recommendation, i.e. to form a new opinion that was more conservative than management-propelled precedent of the previous six years.

The team of three analysts reviewing the Credit Support Annexes proposed by Merrill Lynch actively ignored a separate methodology in the form of archaic tables of advance rates for many types of collateral that had been published years earlier by Moody's. These advance rates did not reflect the outright price risk that was being observed in all types of assets by the summer of 2008 nor did it recognize correlation that existed between many of the collateral types and the structured finance payment obligations that they would secure under the PARCS/PYXIS program.

The team considered only cash and U.S. Treasuries for inclusion as collateral under the Credit support Annex for PARCS/PYXIS, given its webs of cross-correlations. However, had the team wished to cover itself rather than do its job, it might have ignored these risks and simply not commented on proposals for inclusion of unsuitable collateral types.

26. Non-Toxic PARCS/PYXIS? Mooted Impact Had Committee Assessment Function Been in Place

A Committee Assessment Function may have prevented Moody's from having been involved with PARCS/PYXIS in its current form. The analysts who were attorneys in the Derivatives Group would have questioned if the safe harbor provisions under the U.S. Bankruptcy Code would apply to the credit default swaps in the program, given their use as vehicles for Merrill Lynch to borrow money from counterparties. To overcome this objection, a committee might then have issued an opinion only after PARCS/PYXIS had implemented a Credit Support Annex that was accompanied by a legal opinion from a major law firm regarding the treatment of the secured assets under the Bankruptcy Code, with a further provision for a new takedown with each individual credit default swap. In turn, PARCS/PYXIS and with it the issuance of CDOs by Merrill Lynch would have been more expensive for Merrill Lynch to operate and thus not susceptible to being over-leveraged from the outset.

A more robust series of committees unfettered by managers' intent may also have required that each credit default swap be reported to the fundamental analysts at Moody's, so that they could track secured obligations of Merrill Lynch as they were being incurred. A reporting mechanism by the Derivatives Group, in turn, might have raised awareness of the systemic risks centering on Merrill Lynch that would have allowed Moody's to form opinions in which those of the fundamental groups and those of the Derivatives Groups informed each other.

Later, as Merrill Lynch's reputation soured, committees might have acted in a more cohesive manner across areas of Moody's rather than as individual silos. Moreover, the committees from the Derivatives Group could have provided insight into the increasingly shoddy and aggressive tactics observed in interactions with the CDO team at Merrill Lynch as an additional factor for the fundamental group to consider in its assessment of Merrill Lynch management. A pertinent question that then could have been posed to the senior management of Merrill Lynch would have been why did it reward bankers so handsomely to pulverize the value of opinions of structured finance into ones of no utility only to turn around and treat rating opinions as fully sound for other applications, such as calculations of capital?

G. This Proposed Rule is a Keeper! Moody's to Maintain Public Comment Site for Each Methodology

The Proposed Rule that "each methodology should be associated with a permanently maintained, publicly available comment site to be used by all interested parties[1]" will strengthen the "credit rating process" by supplying insight and information to committees from a wide array of sources outside of Moody's. These insights and information would otherwise be inaccessible.

The Proposed Rule will aid each member of a committee to develop a more informed private opinion and, where committees are free of management intimidation, to vote the same Moody's opinion. In turn, the Moody's opinion will be as informed and as durable as Moody's can make it, serving its sole purpose of aiding an external party to classify bonds in a meaningful manner.

The comments on the site and Moody's opinions will in tandem signal when a methodology remains relevant and when it should be re-considered. Revision of a methodology may also move more quickly. External parties using opinions informed by a methodology will be more versed in issues surrounding the methodology, rather than being taken by surprise when a methodology review is announced.

Lastly, Moody's will learn if elements of a methodology have been misconstrued or misunderstood by external parties despite efforts to make the methodology transparent to all users. "Transparent" may well mean one thing to Moody's internal counsel and another to an external party stymied by lack of plain English.

Incentivize Moody's Analysts to Use Publicly Available Comment Sites

Moody's analysts should be encouraged to use the publicly available comment sites for all methodologies without fear of intimidation, harassment or retaliation for doing so. To make this encouragement transparent, the Compliance Department will report to a board member on the status of each analyst who has commented on a publicly available comment site an annual basis for the ensuing five years. This suggestion is listed above in *"E. 17. Bears Repeating – If There Be Only One Additional Rule, Let it Be This."*

27. Rating-Triggered Market Losses Incurred by a Bank Counterparty to a Securitization Transaction

The contributor has brought his insights regarding the implications of the Hedge Framework for bank capital to former colleagues in Moody's Credit Policy, Derivatives and Banking Groups, Moody's Analytics and to

[1] Section 15E(c)(3)(A) of the Exchange Act; 1. Section 11.A.1. Self-Executing Requirement; 4.d.

Michael Kanef in RMBS/Compliance. (Mr. Kanef's RMBS/Compliance Department showed a great avidity for the topic while the contributor worked on it in a series of proposed AIG transactions. Please see *"J.36. Post-2008: Cozy Up to Regulators. Clear the Way for AIG. Blame, Blame, Blame the Analysts."* Moody's acknowledged receipt of the contributor's materials, but had offered no response at the time of this writing.

The contributor looked through the websites of other rating agencies to locate emails of as many individuals as possible who are versed in their methodologies that are analogous to the Hedge Framework. As a result, he was able to bring the same insights to many individuals at S&P and Fitch. Fitch performed the courtesy of replying to the contributor and helped refine his thinking further. S&P had not responded at the time of this writing.

The contributor offered to bring his insights to Dominion Bond Rating Service ("Dominion") but his request to a former Moody's colleague at Dominion to supply contacts has been as yet unmet.

The contributor also emailed many individuals at the European Banking Association ("EBA"), again looking though its website to identify those personnel most likely to be versed in the issue. The insights that the contributor offers are germane to the stress-testing of bank capital as they detail real market losses that a bank or other financial institution agrees to incur. To-date, the EBA has not responded to the contributor.

Lastly, the contributor sent the same materials to contacts at the Fed, FDIC and IMF, and to journalists at the *New York Times*, *The Wall Street Journal* and the *Financial Times*, in an effort to advance understanding of the impact of the Hedge Framework on bank capital and the securitization market. The issue is not merely one of philosophy that is useful for a rating agency in forming opinions on banks but irrelevant to the wider world. The issues raised here will profitably inform deliberations among policy makers regarding bank oversight, bank leverage and the role that the securitization markets can be expected to play in generating future economic activity.

A dedicated website for each rating agency large or small would have greatly aided dissemination of the insights. A dedicated website would also have generated more insights from other external parties making use of the websites.

The contributor would have been posted the below on two methodology sites for each agency – that for banking and that addressing the treatment of interest rate swaps and currency swaps in securitization transactions.

Regarding Moody's "Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions" (the "Hedge Framework") and Its Implications for Bank Capital and Securitization Costs

Contractual Provisions Relating to "Replacement" Rent a Hole in the Fabric of the Universe

The above methodology (the "Hedge Framework") has an implication for a bank (or other financial institution, any of which a "bank") that uses the Hedge Framework when counterparty under an interest rate swap or a currency swap to a securitization transaction. This implication has not been considered to-date.

The impact on bank capital and the implications for securitization markets arise even under swaps that are not compliant with the Hedge Framework or analogous methodology of another rating agency. The replacement provisions of the Hedge Framework exist in some form in the contracts of most interest rate swaps and currency swaps where a bank is counterparty to a securitization transaction that has issued rated debt. In short, the replacement provisions of a swap with a securitization transaction oblige the bank counterparty to unload the swap quickly after being downgraded to a specified level. As a distressed liquidator of its own swap portfolio, a bank will incur a market loss on each swap replaced. This market loss is separate from and above that of any financing costs that bank counterparty will have already incurred under separate provisions regarding the posting of collateral.

As banks recognize the impact of their contractual obligations to accept market losses on replacement, they will take write-downs on capital for swaps with securitization transaction already on their books. It is the understanding of the contributor that in these instances, write-downs by European banks will be material. European banks that were underwriters for securitization transactions often took care to retain associated interest rate or currency swaps for their own books.

Additional capital will be set aside for each new swap with a securitization transaction as determined by its replacement provisions. In turn, securitization transactions will pay more for an interest rate swap or a currency swap. The U.S. securitization market for residential housing loans may be particularly susceptible to these higher charges for swaps, given the preponderance of fixed-rate mortgages and investor preference for floating-rate assets.

The write-downs, capital provisions and increased costs to securitize are real. They are not rating agency constructs that are useful in opinion formation but are ultimately theoretical. They are not stresses intended to make a methodology more rigorous, or to compensate for unknowable contingencies, or that serve as a conservative placeholder.

Not Much Incentive to Patch Things Up

The silo nature of rating sectors within Moody's has prevented the fundamental analysts for banks from learning of the scale of the write-downs and capital provisions that originate from swaps with replacement provisions. In turn, structured finance analysts have not known that the swaps with replacement provisions have been under-priced, will be more expensive in the future and impede the resurrection of securitization markets.

A similar silo nature exists within a bank, so that the risk management or treasury function may be unversed in the contractual obligations undertaken by its swap desk. A bank has every incentive to keep these departments from understanding the implications of replacement provisions, as they're bad news for everyone. Each swap in a bank's portfolio will occasion a write-down in existing capital. Each new swap will charge more to cover the capital charge, curtailing activity of the swap desk. Securitizations, already moribund, will be stifled further by higher issuance costs owing to higher swap rates paid.

Still, Moody's Management Tries to Do the Right Thing - Only Kidding!

Panic has played a role in keeping Moody's from developing a holistic understanding of replacement provisions in the Hedge Framework and otherwise. The internal control function of Credit Policy has directed priorities for methodology reviews. Timetables afford scant time for considered analysis and the nature of expected results is emphatically signaled. Job 1 is to keep the earnings machine working. Analysts of individual sectors are given little opportunity to share their insights and no encouragement to develop new ones. The benighted analysts of the Derivatives Group were accorded still less autonomy in addressing methodology challenges. Their status as pariahs self-evidently obliged them to accept whatever was handed out and to be grateful for it.

With respect to the Hedge Framework, Moody's Credit Policy directed that unceasing attention be paid to a decision by the Lehman bankruptcy judge that vitiated "flip clauses" in bankruptcy. This was a headline decision with implications for the Hedge Framework and other analogous methodologies. Moody's was invested in the Hedge Framework. Altering it would have had unleashed a new round of watch list opinions on U.S. and European structured finance transactions. Moreover, Moody's had no methodology to assess the impact on a transaction if "flip clauses" were not enforceable. No structured finance methodology incorporates a simulator of swap mark-to-markets. Life would be easier all around if the ruling of the Lehman bankruptcy judge could be brushed aside.

Not surprisingly, Moody's has concluded that "flip clauses" have no impact on securitization transactions that are counterparty to swaps that are compliant with the Hedge Framework. Moody's Press Release to this effect follows at the end of this section, with notations from the contributor that relate Moody's analysis of "flip clauses" to the larger issue of replacement provisions and corresponding market losses. In the Press Release, Moody's unknowingly and repeatedly acknowledges that its conclusion flows from the contractual obligation of the bank counterparty to accept a market loss on each replaced swap. No exceptions. Rrrrrrripppppp!, there goes the universe. It's time to circle around and review bank methodologies.

Replacement Provisions Mean Market Losses of 0.40% of Un-Netted Swap Notional?

The market losses are not trivial in amount or in the effort that a bank must expend simply to incur them. The downgraded AIG spent two years in arranging for a Derivatives Product Company ("DPC") to intermediate for it as counterparty to approximately 50 CDOs in interest rate swaps. Over the course of the two years, Merrill Lynch Derivative Products AG ("MLDP"), the DPC in question, was downgraded twice, to Aa1 on review for downgrade in June 2009 and to Aa3 in December 2009.

AIG managers tasked with shepherding the transfers through Moody's complained directly to the rating team that the two MLDP downgrades made the transfers much more expensive and time consuming. Moody's management, including the Compliance Department, took note and did all in their power to discourage committees from assessing the AIG proposal in earnest. The AIG committees properly ignored the costs accruing to AIG under its proposals and simply assessed the AIG proposals on their own merits. The committees owed neither AIG nor Moody's management nor most emphatically Moody's Compliance an explanation for simply having done its job. Management and again, most emphatically, the Compliance Department, wanted above all to cut AIG a break.

It should be noted that the ultimate Aa3 rating of MLDP is a strong rating, yet the downgrade from Aaa still obliged AIG to add resources to its proposal to effect MLDP intermediation, i.e. the market loss absorbed by AIG grew. It should also be noted that while the AIG swaps do not comply with the Hedge Framework, they contain analogous replacement provisions. To the best of the contributor's knowledge, the U.S. Derivatives

Group did not apply the Hedge Framework to a single CDO, but rather issued opinions on CDOs with much weaker replacement provisions. Even the weaker provisions obliged AIG to absorb a market loss on each intermediated swap.

The market loss from replacement is in addition to the funding costs of a bank counterparty that is obligated to post collateral to a securitization transaction. A downgraded bank may well incur both types of costs on many swaps where it is counterparty to a securitization transaction. First, a downgraded bank may post collateral for some period against those swaps that are mark-to-market swap assets to securitization transactions. After a period of posting collateral to some swaps, the bank will then incur the posited loss of 0.40% of notional upon all swaps that it replaces, regardless of whether the swap is a mark-to-market asset or liability to a securitization transaction and irrespective of whether collateral had previously been posted to the transaction.

In Detail – the Hedge Framework

A bank will bear a market loss on a removal or a guarantee of a swap[2] with a securitization in its portfolio that is required while its rating remains in a specified tier following a downgrade[3]. To-date, regulators have not considered these market losses when measuring bank capital, nor have rating agencies done so in monitoring bank ratings.

The contract for a swap between a bank and a securitization typically specifies that the bank will perform one or several actions as long as its rating rests in one of two respective tiers after having downgraded[4]. Most importantly, a bank agrees that, while its rating remains in the lower of the two tiers, it will seek to engage a higher-rated entity either as its permanent replacement in a swap or as its guarantor thereunder. The bank also agrees to do so under what are very likely to be materially adverse market conditions. It has only 30 days after the relevant downgrade to engage a higher-rated entity to serve as replacement or guarantor on the best terms that can be arranged for each of its swaps. After 30 days, the securitizations themselves can obtain replacement without regard to the even greater severity of market loss that will be borne by the bank.

The Hedge Framework *intends* that a bank in these circumstances will incur an outright market loss on each swap where it is counterparty to a securitization transaction, this is not an *inadvertent* outcome crying out for a re-think. A contract for this type of swap consigns all unscheduled costs, including outright market losses associated with replacement, to a bank and leaves none to be borne by a securitization transaction[5]. Essentially, a bank is a distressed seller of all of its swaps with securitization transactions for as long as its rating is in the mandatory replacement/guarantee tier.

[2] Interest-rate swaps and currency swaps.
[3] *"Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions"* (Manchester, Weill and Leibholz), Moody's Methodology, October 18, 2010.
[4] ibid.
[5] ibid.

The Way of All Framework Swaps - "Springing Liabilities" Give Way to "Receding Mark-to-Markets"

The market loss of a swap will be the difference between its mid-market value as calculated by a bank for daily P&L purposes[6] and the transaction price for the replacement or guarantee that is effected. At any time, the mid-market value of a swap may be an asset or a liability to a bank and, over the life of the swap, the mid-market value may shift between these two categories an unlimited number of times. However, both a swap asset and a swap liability will realize a market loss upon mandated replacement or guarantee. The swap portfolio of a bank in this sector consists partly of transitional "springing liabilities" and entirely of "receding mark-to-markets,' both types of which are triggered by specified rating downgrades.

The severity of market loss for any individual swap that is removed from a bank portfolio will be a function of, among other factors: swap type, duration, mid-market value (particularly where a securitization had borrowed money under a swap[7]), and potential exposure; embedded optionality, particularly if balance-guaranteed[8]; securitization sector; total number of such swaps in a bank's portfolio; and the number of highly-rated entities willing to serve as a replacement counterparty or a swap guarantor. There is no cap on how large the market loss may be for any individual swap - it may exceed 100% of mid-market value[9] for both swap assets and swap liabilities.

To kick things off, assume the bank will incur an outright loss of 0.40% of swap notional on each swap replaced and that the notional of swap assets and liabilities are not netted. All swap mark-to-markets will recede from the bank – it will receive termination payments that are less than its mark-to-market assets and it will pay termination fees that are in excess of its mark-to-market liabilities.

Don't' Even Mention Moody's "Hedge Counterparty Rating"

A Moody's Hedge Counterparty Rating does not address the rating-triggered market losses discussed here. A Hedge Counterparty Rating explicitly omits market risk and concerns itself solely with the seniority of payments to a bank counterparty in a securitization waterfall. A Hedge Counterparty Rating may facilitate replacement through its indication to a new bank counterparty of the value of seniority in the priority of

[6] Mid-market values of swaps with a securitization are not netted in measuring total market losses. Each swap that is removed from a bank portfolio will be transacted at a market loss, regardless of whether it's a mid-market asset or a mid-market liability to the bank. As such, total market losses may be sizeable. For instance, the netted mid-market value of Bear Stearns Financial Products, a significant counterparty under interest-rate swaps to U.S. RMBS issuances, ranged from $2 billion to $3billion at different points in 2008 & 2009. The absolute value of mid-market value would have been higher and of course the gross, un-netted notional much, much higher. It is this latter amount for which a 0.40% loss is posited as a starting point. In 2009, all BSFP swaps, including those with securitization transactions, were assigned to their guarantor, JPMorgan Bank.

[7] For instance, the substantial number of AIG lending swaps to CDOs and other securitizations that AIG, in response to its 2008 downgrade, sought to shift to Merrill Lynch Derivative Products in 2009 & 2010. The request for Moody's to issue RAC in conjunction with this liquidation of AIG's portfolio of securitization swaps was considered in an extensive series of committees that were convened throughout 2009 & 2010.

[8] A balance guaranteed swap ties the notional of a swap to a feature of the securitization transaction counterparty, such as its assets or its liabilities at future payment dates. By definition, these are unknown amounts at outset of the swap. Effectively, a balance guaranteed swap has embedded call options that are executed automatically and in parallel with changes in the specified feature of the securitization transaction counterparty, without reference to whether or not the exercise is economically desirous to the securitization.

[9] In this way, market loss may exceed the loss to a bank from being subordinated in the priority of payments of a securitization, a related topic not discussed here.

payments, but it is improperly used in classifying a swap for capital or rating purposes. For most swaps, this rating would be misleadingly high.

Moody's Press Release On "Flip Clauses" and the "Hedge Framework" with Contributor Notations

Please note: The contributor has inserted notes in bold italics at each ***(implicit acknowledgement in the Moody's Press Release that rating-triggered replacement provisions consign a market loss to a downgraded bank counterparty for each interest rate swap with a securitization transaction, regardless of whether an asset or a liability.)***

Announcement: Moody's: Ongoing uncertainty over flip clauses has no rating impact for most cashflow SF transactions

Global Credit Research - 29 Nov 2010

London, 29 November 2010 -- Moody's Investors Service says that ongoing uncertainty over the validity of provisions subordinating swap termination payments owed by structured finance vehicles to defaulting counterparties -- known as "flip clauses" -- has no rating impact for most cashflow structured finance transactions. This is because Moody's has concluded that the validity of flip clauses is not a material consideration in relation to liquid interest rate and currency swaps that comply with Moody's de-linkage criteria.

BACKGROUND

The validity of flip clauses relating to structured finance swaps remains uncertain. In January, the US bankruptcy court ruled that a flip clause providing for the subordination of swap payments owed by a structured finance vehicle (Dante) to a bankrupt counterparty (Lehman) was unenforceable. On 20 September, leave was granted to appeal that decision. The same flip clause has been the subject of English litigation. Following the Court of Appeal's ruling against Lehman, an appeal to the Supreme Court was scheduled for March 2011. The parties have recently agreed to settle both the US and English proceedings, subject to approval of the US bankruptcy court.

On 28 January, Moody's announced that it was investigating the potential impact of the US bankruptcy court decision on the ratings of structured finance transactions. It has now determined that the validity of flip clauses is not a material consideration in relation to liquid interest rate and currency swaps that comply with Moody's framework for de-linking swap counterparty risk (Moody's Hedge Framework)[1]. These types of swaps are typically used in cashflow structured finance transactions. For the remainder of this announcement, they are referred to as Framework Swaps.

Framework Swaps are likely to be transferred before swap counterparty default ***(with the transferring bank counterparty incurring a market loss on each Framework Swap so transferred)***.

If a swap complies with Moody's Hedge Framework, the counterparty is required to seek a replacement counterparty once it is downgraded below A3/P-2 ***(and to absorb the full market loss that will be charged by***

the replacement counterparty). Therefore, is it likely that liquid Framework Swaps will be transferred before counterparty default ***(with the downgraded counterparty absorbing the full market loss on each Framework Swap so transferred)***, even though Moody's assumes a material likelihood that such transfer will not occur[2]. ***(Moody's also assumes that the transferring counterparty incurs no market loss from transfer of Framework Swaps in the "immaterial" event that such transfer does occur. The contributor posits that each such transfer will cost the downgraded counterparty 0.40% of swap notional, regardless of whether a mark-to-market asset or liability.)***

The validity of flip clauses is not significant if the issuer receives a replacement fee with which to make its termination payment. ***(Exactly the point raised here. An issuer may receive a "replacement fee" from a new counterparty upon transfer of a Framework Swap. In turn, the issuer will deliver the entire "replacement fee" to the downgraded transferring counterparty and, in so doing, will have discharged all obligations to the latter. However, the "replacement fee" will be less than the mark-to-market asset of the Framework Swaps on the books of the downgraded transferring counterparty. In this manner, the downgraded transferring counterparty absorbs a market loss on each of its transferred Framework Swaps.)***

If a counterparty fails to transfer a Framework Swap before it defaults, the issuer may choose to terminate the swap and enter into a replacement with a new counterparty. If the issuer is out-of-the money under the swap, the new counterparty will pay a replacement fee that the issuer will use to make its termination payment[3]***. (Please see parenthetical in preceding paragraph regarding market loss with one caveat. The market loss is likely to be larger in the instance of default by the original counterparty rather than its mere downgrade. The estate of the defaulted counterparty will measure success as having obtained something greater than zero for its mark-to-market asset, i.e. having salvaged something, rather than working backwards from the full mark-to-market asset.)*** In this situation, the ranking of the termination payment is not a material consideration for rating purposes. Indeed, Moody's Hedge Framework contemplates that the replacement fee shall pass directly to the insolvent counterparty outside the waterfall in full satisfaction of the termination payment ***(but not in "full satisfaction" of the mark-to-market asset of the Framework Swap on the books of the defaulted counterpart, hence a market loss.)***

An issuer is very unlikely to terminate an out-of-the-money Framework Swap before finding a replacement. ***(Such replacement counterparty is "very unlikely" to pay for a swap mark-to-market asset unless it underpays for it and in so doing so books a gain. The downgraded counterparty must accept the underpayment as "full payment" for its mark-to-market asset, i.e. absorb the mirror market loss.)***

Even before January's bankruptcy court ruling, there was no observed instance of a structured finance issuer terminating a Framework Swap that was in-the-money for a defaulting counterparty without first entering into a replacement swap. ***(The replacement counterparty paying an amount less than the mark-to-market asset, which when passed on to the estate of the defaulting counterparty, represented a market loss.***) The litigation on flip clauses makes the prospect of such "premature" termination -- which would require trustee or noteholder consent -- more remote still. An uncovered senior ranking termination payment may cause a shortfall of funds for the issuer to make timely payments to noteholders. Moreover, it would expose the issuer to a shift in the market value of the swap between the time of termination and the time of replacement. ***(Moreover still, it would expose the estate of the defaulted counterparty to that same "shift in the market value of the (Framework)***

Swap", i.e. the estate will absorb a market loss on top of the market risk it assumes on its unhedged, daily changing mark-to-market.)

Moody's has considered whether another recent US bankruptcy judgment, concerning a swap between Lehman and Metavante Corporation, may influence the time at which an issuer chooses to terminate a swap with a bankrupt US counterparty. In that case, the judge said that a non-defaulting party can lose its right to terminate a swap if it does not exercise it promptly. Therefore, immediate termination has the advantage of ensuring the issuer is free to enter into a replacement swap at a future time without the risk of becoming double-hedged.

However, in order to justify the risks associated with termination before replacement, an issuer (and the trustee or noteholders) would, at the very least, want to be satisfied that (i) the transaction is likely to benefit from entering into a replacement swap at a future time and (ii) there is a material risk the bankrupt counterparty will, in practice, dispute the issuer's right to terminate at that time.

If a swap is out-of-the-money for an issuer, the projected benefit to the transaction of being able to enter into a replacement at a future time may be limited ***(This is not true. Moody's methodologies for structured finance model a variety of future interest rate outcomes. A swap may well be necessary to maintain the expected losses of a securitization transaction even if out-of-money for an issuer.)*** Moreover, a bankrupt counterparty can generally be expected to welcome the termination or transfer of a swap where it stands to receive a lump sum payment that reflects the market value of its position. ***(The "bankrupt counterparty" may well welcome the "lump sum," although not because the "lump sum" represents "the market value of its position." It will not. Rather, as a distressed entity with limited room to negotiate, the estate of a "bankrupt counterparty" would prefer to receive any lesser amount offered, i.e. the "lump sum," rather than accept a 100% write off its swap asset. Anything is better than nothing. The "lump sum" will not reflect the mark-to-market value of the defaulted counterparty's swap asset. Rather, the "lump sum" will represent a reduced amount that the new counterparty will pay to ensure that it books a gain in assuming a mark-to-market liability.)*** This expectation is confirmed by the Lehman experience. In Europe, Lehman cooperated with issuers to achieve swap replacements ***(for which Lehman received < 100% of its swap mark-to-market assets)***; in the US, it obtained court approval to unilaterally transfer swaps to third parties so as to realize their embedded value. ***(Such "embedded value" < 100% of the mark-to-market swap assets, for reasons cited above.)***

With this in mind, Moody's believes that a structured finance issuer is very unlikely to terminate an out-of-the-money Framework Swap before finding a replacement ***(such replacement paying less than 100% of the mark-to-market of the swap, the difference representing the market loss entirely borne by the original counterparty)***. The risks associated with an issuer incurring an uncovered senior termination payment are almost certain to weigh more heavily than those associated with the possibility of losing the right to terminate at a future time.

A bankrupt US counterparty is very unlikely to reject in-the-money liquid swaps ***(Equally, a bankrupt U.S. counterparty is "very unlikely" to obtain payment for the "in-the-money liquid swaps" anywhere near 100% of the swaps' mark-to-markets.)***

Moody's has separately considered whether a bankrupt US counterparty could be entitled to a damages claim or termination payment if it rejects a profitable swap under the US Bankruptcy Code ***(The phrase "profitable swap" is misused. The author of the Press Release may have intended "a swap for which the bankrupt U.S. counterparty is being paid an amount to terminate." In these circumstances, this will be a "profitable swap" for the new counterparty and an "unprofitable swap to the estate of the defaulted counterparty. A "profitable swap" is one for which the bankrupt U.S. counterparty records a gain against its mark-to-market and will apply equally where the mark-to-market is a liability or an asset. In the former case, the bankrupt U.S. counterparty will pay less than its mark-to-market liability to terminate the swap. In the latter, the bankrupt U.S. counterparty will receive a termination payment greater than the mark-to-market asset. Neither outcome is likely to occur where a counterparty, whether defaulted or solvent, is obligated to "replace" itself in a swap with a securitization transaction.)*** If a structured finance issuer is forced to make such a senior-ranking payment without first receiving a corresponding replacement fee, it could have a negative credit impact for noteholders.

However, there are strong legal arguments against this possibility. Moreover, given the uncertainties, costs and delays involved in litigation, Moody's believes it is very unlikely that a bankrupt counterparty would seek to reject an in-the-money swap if it could instead find a replacement counterparty ***(such "replacement counterparty" paying an amount to bankrupt U.S. counterparty that is less than the swap mark-to-market asset, forcing the latter to incur a market loss.)*** This expectation is consistent with steps taken by Lehman in relation to Framework Swaps.

Moody's has therefore concluded that the validity of flip clauses is not a material consideration in relation to Framework Swaps for which replacement counterparties can be found ***(such "replacement counterparties" will transact at a market gain to themselves and at a market loss to the original counterparty).*** Furthermore, the recent experience of Lehman swaps supports Moody's assumption that replacement counterparties can generally be found for interest rate and currency swaps ***(ditto immediately above).*** For these reasons, the final outcome of the Dante litigation -- whatever it may be -- is not expected to affect the ratings of cashflow structured finance transactions that incorporate Framework Swaps only. ***(Indeed, the underpinning of the Hedge Framework has been validated. A bank counterparty to a Framework Swap agrees via replacement provisions in the swap contract to absorb a market loss should it be downgraded to certain levels. Moody's Methodology for Banks requires review.)***

End Notes:
(1) Moody's methodology, "Framework for De-Linking Counterparty Risks from Structured Finance Cashflow Transactions", October 18, 2010.
(2) Moody's Hedge Framework incorporates a requirement for collateral to be posted in contemplation of the issuer terminating the swap and finding a replacement counterparty following counterparty default.
(3) Under Moody's Hedge Framework, the termination payment is defined to exactly match the replacement fee. Where this criterion is not applied, the termination payment is typically defined as the average of three or more market quotations. In this case, Moody's expects that an issuer would not choose to accept a replacement fee that is less than the termination payment.

London
Edward Manchester
Senior Vice President
Structured Finance Group
Moody's Investors Service Ltd.
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

New York
Maria E. Leibholz
VP - Senior Credit Officer
Structured Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom

H. In Short: Remaining Proposed Rules Will Be Downright Dangerous if Applied to Moody's

The contributor comments on those of the Proposed Rules that will weaken the quality of opinion formation at Moody's. These Proposed Rules sanction the Compliance Department to harass and intimidate analysts who act independently of management, particularly when voting in committees. Management direction to committees to form opinions for public consumption at odds with their private views was responsible for the non-durable, hollow opinions on CDOs and RMBS. The Proposed Rules identified as counterproductive offer management the tools to issue still more hollow opinions with similarly-short shelf lives in the future.

The contributor has commented only on Proposed Rules that are within his competence as a former analyst in the Derivatives Group. The contributor is not an attorney and cannot offer a view on legal issues. Nor does the contributor comment on Proposed Rules that concern the utility of ratings over time and the impact of large rating downgrades. Users of ratings have standing to comment on those Proposed Rules.

Hmmmmnnn – Ever Wonder What, Exactly, Becomes an Analyst Most?

Are the Proposed Rules intended to raise the caliber of those seeking to become Moody's analysts? Has the Commission reflected on why one would choose to embark on a career as a Moody's analyst? Why an analyst would remain at Moody's if the Proposed Rules were implemented? Will the Proposed Rules encourage independent voting by analysts? Do the Proposed Rules dovetail with the goals of an analyst to form opinions as rigorously as possible so as to vote a Moody's opinion that she believes will be durable?

Proposed Rules + Moody's Practices = Flay the Analysts, Press Them Into Indentured Servitude

Let's Piece Together the Proposed Rules and Current Practice at Moody's. The "internal control function" of Credit Policy establishes methodologies and specifies models. The "internal control function" of Compliance tests analysts on "competency" in "the credit rating process," i.e. the content of Credit Policy methodologies and models. Compliance grades the tests in secret and inflicts punishment on those analysts whom it has designated to fail. Senior managers ensure that tested items are absorbed wholesale into each committee opinion. When the initial opinions are revised to a considerable degree at a later date, Credit Policy, Compliance and management all flay the analysts!

To wrap-up each calendar year, Compliance attests to the board of Moody's Corp. and to the SEC that the above have been faithfully performed in the preceding calendar year.

For the following year, Compliance "looks back" and tracks analysts who have obtained employment elsewhere. Those analysts only think they're free.

A Pox on All at The House of Moody's? Only the Flayed Analysts? Management to be Inoculated?

Why not a pox on all at the House of Moody's? Most other houses in the country are pockmarked; there is no reason that Moody's should be passed-over. But a pox on only the analysts? Has Moody's management earned an inoculation against all pox?

I. In Detail: Comment on Those Proposed Rules That are Downright Dangerous

The contributor has endeavored to respond to the Proposed Rules in the format requested therein. Sections and page numbers refer to Draft "SEC Proposes Rules to Increase Transparency and Improve Integrity of Credit Ratings" of May 26, 2011. Contributor apologizes for any confusion stemming from differences between his reliance on the draft Proposed Rules and the Proposed Rules as published subsequently in The Federal Register.

A citation in the format of *"Letter. #. Heading Title"* refers to a section within this Comment. The page number for each such citation may be found herein in the Table of Contents.

28. Section II. A. Internal Control Structure 1. Self-Executing Requirement

Section 15E(c)(3)(A) of the Exchange Act – General Observation

The Compliance Department of Moody's has eagerly embraced its mandated role to "establish, maintain, enforce and document" an effective "internal control structure" by drawing on its extensive RMBS experience to intimidate analysts and reverse committee outcomes.

The Contributor experienced such harassment from the Compliance Department throughout 2009 as the course of a DPC methodology resulted in multiple downgrades, most notably with respect to MLDP. Two successive downgrades of MLDP made a proposed series of transactions between it and AIG more expensive to execute. The Compliance Department forced the first downgrade to be re-considered in a new committee and was stopped early in its attempts to do the same following the second downgrade. These events are itemized in *"J.36. Post-2008: Cozy Up to Regulators. Clear the Way for AIG. Blame, Blame, Blame the Analysts."*

Mr. Michael Kanef, Chief of Regulatory Affairs and Compliance Officer, directs the intimidation. Prior to obtaining his first exposure to Compliance in 2008, Mr. Kanef headed asset-backed ratings where he served as impresario for the RMBS ratings debacle. Other RMBS managers who were propelled into control functions with equally scant experience include Mr. David Teicher and Mr. Murray Markowitz in Compliance, Mr. Nicolas Weill in Credit Policy and Mr. Warren Kornfeld in Global Structured Finance Strategic Initiatives.

Mr. David Teicher is now a manager in the Sovereign Ratings Group, where he is well-placed to report to his RMBS/Compliance colleagues on activities regarding sovereign ratings and analysts. Mr. Teicher had little if any experience in analyzing sovereign entities prior to joining the group in spring 2011. At Moody's he had worked in the ABS Group, the Derivatives Group rating CDOs, the RMBS Group and the Compliance Department.

Firm-wide marching orders from Credit Policy, the second "internal control group" within Moody's, favored conservative opinions in the aftermath of the debacle. Credit Policy is reversing itself in some sectors such as

CLOs, where it is waiving through a market-friendlier methodology. In other market-friendly gestures, Credit Policy has re-approved an existing methodology regarding the provision of interest rate swaps to securitization transactions, despite the negative impact of the methodology on bank capital. This impact is detailed in *"G.27. Rating-Triggered Market Losses Incurred by a Bank Counterparty to a Securitization Transaction."*

Section II.A.1. Request for Comment

Section II.A.1. Request for Comment 1. (page 8)
With respect to Moody's, "the objectives of the self-executing requirement in Section 15E(c)(3)(A) of the Exchange Act" referred to in this Section cannot be adequately achieved in the absence of the Commission prescribing factors.

Section II.A.1. Request for Comment 2. (page 8)
The Commission should evaluate the "internal control structure" of Moody's solely through examination in which management and the board of Moody's Corp. demonstrate how implementation of this structure in 2002 would have produced more informed opinions regarding CDO, RMBS and SIVs.

Evaluation of annual reports will provide only marginal value. Moody's has ample resources to prepare impressive reports that address concerns of the Commission in theory and ignore them in spirit.

Section II.A.1. Request for Comment 3 (pages 8-9)
Intentionally blank.

Section II.A.1. Request for Comment 4.a. (page 9)
The controls in place are reasonably designed to ensure that changes to methodology are "subject to an appropriate review process." In practice, Moody's circumvents this intention entirely. The Credit Policy Group at Moody's has centralized review of all methodologies into its own compact body and does so in a very hands-on manner. Analysts from the rating sectors are the nominal architects of methodologies but must incorporate all comments from Credit Policy into their work. Credit Policy cannot be viewed as independent from "the persons that developed the methodology or methodology update." Rather, they are one in the same.

From 2008 onwards, Credit Policy imposed extremely conservative changes in all areas of structured finance to show that Moody's had learned from the past and adjusted its behavior. However, it has already begun moving along a reversal of the major 2008 change in the methodology for rating CLOs, i.e. removing the default stress of 30%. While other changes are also being proposed that offset the impact of removing this stress somewhat, Moody's estimates that most CLO classes will be upgraded by 1 or 2 notches should the proposed changes be implanted in their entirety. Unsurprisingly, CLOs represent one of the few viable asset classes rated by the Derivatives Group.

Credit Policy also affirmed an existing methodology for interest rate swaps in cashflow securitizations in October 2010. While several challenges suggested a more conservative treatment was warranted, changes would have made securitizations more expensive to issue and would have resulted in higher capital charges for the banks providing the hedges.

Moody's management cannot be trusted to approve methodologies. A committee process should approve new and updated methodologies and review existing ones. The committees should be constituted of analysts who will be applying the new methodology, managers and outside analysts to offer a broader view. This work will also be evaluated as described in *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process."*

Section II.A.1. Request for Comment 4.b. (pages 9-10)
A rating committee must retain complete discretion in forming an opinion, regardless of the status of the applicable methodology. The "credit rating process" flourishes only achieved when a committee forms an opinion that considers all information at hand, including shortcomings in the applicable methodology. Where the methodology is not under review, a committee opinion can signal that such a review is warranted.

The alternative is not to convene any committees until a methodology review has been completed. In this case, the private opinions of Moody's will diverge markedly from the public opinions that grow staler by the day.

This was the case with the multi-step RMBS downgrades in 2007. Derivatives analysts repeatedly complained that RMBS Monitoring was managing the downgrade process to occur in several steps, rather than in one massive action. The step-wise process in turn slowed down the resulting CDO downgrades.

Section II.A.1. Request for Comment 4.c. (Page 10)
It is necessary to periodically review methodologies in use, although the review should be conducted by committee as suggested in Request for Comment 4.a., above.

Section II.A.1. Request for Comment 4.d. (Page 10)
Each methodology should be associated with a permanently maintained, publicly available comment site to be used by all interested parties, including Moody's employees. Moreover, the responses by methodology committees, including the views of individual members who did not share the opinion of the committee, should be summarized on the site. Moody's should be required to make all "comments received as part of the consultation publicly available" in their entirety as received.

The contributor posts a real-world comment regarding a Moody's methodology above in *"G.27. Rating-Triggered Market Losses Incurred by a Bank Counterparty to a Securitization Transaction."*

Moreover, the controls above should meet a higher standard than being "reasonably designed." Failure by Moody's to comply should be one of the serious infractions that represent a non-working control function, and should be reported as such.

Section II.A.1. Request for Comment 4.e (page 10)
It is hard to argue against this point. However, the RMBS models prior to 2008 presumably still would have been implemented had this control been in place. Their baseline assumption that house prices would appreciate 4% each and every year for 45 years apparently worked just fine in the model.

Section II.A.1. Request for Comment 4.f. (page 10)
Ditto. The specious argument presented by Moody's that the scale of the fall in real estate prices was unforeseeable presumably would have been borne out by earlier backtesting of the run-up in real estate prices.

Section II.A.1. Request for Comment 4.g. (page 10)
It is hard to imagine the Credit Policy opining that such work was not done for a new asset class. It is even harder to imagine that the Compliance Department would opine that Credit Policy had not done sufficient analysis for a new asset class to be rated.

Section II.A.1. Request for Comment 4.h. (pages 10-11)
Ditto.

Section II.A.1. Request for Comment 4.i. (page 11)
The logic here is circular. In-use methodologies may keep ratings stagnant, in which case the ratings assigned at issuance will appear to have been "correct."

What is the rationale for retroactively reviewing "the work of the analysts employing the methodologies" following large downgrades? Opinions are formed by committees, not by individuals. Further, analysts might be inhibited from recommending in committee that a previous opinion be adjusted if doing so means they are to be punished.

The dismal quality of opinions formed by Moody's was attributable to management decisions, not the work of analysts. This proposal hands management another tool to evade responsibility for its failure to mitigate the conflict of interest at Moody's. The proposal also gives the Compliance Department more grounds on which to harass analysts.

The Committee Assessment Function described in *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process"* will address all aspects of an analyst's responsibility on an ongoing basis without introducing the specter of retroactive payback.

Section II.A.1. Request for Comment 4.j. (page 11)
A lead analyst presents a recommended opinion as part of her opening remarks in a committee. She does not "develop an initial credit rating" – only the tally of all votes forms an opinion. Each voting member, including the lead analyst, has one equal vote in forming the opinion.

As discussed in *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process"* the work of all members in committees, including the monitoring chair, the lead analyst and all other members, should be subject to evaluation by a Committee Assessment Function that reports directly to a board member of Moody's Corp, bypassing management completely.

Moody's cannot be trusted to evaluate committee work. In the experience of the contributor, Derivatives managers conducted themselves in committees as if their views were the only ones that mattered. It is for this reason that Moody's managers should not be allowed to vote in committees.

The Compliance department at Moody's should not have the ability to evaluate analysts on a subjective issue such as performance in a committee. This should be the role of the Committee Assessment Function.

Section II.A.1. Request for Comment 4.k. (page 11)
See Request for Comment 4.j. immediately above regarding committee memo and the recurring, erroneous assumption that an analyst develops "an initial credit rating."

Section II.A.1. Request for Comment 4.l. (page 11)
Ditto Request for Comment 4.j. in its entirety.
Section II.A.1. Request for Comment 4.m (page 11)
Please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Away Management Residue."*

Section II.A.1. Request for Comment 5. (pages 11-12)
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Section II.A.1. Request for Comment 6.a. (pages 13)
This is a dangerous provision to be applied to Moody's. The Compliance Department is itching to discipline Moody's employees and is quick to intimidate and harass any employee who does not submit to the marching orders of the week. The Human Resources Department backs management and is not credible as a function that protects the independence of analysts.

There is currently no oversight of the Compliance Department to check if employees are disciplined in a systematic fashion. What prevents the Compliance Department from disciplining one employee for an infraction that it overlooks in another?

Moody's Compliance Department Swings Both Ways for DPCs

The contributor was subject to attempts at discipline by the Compliance Department, which raised trumped-up charges against him in July 2009 and again in early 2010. Each incident dovetailed with a downgrade of Merrill Lynch Derivatives Products AG, a DPC for which the contributor was lead analyst and with which AIG was seeking to execute a large transaction.

Compliance standards differed for Doug Lucas, a senior manager who obtained not-yet-public information of three impending DPC downgrades in December 2009. Mr. Lucas had worked for Citi Swapco Inc., one of the three DPCs, and was meeting with his former employer as the downgrades were being processed for publication. The Compliance Department brushed off this complaint with the response that, as DPCs did not issue debt, there was no injury that could be caused.

Section II.A.1. Request for Comment 6.b. (page 13)
Please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Away Management Residue."*

Section II.A.1. Request for Comment 7. (page 13)
The Compliance Department will happily implement policies that serve as just so much more Window-dressing to impress the SEC and will document its fictional control structure to the extent asked.

Section II.A.1. Request for Comment 8. (page 13)
Please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Off Management Residue."*

29. Section II. A. Internal Control Structure 2. *Proposed Amendment to Rule 17g-2*

Section II.A.2. Request for Comment. Intentionally blank.

30. Section II. A. Internal Control Structure 3. *Proposed Amendments to Rule 17g-3(B)*

Let's Think About This – Are We Interested in Moody's Self-Assessment?

The Contributor is perplexed as to how the moral hazard of management assessing the effectiveness of its own internal control function can be avoided. It is for this reason that *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process"* suggests a new function to evaluate the contribution of members to committees over the course of a year reports directly to a board member of Moody's Corp. and bypasses management completely.

Section II.A.3. Request for Comment

Section II.A.3. Request for Comment 1. (pages 17-18)
Intentionally blank.

Section II.A.3. Request for Comment 2. (page 18)
All Moody's analysts and most Moody's management participate in committees. Therefore, managers are among the "personnel who use the policies, procedures, and methodologies for determining credit ratings." For this reason, the contributor advocates creating a Committee Assessment Function that reports to a board member of Moody's Corp. and bypasses management entirely. As advocated earlier, the Commission should canvass Moody's analysts as to the attributes of this control function beyond those forwarded here.

Even an honorable Compliance Department could not opine on the deliberations and voting of a committee. A Compliance Department can only verify that all material aspects of a committee are memorialized per the established documentation standards. The Compliance Department at Moody's should not be allowed anywhere near an actual committee.

As noted earlier, there is not a control function with respect to adherence to methodologies. A methodology does not ordain a Moody's opinion; rather it and many other factors inform a committee as it produces an opinion.

The senior-most management of Moody's Corp. oversees the Compliance Department and sanctions its harassment program. For this reason, a dedicated board member of Moody's Corporation must oversee the Committee Assessment Function and also report on the status of any employee who brings a complaint to the Compliance Department; brings a complaint against the Compliance Department or who comments on Moody's website regarding current methodologies.

A board member of Moody's Corp. should also interview each employee who has been disciplined by the Compliance Department on an annual basis, as described above in *"E.17. Bears Repeating – If There Be Only One Additional Rule, Let it Be This."*

Section II.A.3. Request for Comment 3. (page 19)
Intentionally blank.

Section II.A.3. Request for Comment 4. (page 19)
Intentionally blank.

Section II.A.3. Request for Comment 5. (page 20)
Please see Request for Comment 2. above.

Section II.A.3. Request for Comment 6. (page 20)
The Commission should clarify that the Committee Assessment Function is to address the performance of members in committees over the course of the entire year.

Section II.A.3. Request for Comment 7. (page 21)
The Commission should not set standards for the Committee Assessment Function. The assessment will necessarily be largely qualitative as corroborated by fellow committee members. Having the evaluation comprise a large part of the annual performance review of each analyst and manager will incentivize them to ensure the effectiveness of committees.

The Commission should first consult with an array of Moody's analysts in compiling "guidance on how an NRSRO must assess the effectiveness of the internal control structure."

Section II.A.3. Request for Comment 8. (page 21)
Please see Request for Comment 7. above.

Section II.A.3. Request for Comment 9. (pages 21-22)
Please see *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process."*

Section II.A.3. Request for Comment 10. (page 22)
Moody's management should certainly report fraud and significant errors. Moody's defines conflict of interest for the Derivatives Group so broadly that the definition lacks meaning.

Section II.A.3. Request for Comment 11. (pages 22-23)
Please see *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process."*

Section II.A.3. Request for Comment 12. (page 23)
Intentionally blank.

Section II.A.3. Request for Comment 13. (page 23)
Intentionally blank.

Section II.A.3. Request for Comment 14. (page 24)
Please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Away Management Residue."*

Section II. C. "Look-Back Review" 1. *Proposed Paragraph (c) of New Rule 17g-8*

"Look-Back" and "Review" Those Happy, Un-Conflicted Days at Moody's Investors Services

An analyst has not the means to "influence" a "credit rating" unduly, whether or not she has a "conflict of interest" however defined. An analyst possesses one equal vote in forming a Moody's opinion and is one of many voting and non-voting members who deliberate prior to voting the opinion.

The number of voting members of a committee determines whether the equal influence that each voting member has in forming a Moody's opinion is, in fact, outsized. For this reason, an additional rule requires Moody's to report the number of voting members (although not the tally of votes) in the press release that accompanies publication of a Moody's opinion. The more voting members, the less any individual voting member can "influence" an opinion. Please see *"E.21. Cite Total Number of Voting Members in Opinion Press Release."*

More to the point, the "conflict of interest" that "influences" the "credit rating process" at Moody's originates with managers who intend to stay at Moody's, not from the lucky analyst who manages to escape. Moody's managers do all they can to distort the "credit rating process" so as to extract opinions that support the Moody's earnings franchise and their individual compensation. Please see *"C. Moody's Enshrines Management Conflict of Interest in Opinion Formation"* generally and *"C.12.Moody's Stock Options Exacerbate Conflict of Interest, Particularly for Senior Management"* in particular.

As mitigation for this conflict of interest that stems from Moody's management, please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Off Management Residue."*

General Observation of Proposed Paragraph (c)(2) of New Rule 17g-8

No Moody's opinion is "solely a product of (its) documented procedures and methodologies" nor do these "determine credit ratings." Please see *"D. The "Credit Rating Process," Committees and the Distinction Between a Private and a Public Opinion"* generally and *"D.13. Published Methodologies Do Not Ordain a Moody's Opinion"* in particular.

For major overreaction by Moody's Compliance Department to non-existent analyst "conflict of interest" that had had no impact on subsequent Moody's opinion, please see *"J.36. Post-2008: Cozy Up to Regulators. Clear the Way for AIG. Blame, Blame, Blame the Analysts."*

Footnote 89 on page 42 of the Proposed Rules shows a particularly egregious misunderstanding of the "credit rating process." It cites the hypothetical case of an analyst who "upgraded the credit rating assigned to an issuer's securities…" No individual analyst, manager, or systems staff has the ability to "upgrade" a Moody's opinion. Only a committee issues a Moody's opinion.

Sections 11.C.1 and 11.C.2. Requests for Comment

Section II.C.1. Request for Comment 1. (pages 45-46)
Yes. The requirements in proposed paragraphs (c)(1), (2) and (3) will completely destroy the already ragged opinion formation at Moody's.

Moreover, the requirements will make analysts even more susceptible to the conflict of interest that arises simply from working at Moody's itself as it will leave them fewer opportunities for employment elsewhere. An issuer who risks watch status and possible downgrades for hiring an analyst who formed opinions on it will simply not hire someone else, leaving the analyst more beholden to Moody's management.

New challenges require new solutions. Why not revive indentured servitude?

Section II.C.1. Request for Comment 2. (page 46)
The Commission should definitely take a stab at defining "what it means to have a conflict of interest "influence" a "credit rating." It will find that the task impossible and, in so finding, will develop a better insight into the only salient conflict of interest that influences opinion formation at Moody's, that which arises simply from working at Moody's.

Section II.C.1. Request for Comment 3. (page 46)
Where there's a will to find a "conflict of interest" that can be pinned on an analyst, Moody's Compliance will find a way to do so. For major overreaction by Moody's Compliance Department to non-existent analyst "conflict of interest" that had had no impact on subsequent Moody's opinion, please see *"J.36. Post-2008: Cozy Up to Regulators. Clear the Way for AIG. Blame, Blame, Blame the Analysts."*

Section II.C.1. Request for Comment 4. (pages 46-47)
Please see Request for Comment 1. above, particularly with respect to "indentured servitude."

Section II.C.1. Request for Comment 5. (page 47)
Please see all of above in this "Section II. C. "Look-Back Review" 1. *Proposed Paragraph (c) of New Rule 17g-8."*

Section II.C.1. Request for Comment 6. (page 47)
The most useful piece of information that may be added to any press release that accompanies publication of a Moody's opinion is the number of voting members who formed the opinion. Please see *"E.21. Cite Total Number of Voting Members in Opinion Press Release."*

Section II.C.1. Request for Comment 7. (page 47)
Yes. The issue is a red herring. For suggestions in how to strengthen opinion formation at Moody's, please see *"E. Additional Rules: Hold Analysts' Feet to the Fire in Each Committee. Burn Away Management Residue."*

Section II.C.1. Request for Comment 8. (pages 47-48)
Ditto.

Section II.C.1. Request for Comment 9. (page 48)
Ditto. Please also see *"D. The "Credit Rating Process," Committees and the Distinction Between a Private and a Public Opinion"* generally and *"D.13. Published Methodologies Do Not Ordain a Moody's Opinion"* in particular.

Section II.C.1. Request for Comment 10. (page 48)
Ditto.

Section II.C.1. Request for Comment 11. (page 48)
Please see Request for Comment 7. above.

Section II.C.1. Request for Comment 12. (pages 48-49)
Please see all of above in this "Section II. C. "Look-Back Review" 1. *Proposed Paragraph (c) of New Rule 17g-8."*

Section II.C.1. Request for Comment 13. (page 49)
This is getting seriously tiring. Would someone please alert the Commission to the silliness of this entire proposal.

Or is the Commission seeking to wear out contributors, similar to bankers' attempts to wear out Moody's analysts as recounted in *"C.35. Pre-2008: External Paymeisters Come First, Last and Always. Analysts to be Seen, Not Heard."*

Section II.C.1. Request for Comment 14. (page 49)
The information proposed by the new paragraphs will be less than useless for users of Moody's opinions. The information will give the impression that a serious issue has been addressed, whereas the issue is an entirely fatuous one.

Please see "*E.21. Cite Total Number of Voting Members in Opinion Press Release"* regarding information of utility for external parties using a Moody's opinion.

Section II.C.1. Request for Comment 15. (page 49)
Please see Request for Comments 7. & 13.

Section II.C.1. Request for Comment 16. (page 50)
Please see Request for Comment 15.

Section II.C.2. Request for Comment 1. (page 51)
Moody's will happily document anything. Who cares?

31. Section II. F. Credit Rating Methodologies 1. *Proposed Paragraph (a) of New Rule 17g-8*

Give Compliance Lots and Lots of Busy Work. Keep It Well Away From Committees

A Moody's opinion should not be "determined using procedures and methodologies, including qualitative and quantitative data and models," regardless of who approves them. As discussed in *"D.13. Published Methodologies Do Not Ordain a Moody's Opinion"* a methodology informs a lead analyst in recommending an opinion; a methodology informs committee deliberations; a methodology informs each committee member as she makes her opinion and, in doing so; informs the Moody's opinion. A methodology does determine an opinion.

The Committee Assessment Function described in *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process"* will ensure that committee members protect each step of the "credit rating process" that begins anew with each committee.

The Compliance Department at Moody's should be restricted to checking that committee procedures are followed and that Moody's documentation policy is adhered to. In turn, two additional rules suggested will discourage the Compliance Department from harassing employees who act to protect the "credit rating process" in a manner at odds with management dictate. These additional rules are discussed in *"E. Additional Rules to Mitigate Impact of Management Conflict of Interest on Moody's Opinion 17. & 18."*

The first requirement will oblige the Compliance Department to report to a board member of Moody's Corp. the status of an employee who has made a complaint to the Compliance Department; has made a complaint against the Compliance Department; or has commented on a Moody's publicly available website associated with a Moody's methodology on an annual basis for five years. The second requirement obliges the Compliance Department to report on each employee who has been subject to a disciplinary proceeding in the preceding year.

A methodology is not prescriptive or all-encompassing. Methodological issues arise in each committee and each committee adds to the unpublished aspects of a methodology that inform future committees. There is no manner in which the board of Moody's Corp. can "approve" this process that augments a published methodology. This process occurs many times every day, each time that a committee forms a Moody's opinion. Avoiding over-reliance on published methodologies is discussed in "*D.13. Published Methodologies Do Not Ordain a Moody's Opinion."*

Describing how a committee used common sense to form opinions on PARCS/PYXIS and adjust the methodology informing the program without publishing on the topic, see *'F.25. Analysts Form PARCS/PYXIS Opinions Using Common Sense, Not Published Methodology."*

Regarding proposed paragraph (a)(2) of new Rule 17g-8 that implements 15E(r)(1)(B) of the Exchange Act, the Commission should not use text that mirrors the statutory text with respect to Moody's. Rather, the Commission should introduce text that directs Moody's to form a Committee Assessment Function as outlined in *"E.22. Committee Assessment Function - Analysts Police All Aspects of the "Credit Rating Process"* as well as introduce additional rules discussed in the remainder of *"E. Additional Rules to Mitigate Impact of Management Conflict of Interest on Moody's Opinion."*

Regarding proposed paragraph (a)(3)(i) of new Rule 17g-8 of the Exchange Act, Moody's cannot "ensure that when material changes are made to credit rating procedures and methodologies (including qualitative and quantitative data and models), the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply."

To start, the "qualitative" aspects of "credit rating procedures and methodologies" cannot be "applied consistently to all credit ratings to which the changed procedures and methodologies apply." Qualitative assessments vary from committee to committee. Each qualitative assessment is unique to the committee that forms it.

Moody's cannot speak to the application of quantitative aspects of changed "credit rating procedures and methodologies." Each committee applies these changed aspects as it sees fit.

Section II.F.1. Request for Comment

Section II.F.1. Request for Comment 1. (page 133)
No. Please see all comments above and "*D.13. Published Methodologies Do Not Ordain a Moody's Opinion."*

Section II.F.1. Request for Comment 2. (page 133)
Ditto Request for Comment 1.

Section II.F.1. Request for Comment 3. (page 133-4)
Ditto Request for Comment 1.

Section II.F.1. Request for Comment 4. (page 134)
Ditto Request for Comment 1.

Section II.F.1. Request for Comment 5. (page 134)

Section II.F.1. Request for Comment 6. (pages 134-135)
The Commission should not prescribe the amount of time to elapse between the adoption by Moody's of material changes to procedures and methodologies and the time of subsequent rating actions. A prescription of a

maximum amount of time would have the unintended incentive for Moody's to delay the adoption of a material change until it could be sure of subsequent compliance.

Section II.F.1. Request for Comment 7. (page 135)
With respect to Sections 15E(r)(3)(B-D), Moody's should publish such changes to "credit rating procedure" or "methodology", reason for the change and impact of the change on two sites on its website. Moody's should maintain a dedicated site for all such changes in all rating sectors. Additionally, Moody's should also publish across the same information on the publicly available website dedicated to the applicable methodology, per *"G. This Proposed Rule is a Keeper! Moody's to Maintain Public Comment Site for Each Methodology."*

Section II.F.1. Request for Comment 8. (pages 135-136)
Intentionally blank.

Section II.F.1. Request for Comment 9. (page 136)
Reference to published methodologies has given Moody's a defense for having formed such poor opinions on CDOs and RMBS. The methodologies are "freely accessible" and "transparent." Any failure lay with the external party using a CDO or RMBS opinion, not Moody's in forming them.

See also General Observations above.

Acid Test: Impact of Proposed Paragraph (a) of New Rule 17g-8 if Implemented in 2002

It may be argued that the spirit of the proposed paragraph was in force from 2002 onwards. Management focused on uniformity and consistency in evaluating CDOs. As CDOs were constantly being issued, the banker for each CDO claimed the right to piggyback off poor precedents that had either recently been issued or was still being rated. Management consoled analysts that they would improve matters on a subsequent CDO.

Opinions on CDOs and RMBs prior to mid-2007 were hollow for the reason that they had for some number of years applied existing "credit rating procedures and methodologies" in a completely uniform manner, per management diktat.

Each RMBS analyst operated the same RMBS model that simulated the annual change in U.S. housing prices over the 45-year legal life of a transaction around a baseline 4% appreciation for each and every of the 45 years. Each RMBS rating team performed exactly the same amount of due diligence on the underlying residential mortgages.

Each Derivatives analyst operated a Moody's model that embedded the same correlations among types of ABS. The correlations were specified in 2000 when CDOs of ABS contained many types of different ABS assets and were still in use in 2006-2007 when CDOs of ABS contained primarily mortgage-based assets. Management uniformly opposed suggestions in individual committees that reliance on these methodologies be tempered. A committee that formed an opinion that was even one notch lower than that indicated solely by reference to model results was affording itself unacceptable discretion and would not have been applying methodology "uniformly."

Moody's management sided with CDO bankers in acceding to full adherence to published methodologies against analysts or committees who argued that the case at hand did not warrant such rigid adherence. Suggestions that stresses should be added to a transaction in which one type of structured finance overlapped another were rebuffed by bakers and mangers alike as an admission by Moody's that it did not believe its own ratings.

32. Section II. G. Form and Certification to Accompany Credit ratings

1. Paragraph (a) – Prefatory Text
Intentionally blank.

2. Paragraph (a)(1)(i) – Format of the Form
Intentionally blank.

3. Paragraph (a)(1)(i) – Content of the Form
Please see *"E.22. Cite Total Number of Voting Members in Opinion Press Release."*

The contributor does not have a view as to which paragraph will contain the number of committee members who voted an opinion.

33. Section II. I. Standards of Training, Experience, and Competence 1. Proposed New Rule 17g-9

Analyst Competency Demonstrated in Committees, Not in Compliance Testing Labs
An analyst who is "competent" in discharging her responsibilities in the "credit rating process" possesses the character to form her opinion a committee in as rigorous manner as possible and to vote the same as Moody's opinion. Working backward from this final step in the "credit rating process," a "competent" analyst will challenge the views of other members of all title in committee and will do the same in communicating with external parties prior to convening in a committee. A competent analyst will continually assess the utility of methodologies that inform the committees in which she participates. She will also speak up and lodge complaints when she believes that the "credit rating process" is not functioning as it should.

A "competent" analyst may possess any of a myriad of combinations of professional and educational qualifications. Without the character to act as described above, however, no combination of professional and educational qualifications will render an analyst "competent," regardless of how much training she undergoes.

The Committee Assessment Function recommended in *"E.22. Committee Assessment Function -- Analysts Police All Aspects of the "Credit Rating Process*" will evaluate "competency" in the "credit rating process" and reward analysts who form opinions vigorously and vote them. Periodic testing of analysts on their "knowledge of the credit rating process" will reward "incompetency" in its suggestion that opinion formation in committees is a linear, rule-based process subject to a static body of guidelines.

Periodic testing also offers management another avenue through which to harass and intimidate analysts.

Section II.I.1.a. Request for Comment

Section II.I.1.a. Request for Comment 1. (p218)
Individuals do not "produce…credit ratings," accurate or otherwise. Hence there is no standardized training that can achieve this goal, although Moody's management pretends otherwise. *Per "E.22. Committee Assessment Function --* *Analysts Police All Aspects of the "Credit Rating Process*," the Committee Assessment Function will design training regarding performance in a committee and in earlier steps in the "credit rating process," but these responsibilities are general ones that do not lend themselves to evaluation through ongoing testing. Rather, the Committee Assessment Function will evaluate committee performance directly through ongoing observation of committee duties.

The Commission may wish to interview junior analysts at Moody's to understand their thoughts regarding training and the best means for them to absorb its lessons. It is not apparent to the contributor that test results will correspond with performance in committee. The Commission may also wish to interview the Moody's management regarding the mix of analyst seniority, i.e. junior, mid-level and senior, that it considers optimal in staffing individual rating practices.

Moody's Training Rejuvenates!

Moody's has instituted a training requirement for analysts to fulfill on an annual basis. The outcome has been a return to high school, where attendance is kept and analysts are warned that they will be marked "not present" if they leave early a training session early (Bathroom breaks are okay.)

While analysts are physically present, they are generally absent in mind as they chat and catch up on electronic communications. Most entertaining are training sessions held in computer labs, where analysts peruse screens of interest until the trainer begins walking around the lab. Presto, the training materials materialize on each screen simultaneously, a feat of synchronicity best appreciated from the back row.

High school is exactly where Moody's management seeks to locate its analysts, smack in the middle of junior year where the focus on grades is at its most acute. Analysts can preen in committees, occasionally convince others of their views and introduce topics of philosophical interest, but they should not vote an opinion unless it has been sanctioned by their minders.

Post-committee, analysts may express themselves on any aspect of the "credit rating process" as sardonically as they choose. After all, Moody's is in the business of forming opinions! But a wise analyst will exercise this liberty only in private and only among a trusted few. Senior year and college recommendations still lie ahead.

Section II.I.1.a. Request for Comment 2. (pages 218-219)
Intentionally blank.

Section II.I.1.a. Request for Comment 3. (page 219)
Intentionally blank

Section II.I.1.a. Request for Comment 4. (page 219)
There are few areas of technical expertise that are relevant across the range of rating sectors within Moody's,

aside from those that Committee Assessment Function can cover in a few sessions. Most training sessions at Moody's have no bearing on the daily responsibilities of analysts, and the analysts respond accordingly. It also goes without saying that no training sessions contain content that is critical of the management of Moody's or Moody's Corp and none address the management failures that produced the hollow opinions on CDOs and RMBS of the last decade.

Comparisons to training for other professions are fatuous. Attorneys, doctors and auditors abide by highly prescribed codes, standards and best practices that are formed by external bodies and that are observed by each practitioner. In contrast, training and testing on the "credit rating process" at Moody's will fix the analysts' minds firmly on the navel of the company, leaving their bodies to follow management wherever it is leading on the day.

Section II.I.1.b. Request for Comment

Section II.I.1.b. Request for Comment 1. (p219)

Committees in the Derivatives Group require expertise in all four of the factors on a collective basis but do not require it to the same extent in each member on an individual basis. Indeed, that would be impossible.
An informed opinion considers the views of attorneys, analysts versed in the operations and specification of models and other analysts with experience across several sectors. Typically, junior analysts present model output from a range of scenarios and describe the inputs of each, conveying insight as to the sensitivity of the opinion to different factors. Legal analysts and technical analysts assess the conformance of modeling treatment with the parameters contained in legal documentation. The two types of analysis are necessarily intertwined and lead both analysts to an understanding of the other's approach.

Senior analysts discuss the opinion from a wider perspective, drawing on experience with a range of sectors, models and legal structures and on the limits to their analysis in the absence of qualitative assessments. Sectors that use highly quantitative modeling in particular must guard against tendencies to treat model results as absolute and inviolable. Senior analysts also probe the rating team on its subjective experience in forming the recommended opinion and on any items that leave them discomfited.

Section II.I.1.b. Request for Comment 2. – 5. (pages 222-224)

Intentionally blank.

Section II.I.1.c. Request for Comment

Section II.I.1.c. Request for Comment 1. (page 227)

Periodic testing of analysts will implement Section 936(2) of the Dodd-Frank Act if that section directs Moody's management to ratchet up the intimidation and harassment of analysts.

Why Exactly Would One Become a Moody's Analyst?

Let's piece together a testing requirement with other Proposed Rules and current practice at Moody's. Credit Policy will lay down methodologies and specify models. Compliance will test analysts on the content of these methodologies and models and inflict punishment on those who fail. Senior managers will ensure that the tested items are absorbed wholesale into each committee opinion and, when these initial opinions are revised to a considerable degree at a later date, analysts are punished again!

Has the Commission reflected on why one would choose to embark on a career as a Moody's analyst? Will implementation of the Proposed Rules raise the caliber of those seeking to become analysts?

If the intention is to inflict a pox on all who dwell at the House of Moody's, fair enough. Most houses in the country are pockmarked, there is no reason that Moody's should remain pristine. But a pox only on the analysts? Has Moody's management earned an inoculation against all pox?

Section II.I.1.c. Request for Comment 2.
Please stop with the testing. Just stop and walk away.

Section II.I.1.c. Request for Comment 3.
Requiring that at least one member of a committee at Moody's have at least three years of experience working in Moody's committees is sensible. Other experiences in assessing credit should not serve to fulfill this requirement. Performing credit analysis elsewhere is not based on the one member/one vote used to form a Moody's opinion.

CDO Wizard Confers Magical Powers Upon All in the Derivatives Group

Management in the Derivatives Group led committees to form the most hollow of opinions on certain CDOs by conferring upon very junior analysts the "expertise" to assess them.

The 2006 training session on how to evaluate multi-counterparty, hybrid synthetic/cash CDOs of ABS ("M-CHS/C CDOs of ABS") lasted less than two hours and ties together neatly the themes of "training" and "experience" under Proposed New Rule 17-g9.

No amount of subsequent training could have compensated for the decision by Moody's management to hire junior analysts with little experience and to assign them as lead analysts for the most complicated of CDOs. Were the junior analysts who were hired expressly for their lack of experience to be penalized when test results subsequently revealed them to be, um, inexperienced? Should management have awarded itself a performance bonus for having exceeded its hiring metrics?

Ungrateful Mini-Merlin Wants a Different Kind of Powers. Hold the Mini-Muffins!

In late 2009, the management of the Derivatives Group refused outright to consider a request that they organize a training session on how analysts might deal with difficult bankers. The long-standing CDO policy that an analyst endures all that a banker doles out (and likes it, too) was a venerated one and it was not changing. What ain't broke don't need fixing.

The analyst made this request during a mandatory "open forum" in which each and every Derivatives analyst was called upon in turn to parrot the view that training in dealing with external constituents was very important. The analyst was working with a very difficult banker and was just fleshing out exactly which external constituencies were under discussion.

The Derivatives managers had a different external constituency in mind. The correct request was for training on how to pitch the "new, reformed, and relevant" Moody's when cold calling investors for just this purpose. Each and every analyst was expected to know the correct answer and to endorse it. That was the purpose of an "open forum."

The Derivatives analysts were fortunate. Each was to transform herself into a "sell-side" analyst and establish her own distinct brand. Moreover, Moody's would train her in how to do so! An analyst who didn't acknowledge the magnanimity of this gesture was her own worst enemy. Management couldn't help her.

A particular complaint to rebut when cold calling was the recurring one from the CLO sector that a 30% default stress had been arbitrarily implemented by Moody's to demonstrate what a rugged rater it had become. This same 30% default stress will be discarded in the imminent CLO methodology update that recognizes the accumulating, incontrovertible evidence of sustained economic vigor in the United States. CLO upgrades all around!

34. Section VI. Consideration of Impact on the Economy

The Commission must advise OMB that the Proposed Rules constitute a "major" rule for the purposes of the Small Business Regulatory Enforcement Act of 1996 ("SBREFA").

"Under SBRFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease)."

Existing practices at Moody's have cost the economy $765 billion since 2008. The Proposed Rules promise that a similar cost will be incurred in the next 7,650 years. Amortized, this outcome will result in the decrease in the economy of $100 million per annum.

As a "major" rule, the effectiveness of the Proposed Rules should be delayed pending Congressional review.

J. Moody's Policies - Insinuate Itself into Good Graces of External Taskmasters, Clamp Down on Analysts

35. Pre-2008: External Paymeisters Come First, Last and Always. Analysts to be Seen, Not Heard

The contributor was left to his own devices to produce quality work and strategized relentlessly on how to do so. Each workday consisted of non-stop ducking and weaving so as to hold firm against the unrelenting pressure from bankers, issuers and management. In one annual review, the contributor mentioned that doing the good job for which he was recognized was taking a toll. Managers replied that they were sorry, that should not be the case, but they did not readjust their priorities.

Moody's incentivized an analyst to accede to all items demanded by an external paymaster and to work to the paymaster's schedule. Self-respect was the prime barrier that kept the contributor and other Derivatives analysts from being agents in the degradation of their own work.

Raising an issue to one's manager inevitably resulted in a series of phone conversations with a banker, her bosses, issuer and outside counsel on one side and the contributor and fellow analyst on the other side. The manager presided, trying to broker an agreement. Sometimes, the manager treated the views of each side as equally valid. More often, the contributor and colleague began on the defensive and stayed there throughout the call. The analysts argued their corner as effectively as possible while their manager remained silent egging on the rating team to fold.

Putting up a spirited effort before caving-in made analysts look good in the eyes of management. Opposing a banker or issuer brought only trouble from Moody's senior management. It also inevitably ensured that the parties would re-convene on the following day for a heated reprise. The banker and Derivatives manager would each be joined by still more of her managers, leaving the two members of the rating team even less leverage to maintain their position.

Holding the line on these calls required preparation and a determined state of mind. Bankers and issuers were willing to have as many calls a day as were necessary to wear a rating team down. A manager often opened the door for the analysts to let go of an issue that the same manager had presented in a group meeting as vital to implement with no compromise.

Not once in eleven years did a manager ask if the contributor was analyzing an issue with sufficient rigor. Nor did management in a single instance suggest that a harder stance should be adopted towards a banker or issuer.

Prior to 2010 the contributor received very high ratings for his ability to work on difficult transactions and for his analytical capabilities. He would not have remained at Moody's otherwise. Yet, formal feedback in annual reviews centered on the recurring themes that the contributor should make life easier for bankers and issuers and that he should be more alert to the bottom line. Management cautioned the contributor that he had been lucky in that concerns he had raised emphatically had in fact materialized. One day he would be wrong and then he would be wrong on his own. The contributor was told to offer solutions to bankers and issuers in areas where he was well-versed, rather than continue his practice of simply identifying shortcomings. Management would like the contributor to become the public face of one of the new structured finance methodologies so as to market the capabilities of Moody's. Each year, the contributor was compelled to defend time spent on monitoring DPCs at the expense of rating new CDOs and monitoring existing ones.

Informal assessment followed along the same lines. A recently-promoted managing director let the contributor know that a senior manager had accused the contributor of killing deals. A banker had come to Moody's to preview a CDO with the ability to invest in the local currencies of 100+ countries. The contributor, who had been a currency trader and a currency analyst prior to joining Moody's, pointed out that, for a start, many of the currencies were not tradable. They were units of measurement used in compiling national accounts.

Pointing out shortcomings in a preview meeting was critical to preserving the integrity of a CDO opinion down the line. CDO bankers routinely cited that they had obtained management buy-in in preview meetings when refusing to consider comments made by a rating team. *Maybe*, the banker would open discussions on the topic in a subsequent CDO, but not at the late stage of the current one. Taking pre-emptive action so that an analyst would not start from this losing position was in the view of one senior manager "killing deals."

Feedback from senior managers to the contributor consistently took the form of intimidation. Brian Clarkson employed this approach, stationing himself in a well-traveled hallway with a checklist of complaint ready for whichever analyst happened by. In one instance, Mr. Clarkson expressed regret that the contributor had completed methodologies that were comprehensive and fully documented. In fact, the contributor had done exactly that to keep senior management from diluting a methodology for the sake of more business.

DPC Was "Black Hole" in the P&L of Managing Director

Bill May, Managing Director for DPCs until 2009, repeatedly bemoaned that monitoring a certain DPC required so much of the contributor's time. According to Mr. May, the DPC was a "black hole in my P&L."

The contributor estimated that monitoring a DPC properly was the equivalent of rating two new CDOs per year. The contributor devoted the full amount of time that he believed was necessary to monitor each DPC. Moody's may have cut a bad deal in setting monitoring fees for DPCs, but that did not mean that the contributor should degrade his own work nor shortchange the external users of DPC ratings.

The hole that an individual DPC might have rented through the P&L of Mr. May was not a deep one, except in comparison to the 90% margin that was earned on each CDO.

Moreover, at least 15 DPCs were paying annual monitoring fees to Moody's at the time that the contributor joined the Derivatives Group in 1999. In turn, Moody's allocated exactly *zero* resources to monitoring the majority of these DPCs. Collectively, the DPC sector was earning the benchmark 90% that Moody's had penciled in for the Derivatives Group.

Court the Bankers. Embrace the Bankers. Love the Bankers. Never, Ever, Harm a Banker

Sometime in 2003-2004, Clarkson mentioned that he had heard the contributor had given a "hard time" to Geoff Witt, a Merrill Lynch banker. The contributor was lucky that the banker had been Geoff Witt," otherwise…" The contributor was surprised as the call with Mr. Witt had occurred some considerable time earlier but said nothing and kept walking.

The ABS Group of Moody's regarded Geoff Witt as among the most obnoxious of bankers, a very impressive designation given the competition.

"Giving a hard time" to Mr. Witt consisted of the contributor explaining in an extremely polite manner that a trade being proposed for Merrill Lynch Derivative Products AG was in conflict with Moody's methodology for DPCs.

The contributor was extremely careful in making his points on the conference call as he was speaking alone from his office and could not gauge the reactions of his ABS colleagues also on the call. (After the call, the ABS analysts offered that they had rolled their eyes whenever Mr. Witt spoke.)

The warning brought home that Mr. Clarkson was yet one more obstacle among the very many whom around whom analysts must duck and weave on a daily basis simply to do their jobs correctly.

Making It All Up: Moody's Methodology for Structured Investment Vehicles ("SIVs")
In 2005, a Derivatives analyst led a session on the Moody's methodology for SIVs in a computer lab. Each analyst operated a program that determined SIV haircuts for a range of assets.

The training session left the contributor confused. The SIV methodology remained inaccessible despite the explanations and the hands-on training. As the contributor was not as quantitatively gifted as his PhD colleagues, he assumed that he had missed something. After the session, the contributor asked if a colleague shared the impression that something wasn't adding up. The colleague replied that nothing about SIVs added up. In rating SIVs, analysts ran the SIV tool and presented the output to Henry Tabe, their manager. Mr. Tabe then disregarded the output and made up haircuts that were palatable to SIV issuers.

The contributor added SIVs to the growing list of asset classes to be avoided at all costs.

Management Launches Personal Attacks on Mark Zandi

The contributor and Mark Zandi spoke at the entrance to Moody's in the summer of 2008. They had been colleagues together 20 years earlier at the WEFA Group, an economic consultancy, along with Paul Getman and Karl Zandi, Mark's brother.

The contributor had followed the progress of his former colleagues after they left The WEFA Group to found their own firm and took note in 2005 when the firm was acquired by Moody's Corp. At that time, Mr. Zandi's forecasts were very bearish on both the U.S. economy and the outlook for U.S. real estate, particularly in comparison to forecasts of other economists. The contributor had long wondered how Mr. Zandi's forecasts, which were so unsupportive of Moody's RMBS franchise, had gone down with senior management.

The chance meeting in 2008 was an opportunity to find out. Mr. Zandi related that, for some period of time after being acquired, Moody's management had unleashed an onslaught of criticism of his forecasts. Mr. Zandi added that, in his view, some of the criticism by management felt like personal attacks.

Mr. Zandi finished by saying that, as his U.S. forecasts subsequently materialized (18 months later), he had built so much external credibility that "now they (Moody's management) can't say anything."

<u>BH Notes Regarding Mark Zandi and Economy.com</u>

1. The germane question is not, "Why didn't Moody's use the Zandi forecasts in its RMBS models?" as asked at the second FCIC session on rating agencies. Rather, the pertinent question is, "What factors enabled Mr. Zandi to preserve his independence after being acquired?"

2. Had the RMBS model incorporated Mr. Zandi's forecast for house prices, management would have undone its effects elsewhere in the RMBS model and in RMBS committees. When the fix is in, the fix is

in. The means are secondary.

3. Moody's senior-most management at time that the "personal attacks" were launched on Zandi is still largely intact, notably Ray McDaniel, John Goggins, Andy Kimball and Michael Kanef.

Two Paymeisters Balk at Application of CLO Methodology to Fortress Credit Investments. That's OK!

In spring 2006, the contributor and another senior analyst were assigned as quantitative analyst and legal analyst, respectively, for Fortress Credit Investments.

Natixis was the arranging bank, with Will Fischer as primary contact for the Moody's Team. Mr. Fischer was not an alumnus of the Derivatives Group at Moody's but David Powar, his supervisor, was an alumnus. The transaction was a hybrid Middle Market Loan/CLO with Fortress as collateral manager.

The two Derivatives analysts asked each other repeatedly "who do the bankers and manager have a call into at Moody's?" Almost every comment offered by the team met with resistance from Mr. Fischer and resulted in a conference call with Bill May, the Managing Director for CLOs, Mr. Fischer, Mr. Powar and the rating team. As the Pricing Date neared and the list of unresolved issues grew, the conference call attendees also included Gus Harris, the Team Managing Director and the principal from Fortress.

Mr. May appeared increasingly nervous as the Pricing Date approached with many items still being contested by Natixis. In contrast, Mr. Harris dove right in as broker between the rating team on one hand and Natixis and Fortress on the other. The important thing was to keep the process on track. Neither Mr. May nor Mr. Harris backed the rating team in trying to hold the line against the aggressive manager and bankers.

The CLO was upsized in 2007 on identical terms which the rating team warned Natixis would not be accepted in future deals. The warning proved hollow. Few CLOs were issued after the summer of 2007.

Natixis had submitted a capital structure that was way out of bounds, with proposed ratings that were three notches higher than those shown in the contributor's model. Responsibility for reconciling the two models lay squarely with the contributor. Instead of simply telling a banker that her proposal would not attain the proposed ratings and to try again, the analyst was expected to identify and rectify the banker's error.

The contributor needed a few days to find that the Natixis model incorporated an out-dated assumption that had not been part of Moody's methodology for five years. Mr. Fischer and Mr. Powar of Natixis objected vociferously to changing the capital structure. They ultimately made adjustments which brought the model results closer in line to the proposed ratings, but which did not meet the standards to which other CLOs were held. Mr. May and Mr. Harris had introduced the uniform standards for CLO model results, but raised no objections to the weaker results for the Fortress CLO. They simply asked if they were acceptable to the contributor.

The contributor's colleague had similar experiences in conducting legal analysis. Very basic provisions were absent in the governing documents and Natixis resisted suggestions that the deficiencies be remedied. On the daily, hastily arranged, emergency conference call with Natixis, Mr. May and Mr. Harris asked if the legal analyst approved of the documentation, even though the documentation omitted points that the same managers had insisted must be present in all CLOs.

Observations Regarding Fortress Credit Investments

1. External parties who directed deal flow to Moody's were its most important constituents. This held true whether the external party was a banker or a CLO manager and also whether the external party had worked at Moody's or not.

2. For instance, Mr. Peter Sallerson and Mr. Richard Eimbinder, formerly of Bear Stearns, had a pipeline of CDOs to rate and had enormous influence with Gus Harris, a Managing Director in the Derivatives Group. Neither Mr. Sallerson nor Mr. Eimbinder had previously worked at Moody's.

3. The contributor did not rate any more CDOs after Fortress Credit Investments and was extremely happy to have extricated himself from the sector.

Would That a Moody's Methodology Had Remained Safely Opaque

Again in a hallway, Mr. Clarkson mentioned in almost a forlorn manner that when he had nominated the contributor to investigate bankers' complaints regarding the provision of interest rate swaps to cashflow securitizations, he hadn't intended for the contributor to produce a comprehensive methodology (the "Hedge Framework.")

The contributor thought "tough, the methodology is published and is intentionally comprehensive, as it is used in almost all cashflow securitizations around the world."

The contributor intended from the outset to frustrate Clarkson and other senior managers in their quest for a watered-down methodology that would appease bankers.

The Hedge Framework had systemic implications as it contained a major assumption that supported the securitization market for many asset types. In modeling these securitizations with an interest rate swap or currency swap, all three rating agencies assumed that the counterparty would always pay all amounts owed under the swap and never cause the securitization to incur unforeseen costs.

The contributor and colleagues worked hard and tactically to circumvent the obvious goal of Clarkson and other senior managers to produce a degraded methodology.

Moody's affirmed the Hedge Framework almost in its entirety in October 2010. Prior to leaving Moody's, the contributor argued that the Hedge Framework should not be re-affirmed but should address challenges that had emerged both in the legal arena and in the transactional one. These challenges are discussed *in "G.27. Rating-Triggered Market Losses Incurred by a Bank Counterparty to a Securitization Transaction"* which demonstrates implementation of the Proposed Rule that directs a rating agency to maintain a publicly accessible website associated with each methodology.

"Staying Involved" with Credit Derivative Product Companies ("CDPCs")

In 2006-2007, the contributor and a senior colleague were the quantitative analyst and legal analyst, respectively, for a proposed CDPC that was sponsored by Bear Stearns Asset Management ("BSAM"). The credit default swap offerings of the BSAM CDPC were ambitious and required significant analysis and investigation.

The BSAM team was respectful in its dealings with the rating team, but repeatedly made the point that Moody's lagged behind S&P and Fitch. BSAM cautioned that, while it would like to continue working with Moody's, it closed without Moody's, doing so would be difficult.

The team reported to Yvonne Fu, MD for CDPCs, that the warning had become acute. S&P and Fitch were preparing to assign provisional rating to the BSAM CDPS, whereas Moody's was not ready to do so. If provisional ratings were assigned, Moody's would be left far behind and potentially dropped altogether. Ms. Fu, in turn, passed the message to her supervisor, Yuri Yoshizawa. Ms. Yoshizawa relayed via Ms. Fu that Moody's should "stay involved" in some part of the capital structure of each CDPC.

Revenues were not the issue. Ms. Fu explained that rating CDPCs was a "service" to their sponsors. These sponsors were important to the overall Moody's franchise as active issuers of CDOs and RMBS. Management did not want to damage the overall relationship with these issuers over the small CDPC sector. "Staying involved" with each CDPC by rating some part of its capital structure kept management on sides with the issuers and preserved opportunities should the CDPC sector grew more important in the future.

Ms. Fu directed the rating team to press on with BSAM, to see if enough analysis could be completed to warrant a provisional rating for the BSAM CDPC, even if the analysis fell short of that which was usually required.

The contributor is proud of his work with SFOCs (largely DPCs and CDPCs), that of his colleagues in SFOCs and the manner in which SFOC committees were conducted throughout his tenure. In short, Moody's said "no" in this sector more often than it said "yes."

However, the contributor has come to realize that the SFOC rating teams were not subject to the same relentless management pressure as the CDO teams. The SFOC sectors were viewed as servicing important external constituents rather than as profit centers to be exploited to the hilt.

Isn't She Lovely? – Getting to Know Ms. Pamela Stumpp

In 2007, the Team Co-Leader of SFOCs was assigned Pallium Investment Management LLC ("Pallium"), a CDPC.

Ms. Pamela Stumpp, a Managing Director/Chief Credit Officer Corporate Finance of Moody's prior to joining Pallium, often took the lead in communicating with the senior colleague of the contributor. Ms. Stumpp did not work in the area of Derivatives while at Moody's and was largely unknown to the Derivatives Group prior to joining Pallium. After joining Pallium, Ms. Stumpp became known by a substantial portion of the Derivatives Group. That may have provided some solace given that Pallium was stillborn despite incessant attempts at revival. Other Pallium personnel in communication with Moody's were Mr. Conrad Voldstad and Dr. Flavio Bartmann.

The analyst offered at a very early stage that in his opinion, Pallium was not ratable by Moody's. The central premise of Pallium was that it would post collateral against the mark-to-markets of credit default swaps that it had written. The analyst observed that the obligation to post collateral was unlimited, given the unbounded nature of mark-to-markets for credit default swaps. However, the collateral that could be posted against the unbounded mark-to-markets was limited to the real assets of the company, which were finite and unlikely to be augmented in the future.

A committee shared the analyst's opinion which was duly communicated to Pallium. Additionally, the analyst let Pallium know that he had no more time for the CDPC. Given his workload and that of the CDPC team, he could focus only on issuers with a viable chance of being rated.

Almost immediately, some element of Moody's senior management relayed the message that work was to resume on Pallium. Yvonne Fu, a Managing Director in the Derivatives Group let the analyst know that this was to be the case and that Ms. Stumpp was to be heard out. The analyst endured a great deal of communication with Ms. Stumpp and her Pallium colleagues, sometimes in person at Moody's offices.

This mysterious order from senior Moody's management proved a standing one. In the following months, Ms. Stumpp responded to rebuttal by the rating team by insisting that Pallium had yet another solution that she would like to convey in person. However, it was obvious to the analyst that Ms. Stumpp had nothing to add to the proposal. His initial opinion as to why Moody's could not rate Pallium remained valid. The obligations of Pallium were unbounded and its capital assets were finite.

The calls from senior Moody's management ensnared not only the Pallium analyst. Over time, Ms. Fu, Nicolas Weill of Credit Policy and several other analysts were dragged in. All opined that the Pallium proposal was not viable, was wasting their time and did not understand why they were forced to keep responding to it.

Notably, Ms. Fu did not insist to her superiors that the work on Pallium should cease so that the team could better meet its other responsibilities. The Derivatives Group was expected to march for as long as senior management directed.

Pallium dragged on and on and was never rated by Moody's.

<u>Observations from Getting to Know Ms. Pamela Stumpp</u>

1. Ms. Stumpp may well contend that she has never met nor heard of the contributor. That is exactly the point. The pull that Ms. Stumpp had with senior management ensured that many persons who were unknown to Ms. Stumpp wasted their time on Pallium.

2. Likewise, the contributor had never heard of Ms. Stumpp prior to being dragged into Pallium.

36. Post-2008: Cozy Up to Regulators. Clear the Way for AIG. Blame, Blame, Blame the Analysts.

Moody's In The Community – RMBS Managers Learn About Compliance and Get Paid for It, Too!

Moody's has conducted an in-reach program that has placed managers from disadvantaged RMBS backgrounds into control functions where they can explore their latent interests in Compliance or Credit Policy. One fellow completed his Compliance internship with a special project to identify former colleagues in the Derivatives Group who seemed dubious as Compliance was explaining its latest policies. He has been a manager in the Sovereign Group since spring 2011.

The Compliance Department tried to reverse a committee opinion on a DPC with which AIG was planning a transaction by searching for infractions that could be attributed to the contributor.

RMBS/Compliance Out-Does Regulators by Building Potemkin Village

Item 1. May 2009

Group Managing Director Yuri Yoshizawa asked 3 SVPs, including the contributor, to assume selected managerial responsibilities within the Derivatives Group. Each SVP was given responsibility for 6 or 7 Derivatives analysts.

Item 2. May 2009

Compliance Department unveiled the new Trading Policy applicable only to the Derivatives Group. A "restricted list" of approximately 3,000 financial entities became off limits for investment by those in the Derivatives Group.

A June 2009 timeline was set for Derivatives employees to divest themselves of all exposure to any name on the restricted list. Many analysts had exposure in tax-advantaged accounts, such as 401Ks or IRAs. If analysts wished not to divest, they could transfer their holdings to a blind trust that would be reviewed by Compliance for conformity to the Trading Policy. Analysts would bear all costs in designing and establishing a blind trust – no guidance was offered by the Compliance Department.

Derivatives analysts -- including the contributor -- peppered Compliance officers with questions at the roll-out meeting. Why was this policy being implemented when it bore no relation to the poor opinions that had been formed on CDOs? How would the Trading Policy prevent poor opinions from being formed in the future? Why was the restricted list much more exhaustive than that requested by the SEC? Would analysts who incurred the costs of complying with the Trading Policy be guaranteed a job after having done so? What trading policies applied to Ray McDaniel and other senior managers?

Gail Weiss, the lead Compliance officer, derided these questions and questioners by stating, "Have you read the *New York Times*?" (Please see 4.a below regarding the contributor and the *New York Times*.)

David Teicher, a second Compliance officer present at roll-out meeting, had worked in the Derivatives Group and the RMBS Group before joining the Compliance Department and knew the Derivatives analysts well. Those

Derivatives analysts who had asked particularly audacious questions received follow-up clarification by phone from Michael Kanef himself, Chief Regulatory Affairs and Compliance Officer. (Mr. Kanef had not attended the roll-out meeting.) To the analyst who asked about the trading policies for senior management at the roll-out meeting, Mr. Kanef responded, "What exactly do you not understand by conflict of interest?" He did not identify the other Compliance officers who joined him on this phone call.

Several Derivatives colleagues subsequently asked this analyst to report Mr. Kanef's call, as it was intended to intimidate not only that analyst but all others in the Derivatives Group. The analyst did not find it beneficial to do so.

At least one manager in the Derivatives Group was exempted from the Trading Policy. The manager had acquired exposure to AIG in late 2009 or 2010 but did not divest the exposure per the Trading Policy nor did the manager set up a blind trust that satisfied the Compliance Department. However, Compliance allowed this particular manager to retain the AIG exposure and simply recuse from any discussion of AIG inside of a committee or outside of it. This course was not available to analysts.

Derivatives Analysts Whisked Away to Potemkin Holding Pen

Item 3. May 2009
Compliance Department observed to Yuri Yoshizawa that the Derivatives analysts had asked too many questions at the roll-out meeting for the Trading Policy and stood out among other groups for having done so and not in a good way. Analysts in other groups, subject to new trading policies that were not as restrictive as that for the Derivatives analysts, accepted the policies easily. Ms. Yoshizawa rescinded her request that the three SVPs perform selected management duties.

Item 4a. May 2009
Michael Kanef called the contributor's MD to inform him that contributor had not returned a banker's call. This incident is related in the DealBook column of the *New York Times* of April 13, 2011. A Bank of America banker called the contributor regarding replacement clauses for downgraded providers of interest rate swaps to securitization transactions, largely CDOs.

Former Chief Operating Officer at Moody's Corp. Brian Clarkson testified to staff of the Financial Inquiry Commission that when analysts did not return a banker's call, "then there was a problem." Fleshing this policy out from the vantage of the contributor, an analyst must return as many calls in a day as a banker placed, even when each call addressed the same topic in an effort to wear the analyst down.

The contributor explained to his MD that he had returned the first two calls of the banker that day, but ignored the rest. The contributor also observed that the call from Mr. Kanef was not a friendly one, to which the MD readily agreed. However, the MD explained, he had "could not *not*" respond to Mr. Kanef's concern.

Intimidation by the Compliance Department apparently extended past analysts to managers, as well. The MD was a good friend of the contributor and had evaluated him highly in each of the previous ten years. Still, the MD did not feel that he could fob off Mr. Kanef and not bother the contributor. Nor did he subscribe to the

belief that he should freeze Mr. Kanef in his inquiry by asking why the telephone etiquette of a 48-year old Senior Vice President was of concern to the Chief Regulatory Affairs and Compliance Officer.
The contributor raised the call from Mr. Kanef in a conversation with personnel from the Human Resources department. In following up on the issue, Dana Weinshank of Human Resources and Internal Counsel Jessica Lieberman breezily dismissed implications from the call by Mr. Kanef, saying no, no, no, there was no intention to intimidate. Mr. Kanef "just thought" the contributor's MD would like to know about the unreturned bankers' calls. That was all.

Item 4b. 2009 – 2010
AIG was the downgraded hedge provider that the men from Bank of America were calling to discuss. AIG was counterparty to interest rate swaps with 50+ CDOs and other ABS transactions that had become deep-in the money, mark-to-market assets of AIG. In addition to providing an interest rate hedge to the transactions, AIG had also lent money to some of them at issuance. The CDOs that had borrowed in this fashion were repaying the loans through higher-than-market fixed rates that had resulted in particularly large mark-to-market assets for AIG.

The respective swap contracts allowed the CDOs (both those that had borrowed from AIG and those that had not) to terminate the swaps without making any payment as AIG had not complied with the replacement provisions following its 2008 downgrades. If the CDOs had exercised these rights, they would have removed a large liability from the top of their waterfalls, to the benefit of their rated notes. By corollary, AIG would have recorded a 100% loss on each of the deeply-in-the-money swap assets.

The contributor believes that much of the attention paid to him by the Moody's Compliance Department resulted from his analysis of the proposal by AIG to transfer these CDO swaps to Merrill Lynch Derivative Products AG ("MLDP), a DPC affiliate of Bank of America. The contributor was the lead analyst of MLDP for his entire tenure at Moody's. MLDP was downgraded to Aa1 on review for possible downgrade in June 2009 and to Aa3 in December 2009.

Each downgrade of MLDP raised the costs for AIG to transfer the swaps to MLDP and obliged AIG to revise its proposal in a more complicated manner. The MLDP downgrades flowed from a review of DPC methodology that had been prompted by the filings for voluntary bankruptcy by two Lehman DPCs. Moody's published a revised methodology in June 2009 and subsequently downgraded all DPCs to ratings below their long-standing ones of Aaa. Neither Fitch nor S&P have conducted a similar review. Both continue to rate DPCs at a Aaa equivalent.

Didn't Moody's know better than to make life difficult for the U.S. taxpayers who had bailed out AIG and expected to be repaid? In a conversation regarding their proposal, AIG made the point that if MLDP hadn't been downgraded to Aa3, the series of committees and revised proposals would not have been necessary. Didn't the Derivatives analysts know better than to cause more problems for Moody's? AIG was paying Moody's to consider its proposals and, depending on the manner in which they were executed, MLDP might pay Moody's also.

The contributor believes that senior management at Moody's wished to green-light AIG's proposal with minimal review and allow AIG to hold the transaction's costs to a minimum. Yuri Yoshizawa stated that while she was not participating in the extensive series of AIG/MLDP committees, she was tasked with reporting on their progress as they were receiving a lot of attention from senior management.
Nicolas Weill of Credit Policy observed that when he had asked that DPC methodology and ratings be revised to reflect the actions for the Lehman DPCs, he didn't necessarily mean to bring about the comprehensive review that resulted. Credit Policy was unabashedly directing the revisions of most methodologies in the Derivatives sector in a conservative direction, but apparently wanted to be more lenient on DPCs, at least those transacting with AIG.

Don't Ask, Don't Tell: Derivatives Analysts Pulled Up Short for Inquiring Into Ratings Debacle

Item 5. June 2009

Weekly meetings of Derivatives Team Leaders worldwide became increasingly contentious as several Team Leaders based in New York pressed for review of previous and current operations of the Derivatives Group. This small minority of Team Leaders were agitating to conduct a post-mortem on CDO opinions that would have proved convincing to them and other analysts regardless of findings.

Yuri Yoshizawa headed these weekly meetings, which typically had 40 participants of at least Vice President level in New York, Europe and Asia. Despite the number and seniority of participants, Ms. Yoshizawa focused the meetings on minutiae such as the schedules of secretaries. A representative from Communications began attending these meetings and kicking them off by sharing the response by Moody's management to the latest public relations fire.

After several weeks of contention by the New York Team Leaders, Ms. Yoshizawa tasked the contributor with developing a set of questions and concerns to present to senior management. The next week the contributor delivered a Word document with 20 observations to be presented to Ray McDaniel. The comments were intended to be supportive in tone. Many of them offered suggestions to prevent a future ratings fiasco and others identified the new policies that had been implemented by Compliance in an ostensible effort to achieve the same goal, but which were found wanting. A major theme underlying the comments was that management should consult directly with Derivatives analysts regarding the discredited opinions. The approach of management had been to tell the Derivatives analysts the causes for the poor opinions and to apprise the analysts of how the causes would be addressed.

Ms. Yoshizawa lauded the comments as concise and even-toned and suggested that others who wished to add additional ones do so via email that carbon copied all Team Leaders. Within a few days, four Team Leaders had submitted points and, shortly after the last submission, Ms. Yoshizawa emailed Team Leaders to notify them that the effort was being stopped immediately. Upon being confronted about her decision, Ms. Yoshizawa acknowledged that she had not read the email chain or any comments, but had shut the process down at the suggestion of Team Managing Director Yvonne Fu. Ms. Fu advised that the whole process was getting out of hand and the comments would prove embarrassing if, for instance, they showed up in the Wall Street Journal.

Ms. Fu was a Managing Director in 2006-2008 with responsibilities for CDOs of ABS, reporting to Ms. Yoshizawa. Ms. Fu had never offered an explanation to the Derivatives Group regarding her decision-making in this period. That policy was not to change.

Item 6. June 2009
The following week's meeting of Team Leaders was attended by all of the Derivatives managers, who backed Ms. Yoshizawa in her insistence that the Group would forward no comments to Ray McDaniel. If individual Team Leaders persisted in the effort, they did so entirely on their own.

In the parallel meeting of Senior Vice Presidents with Ray McDaniel, the contributor pressed the point that there was a significant blockage of communication between analysts and senior management. Mr. McDaniel concluded that he was very interested in the issue as well as one other point brought up by a separate Senior Vice President, and said he would follow up with each separately. In fact, Mr. McDaniel never followed up with the contributor. However, at the next Company Town Hall, Mr. McDaniel listed the contributor among the Senior Vice Presidents with whom he had had fruitful meetings as part of outreach efforts by senior management.

Management and RMBS/Compliance Open Express Lane Expressly for AIG

Item 7. June 2009
Series of committees began to consider the AIG proposal to issue Rating Agency Condition ("RAC") for the transfer of interest rate swaps with CDOs to MLDP. Ms. Wynne Comer of Bank of America was the banker whose team represented AIG in forming proposals for Moody's to consider.

Ms. Comer interacted with the Derivatives team that was assessing the AIG proposals very aggressively. The contributor was involved in all of these committees and often participated in conference calls with Ms. Comer. Derivatives managers did nothing to disabuse the views of the analysts that Ms. Comer had license to press her points with the analysts in a manner that went well beyond that of simply being a forceful advocate. The managers did not caution Ms. Comer over the course of more than a year that her approach was inappropriate, nor did the managers back the Derivatives analysts on calls with Ms. Comer.

Item 8. June 2009
MLDP and two other continuation DPCs were downgraded following the publication of a revised DPC Methodology. The new MLDP rating was Aa1 on review for downgrade. As the three continuation DPCs were subject to the same revisions, an opinion on each was formed in a single committee.

The committee voted 12-0 to downgrade each of the other two DPCs to Aa1 on review for downgrade. With respect to MLDP, the committee voted 11-0 to downgrade and place on review for further downgrade. One committee member who had voted in the first two instances recused herself with regard to MLDP, owing to a not-yet resolved conflict of interest under the new Trading Policy for the Derivatives Group. Neither the Committee Chair nor the senior-most committee member (who was not the contributor) directed the recused analyst to leave the room for the MLDP vote as was required by new rules for committee proceedings.

Item 9. June 2009 to August 2009

Compliance insisted that the rating of MLDP be reconsidered in a new committee, citing the presence of the recused Derivatives analysts in the first MLDP vote. The second MLDP committee was comprised of 13 new members who did not participate in the first committee and who were not versed in DPCs. The second committee reviewed MLDP for over two months and concluded by rating MLDP Aa1 on review for downgrade, the same opinion as reached by the first committee.

Item 10. June 2009 to December 2009
MLDP rating of Aa1 on review for downgrade complicated the AIG proposal to transfer swaps to MLDP and made it more expensive, as related by both Ms. Comer and AIG. AIG, AIG's outside counsel and Wynne Comer also offered at different points that Moody's should review the AIG transfers with leniency, as the transfers would ultimately benefit the U.S. taxpayer.

Item 11. Fall 2009
Senior managers Doug Lucas and Andy Kimball presented to the Derivatives Group graphs showing the views of external constituents with respect to rating agency analysts. The data was annual from 2004 onward and was broken out by analysts at Moody's, Fitch analysts and S&P.

Andy Kimball opened the meeting by commenting that "These results are terrible" and Doug Lucas followed by marveling at the extent to which Moody's analysts were reviled by external constituents.

Derivatives analysts were generally stunned and had few questions. After all, a major implication was that Moody's management had sat on the information since 2004 without acting. In the period 2004 -2008, Moody's management had rewarded Derivatives analysts above all areas within Moody's, both in issuing strong annual reviews to most Derivatives employees and paying commensurate compensation.

Doug Lucas and Andy Kimball insisted on feedback. They were seemingly convinced that analysts saw the righteousness in being pilloried and would naturally suggest all sorts of fixes if only they would be granted some hope of redemption, however slim. Doug Lucas was reduced to pleading "C'mon, there have to be SOME questions or comments."

The Derivatives managers offered no comments during the meeting. Ms. Yoshizawa ended the meeting by stipulating that analysts should write New Issue Reports in a timelier manner in the future.

After the meeting, Doug Lucas and Andy Kimball let the Derivatives managers know that the silence of the Derivatives analysts was unacceptable. Apparently, the decent response would have been handwringing, gnashing of teeth and pleas for instruction in how one might obtain salvation.

Item 12. Fall 2009
Derivatives managers convene the communist re-education camp to obtain 100% buy-in from analysts in the Derivatives Group for an outreach program in which the analysts would extol the new, reformed and relevant Moody's. Attendance and participation were both mandatory. Analysts were seated side-by-side in a horseshoe. The Derivatives managers sat in the front and called on each analyst in turn to observe that improving the external view of Derivatives analysts was an important goal and that training for the effort was warranted.

The analyst for the AIG proposals asked for a different sort of training – one that would help analysts deal with difficult bankers (read: Wynne Comer, to whom the analyst had been subjected for some time.) The Derivatives managers unanimously swatted away that proposal. This was surprising, given that Ms. Yoshizawa was to testify in a few months to the Financial Crisis Inquiry Commission that management was alert to bankers' "abuse" of analysts.

If You Say So – Senior Moody's Manager Says Buddies Are Not "Corrupt or Venal"

Item 13. In late 2009, Andy Kimball met one-on-one with those U.S. Team Leaders from the Derivatives Group who had clamored for an honest post mortem into CDO ratings and to critique the remedial actions implemented by Credit Policy and the Compliance Department.

The contributor stated that he could not understand why the RMBS and CDO managers who had ushered in the disaster had subsequently been promoted rather than fired. Mr. Kimball answered that he agreed and, had he been the one to decide, he would have fired those responsible. However, it was his understanding that John Goggins, the Chief Counsel of Moody's Corporation, held that firing the RMBS and CDO managers might have been construed as an admission by Moody's that it bore responsibility for the debacle. Instead, Moody's was hewing to the argument that the ratings debacle stemmed from the extreme fall in housing prices that no one could have predicted.

The contributor then shared his view that the principal agent of mass destruction of both RMBS and CDO opinions was Brian Clarkson. Analysts in the Derivatives Group knew that they worked for Moody's only so long as Mr. Clarkson allowed them to do so. Word had circulated as to how much time was given to a former analyst after being fired to exercise her remaining options on Moody's stock. Technically, these options were extinguished at the time of termination, but analysts understood that this would be postponed for a few weeks in the case of those who had been fired.

Mr. Clarkson had expressed pride in having fired much of the previous RMBS Group for not having sufficient market share. Mr. Clarkson had told the attorneys of the Derivatives Group that they were not to kill any deals. Mr. Clarkson habitually threatened individual analysts in on-on-one conversations regarding interactions with bankers that had been relayed to him. Mr. Kimball replied that he had heard many others recount the same themes regarding Clarkson.

The contributor also mentioned that management of the Derivatives Group had long directed analysts to "structure" in the course of their work. For many, many years, Gus Harris and other Derivatives managers intoned that analysts should not merely identify a problem with a transaction but also propose a solution. After all, analysts have the most insight regarding issue of methodology and the concerns of a committee.

(In 2007, Yvonne Fu directed the contributor to standardize a list of those events that would place a CDPC in "Suspension" or in "Wind-Down." The list was approved by a committee and distributed to each CDPC, who then incorporated the list into their operating guidelines. The intent was to standardize these events so that each CDPC was being rated on identical terms. There had been no time to publish the list in a methodology update.

When the contributor reminded Ms. Fu of this in a 2009 Group meeting, she replied "I don't think we want to talk about that.")

In an earlier meeting (a DPC committee), Mr. Kimball had stated that whether or not analyst involvement with an issuer could be construed as "structuring" was a non-issue to him.

Lastly, the contributor discussed the PARCS/PYXIS debacle that had originated solely from management directives in the Derivatives Group that had been issued over the course of many years. (See *"F. Analysts Keep Correlated Collateral Out of Merrill Lynch CDO Hall of Mirrors (PARCS/PYXIS)."* Mr. Kimball said that he would look into PARCS/PYXIS. If Mr. Kimball subsequently kept his word, he didn't tell the contributor. Perhaps Mr. Kimball found that he could not avert his gaze from that CDO Hall of Mirrors.

<u>Notes Regarding Discussion with Andy Kimball</u>

1. In his personal evaluation held in early 2010 with Ms. Yvonne Fu and Ms. Eun Choi, Managing Director, the contributor repeated Kimball's comments that he would have fired RMBS and CDO managers. Ms. Fu was incredulous – "Andy Kimball said that?!"

2. In discussing the possible motives of Eric Kolchinsky in speaking out against Moody's management, Kimball stated that the Moody's defenses against Kolchinsky did not mean that management was "corrupt or venal."

3. The contributor has formed a different opinion.

Item 14. Mid-December 2009
MLDP was downgraded to Aa3. In a subsequent call, AIG personnel lost their tempers with the contributor and asserted that if he had not downgraded MLDP, AIG's task would not have been made so difficult. It is useful to repeat here that no individual "takes a credit action." A lead analyst recommends an opinion to a committee and has one vote in forming the Moody's opinion.

RMBS/Compliance Swings Both Ways for DPCs
Item 15. Late December 2009
A committee downgraded each of three Termination DPCs. During the two hour interim between notification to each DPC of decision to downgrade and public release of the new rating, the contributor received a call from Doug Lucas. The contributor waived the call to voicemail and continued the tasks that were necessary to publish the three downgrades.

After the downgrades were released publicly, the contributor listened to the call. Mr. Lucas had stated that he had worked at Citi Swapco Inc., one of the three DPCs, and was having lunch with his former colleagues that very day. These former colleagues had alerted Mr. Lucas to the downgrade and had discussed its rationale as they had understood it from the rating analysts. Mr. Lucas had no standing to discuss a rating or its rationale with the DPC – he was not their rating analyst. Mr. Lucas also had no standing to discuss the two other DPCs whose downgrades had not been made public.

The correct course of action would have been for Mr. Lucas to have refused all discussion on the topic. Instead, Mr. Lucas mentioned in his call that he would "love to know" the specifics of the downgrade ahead of his meeting. All three downgrades were non-public information at the time Mr. Lucas called, and they remained so for some hours afterwards. Mr. Lucas was therefore explicitly asking for non-public, proprietary information to share with a DPC. The contributor had never before received such a request and saved the telephone message.

Mr. Lucas had continued his dialing for dollars and subsequently reached Yvonne Fu, the manager with responsibility for DPCs. Ms. Fu knew that the downgrade opinions were not yet public – she had yet to approve them in the publication system. The correct course of action would have been for Ms. Fu to let Mr. Lucas know that his request was inappropriate and that she was reporting it to Compliance. Yet, Ms. Fu forwarded Mr. Lucas on to the rating analyst for Citi Swapco Inc. and directed that analyst to make Mr. Lucas privy to the non-public information that he was seeking.

Ms. Fu sidestepped any responsibility for having abetted Mr. Lucas in his inquiries. She had merely guided him as he nosed around for non-public information. If Mr. Lucas misused the private information that he obtained, he was solely culpable. The contributor has observed that Ms. Fu is not in the practice of opposing managers senior to her, whether they were intent on continuing issuance of CDOs of ABS in 2006-2007 or were seeking non-public information in 2009.

Item 16. Early January 2010

The contributor reported Mr. Lucas's request for proprietary information to Mr. Davis Fisch of the Compliance Department. This was the first such report that the contributor had made in his 11 years at Moody's. He was initially told that not every incident had to be reported to Compliance and was waved away. It was also suggested that he try working through his immediate managers.

The contributor had given Ms. Yoshizawa and Ms. Fu several weeks to act so that a report to Compliance would not be necessary. Each had promised to confront Mr. Lucas and neither delivered on her promise until the exasperated contributor made clear his intention make a report on his own. At that point, Ms. Yoshizawa and Ms. Fu offered up a few gestures of minimal impact.

Mr. Lucas had undermined the rating analysts by offering himself as a source of insight to Citi Swapco Inc. Of particular concern was that each DPC was aware that day only of its own impending downgrade. Keeping with Moody's policies, ongoing practice of the DPC team, common sense and professional pride, no DPC had been given an inkling that others would also be downgraded. One of the other two DPCs was rebuffed utterly in its question of whether other downgrades would occur.

In all manner of their work with DPCs over very many years, the analysts possessed confidential information that they respected to the utmost and that they were not in the habit of bandying about as currency to inflate their own importance. One small indiscretion would undo years of building a reputation for honesty, as well as the analysts' own self-respect.

The contributor forwarded the phone call from Mr. Lucas to Compliance. Upon learning that DPCs did not issue debt, Mr. Fisch concluded that there was little point in pursuing the complaint as there was no possibility of insider trading. Mr. Fisch was a new hire who had 30 years of experience in Compliance but, surprisingly, no experience managing RMBS ratings.

The contributor was unconvinced by the rationale, given the resources that Compliance had demanded be deployed in convening a second MLDP committee the previous summer. Moreover, the contributor had not mentioned insider trading. Rather, the quest for non-public information was part of a larger drive by management to present Moody's as a relevant insider that others in the financial world should want to consult. Toward this end, analysts were being instructed to transform themselves into "sell-side analysts" and dive headlong into the mix of their respective sectors. Mr. Lucas was merely setting a good example.

RMBS/Compliance to Contributor: Hop on Down to a Kangaroo Court!
Item 17. January 2010
In a neat flip, the Compliance Department called the contributor to a meeting with Mr. Fisch and Mr. Murray Markowitz. Mr. Markowitz, who possessed the ABS experience so highly esteemed by the Compliance Department, participated via phone.

The contributor observed that finally there was no more to be said about the twin MLDP committees of the previous summer. The second downgrade of MLDP in December would seem to have put that overworked issue to rest. Actually, Mr. Fisch interjected, the case of the 11-0 committee MLDP with one recusal was not necessarily closed. Mr. Fisch seemed embarrassed to have to start down this course and disavowed responsibility of having to do so. A superior had offloaded the case to him. Mr. Fisch did not know a great deal about it. Mr. Markowitz was either silent or had his phone on mute.

Mr. Fisch then continued with his unpleasant task by asking why the recused analyst had been invited to the June 2009 MLDP committee in the first place. As Team Leader for DPCs, the contributor had selected the committee members. The 12-member committee was large as it was forming opinions on three individual DPCs.

The participation of the analyst who abstained from voting an opinion on MLDP was vital to the committees. The analyst had been the only one who had participated in all of the DPC committees of 2008 related to a significant event regarding a Bear Stearns DPC and the separate issue of the bankruptcy filings of the Lehman DPCs. The analyst was also lead author of revised DPC methodology. The analyst's conflict with Bank of America under the new Trading Policy was well known – this analyst had taken the lead in designing a blind trust and shared this expertise with others. The only unknown in issuing the invitation was whether the blind trust established by this employee would become operational by the time of the committee (such decision was made by the Compliance Department.)

Mr. Fisch brushed this explanation away, eyed his prey and went in for the kill. "On June 24, 2009, the new Trading Policy for the Derivatives Group went into effect," he said, but the contributor immediately cut him off. "I wouldn't have known the date. The new Trading Policy didn't affect me." Mr. Fisch was incredulous. "The new Trading Policy didn't affect you? Then why did you….?" There he caught himself and said no more. Mr. Markowitz remained mute.

The contributor believes that, had Mr. Fisch not stopped himself, he would have continued "…ask so many questions at the roll-out meeting for the new Trading Policy?" Hey, Mr Fisch, a career compliance officer with more than 30 years' experience in the field, why did you not check the monthly brokerage statements of the contributor before having him hop on down to Compliance for a kangaroo trial?

Why was Mr. Fisch, the Compliance officer for all things DPC, straining for any hint of infraction regarding committees that had downgraded MLDP? The very same, very experienced Mr. Fisch had summarily dismissed the complaint that Doug Lucas had obtained confidential, non-public information about a separate DPC on the grounds that "DPCs don't issue debt"?

Inquisitive Analysts Learn Yet Again: Management Extracts Payback Without a Hitch
Item 18. January 2010
The analyst leading the AIG/MLDP committee receives one of the lowest reviews in the group. The analyst reported that, when he challenged the managers as to why his management of the gargantuan AIG task was given no credit, they responded with blank expressions.

The contributor also received one of the lowest reviews in the group despite having documented excellence at each metric contained in the formal review. The contributor had taken care to excel at each management objective, both out of professional pride and in a pre-emptive move to prevent his views of the ratings debacle from being dismissed as coming from one who could not adapt to the new regime. Ms. Fu and a second managing director, Ms. Eun Choi, could not articulate a rationale for the poor review, but merely repeated that they had spent a lot of time developing it. Moreover, the contributor had "met expectations," what was the problem? "Meets expectations" was the lowest review given to an analyst not demonstrably incompetent.

The contributor filed an appeal that was read and signed by Ms. Fu, Yuri Yoshizawa and Andy Kimball, as well as HR. None provided any feedback regarding the appeal.

Other senior Derivatives analysts who challenged management over the course of 2009 and were rewarded with unarticulated poor reviews were told by managers, "Don't worry, you can still buy nice things with your bonus" and "Why are you complaining about your review when so many people in Haiti suffering from the earthquake have it so much worse than you?"

A third, senior analyst who had challenged management throughout the year also received a very low review. This analyst had been designated by Ms. Yoshizawa in 2009 as senior legal analyst for the Derivatives Group. She was tasked by Andy Kimball in 2010 to lead Moody's firm-wide assessment of the game-changing decision that had been handed down by the judge in the Lehman bankruptcy proceedings. During her annual review with Ms. Fu and Ms. Choi, the analyst took exception to an assessment of her that was attributed to Mr. Jian Hu, a managing director in the Monitoring Group for Derivatives. The analyst interrupted the review, walked to the office of Mr. Hu and suggested that he think hard - had he made the assessment? Upon Mr. Hu answering "Let me see. I didn't say that," the analyst demanded that he cross out all that had been attributed to him and returned with the amended document to resume her review with Ms. Fu and Ms. Choi. They made no change to the analyst's review despite the elimination of "supporting" materials from Mr. Hu.

A few analysts fared better in challenging their reviews after pointing out to Ms. Fu and Ms. Choi that elements in their assessments were explicitly contradictory. The reviews lacked internal consistency. Ms. Fu and Ms. Choi upgraded these reviews on the spot; they had sole discretion in the process and could do as they liked.

It should be noted that these reviews were developed under a "rank ordering" system that was being used for the first time in the Derivatives Group. No analyst was reviewed against the performance expected of one with her title or experience, No tie-in was made to the goals set by management in the previous year's review. Nor was an analyst ranked in comparison only to others with the same title. Rather, each analyst from entry-level Associate to Senior Vice President was assigned a discrete place in the "objective" ordering from best to worst. The "expectations" were identical for each.

The contributor asked Yuri Yoshizawa in the last meeting of Team Leaders in 2009 what criteria would be used in assigning a discrete rank to each analyst. The system was new. Ms. Yoshizawa replied that the most important criterion in evaluating an analyst would be how that analyst treated "my people." For analysts based in New York, Ms. Yoshizawa's "people" meant Yvonne Fu, Eun Choi and Jian Hu. Ms. Yoshizawa was as good as her word. The highest ranks were assigned to lower-level, less experienced analysts of genial temperaments who had not been observed by others in the group to have questioned Ms. Yoshizawa, Ms. Fu, Ms. Choi or Mr. Hu.

Derivatives Analysts Stumped by Yoshizawa Testimony – We Were Shielded From "Banker Abuse?"

Item 19. April 2010

A completely unconvincing testimony was offered by Warren Buffett, Ray McDaniel and Yuri Yoshizawa at first round of FCIC hearings regarding the rating agencies.

Warren Buffett shared his view that, as the largest shareholder in Moody's, he had no responsibility to check up on its operations. The value of Mr. Buffett's remaining stake in Moody's has stabilized since his testimony, as the stock of Moody's Corp. has reached $40 from a low of $20 in the summer of 2009.

Ms. Yoshizawa was cautioned by Senator Levin that her testimony was changing, thus rendering it inconsistent with her oath. Ms. Yoshizawa had testified that analysts had been removed from deals after being "abused" by bankers. The next day, the contributor met not a single Derivatives analyst who believed that Ms. Yoshizawa had been truthful under oath.

One analyst observed "What else could she do if she wanted to keep her job?" A second analyst was concerned that Ms. Yoshizawa had created law enforcement issue that would oblige all in the Derivatives Group to respond to inquiries from enforcement authorities. Another analyst responded that the contributor was the third analyst that day who had asked if he believed that Ms. Yoshizawa had lied. The view of this analyst was clear. "Bill May (who reported to Ms. Yoshizawa at the time) removed Rudy Bunja as lead analyst for a CDO at insistence of Deepali Advani (a Lehman CDO banker who had been a Derivatives analyst) and the whole 26th floor (i.e. the Derivatives Group) knew it."

Management offered no forum for analysts in the Derivatives Group to offer their own views on the testimony of Ms. Yoshizawa. Nor were individual views on the topic solicited. Internal communications from senior management, including Andy Kimball, lauded Ms. Yoshizawa for her testimony.

Poor, Poor "Pure Play" Moody's

Item 20. In early summer 2010, Mr. McDaniel updated approximately 30 SVPs on regulatory matters. The contributor asked why Moody's had incurred many more warnings and notices from regulators than S&P & Fitch. Andy Kimball paraphrased the implication for Mr. McDaniel – might Moody's be the worst of the bunch?

Mr. McDaniel focused on Moody's being the only "pure play" among the rating agencies. This status would always subject the firm to more attention. Mr. McDaniel then mused that members of the Financial Crisis Inquiry Commission might be paying particular attention to Moody's because, as a "pure play," Moody's stock could be shorted, before doubling back to say that he didn't want to accuse anyone of anything.

Item 21. May - June 2010

The second round of FCIC hearings regarding rating agencies began at the New School building on 13th Street. Former Derivatives employees Gary Witt, Mark Froeba, Eric Kolchinsky and Rick Michalek testified almost all day, as Brian Clarkson called in sick with gall stones. The main thrust of their testimony was that Brian Clarkson unrelentingly pressured anyone, manager or analyst, who was perceived as an impediment to business. This was the experience of most who had worked under Mr. Clarkson, including the contributor.

The day after the second FCIC hearing, Derivatives analysts openly discussed the testimony. None rallied to the side of Moody's management.

Exasperated Management: It's High Time to Let AIG Have Its Way

Item 22. June 2010

Nicolas Weill of Credit Policy interrupted an AIG/MLDP committee by asking why the transfer wasn't simpler, given MLDP's Aaa rating? (The rating of MLDP was Aa3.)

Mr. Weill apparently didn't remember the outcome of the DPC methodology update which he had presided over and capped the rating of DPCs at Aa1. Mr. Weill also believed that if a DPC were still rated Aaa (none were at this point), no further analysis was needed. In fact, the overlap of credit relied upon by both the Hedge Framework and the DPC methodology was not captured in either CDO or DPC ratings. The same level of analysis would have been required had MLDP remained Aaa. For this reason, DPCs typically did not provide such hedges.

The DPC team had pointed out since 2000 the conflict between the two methodologies in these instances. This was the same subject that had been raised in the conference call with Mr. Geoff Witt of Merrill Lynch in which Mr. Witt had been given a "hard time," according to Brian Clarkson.

Ms. Eun Choi concluded the AIG/MLDP committee by telling the members that they were "crazy" for having assessed the proposal so closely. In addition to Ms. Choi, the committee was comprised of an attorney, two

DPC specialists and two market-value specialists, all of whom Ms. Choi freely admitted had pertinent experience in the areas, whereas she had none.

Item 23. June 2010
The contributor turns down an unsolicited offer by Mark LaMonte to join Credit Policy in a position overseeing the Funds sector. In offering the position, Mr. LaMonte said that Yuri Yoshizawa, Nicolas Weill and Andy Kimball had all recommended the contributor for the position. Mr. LaMonte also stated that he did not wish to consider others in the Derivatives Group for the position and, should the contributor turn it down, he would search outside the firm to fill it.

The offer was flattering, but a little curious given that the contributor was ranked lowest of all analysts in the Derivatives Group in his annual review. The contributor turned the offer down, but was grateful that he could not be dismissed as a failed employee should he offer his views of Moody's.

Item 24. June 2010
Yvonne Fu, Eun Choi and the contributor meet with a Private Equity firm buying Athilon CDPC. The debt and counterparty ratings of Athilon CDPC debt had been downgraded significantly, which had enabled the Private Equity firm to become involved. The subsequent purchase of Athilon CDPC by the Private Equity firm stabilized the existing ratings, but the contributor viewed it as a sad coda for a rating process that had gone off the rails at inception.

The thoughts of Ms. Fu and Ms. Choi ran in a different direction. Returning from the meeting, Ms. Fu asked brightly "I wonder what the ROE is", i.e. the anticipated return penciled in by the Private Equity firm for its investment in Athilon CDPC. Ms. Eun Choi intoned, in a manner that in the view of the contributor would not have been out of place in an episode of "I Love Lucy "Oh, Yvvvvvvvvvonnnnnne…. (There you go again!)"

And Now to Bed

Item 25. July 2010
Andy Kimball urges Team Leaders to imagine that they are testifying to the Senate when they debrief a group of senior managers on the impact of Dodd-Frank upon their respective sectors. The contributor resigns.

The contributor felt only disgust for Andy Kimball having raised the specter of Senate testimony, given the widespread view among Derivatives analysts that Yuri Yoshizawa had lied in offering hers. Other Moody's managers who had testified to the FCIC, i.e. Ray McDaniel and Nicolas Weill, did not convince. Brian Clarkson didn't show up to testify at all. He had kidney stones.

Kanef's Compliance Counsels Kangaroo Court to Quietly Continue

Item 22. June 2010 – May 2011
The Compliance Department has uninterrupted access to monthly brokerage statements of the contributor, although he resigned in July 2010. Only the Compliance Department of a financial firm can notify a brokerage firm that access to the statements of a former employee is no longer needed. It is standard practice for any compliance department in the financial sector to issue such notice within days of the employee leaving the firm.

Such was the case when the contributor's partner and his former employer parted ways. The next brokerage statement of the contributor no longer listed his partner's former employer as having access to the statement. The Compliance Department of Moody's waited almost a year before doing the same.

Perhaps RMBS/Compliance was simply compensating for its earlier failure to check these very same brokerage statements when convening its kangaroo court?

K. Professional Experience of the Contributor

WILLIAM J. HARRINGTON

[redacted]

SUMMARY: Specialist in assessing credit and market risk of counterparties facing structured entities.

<u>EXPERIENCE</u>

1999 – 2010 MOODY'S INVESTORS SERVICES *New York, NY*
2006 – 2010 Senior Vice President and Co-Team Leader, Structured Finance Operating Companies

- The Structured Finance Operating Company ("SFOC") Team rated and monitored 35 companies that in aggregate faced 3000+ counterparties. SFOCs include Derivative Product Companies (DPCs) and Collateralized Swap Programs that provide interest rate, currency and index derivatives, as well as Credit Derivative Product Companies (CDPCs) that write credit default swaps. SFOC counterparties include sovereign, supra-national, corporate, financial, municipal and structured finance entities. Led team in developing methodologies to evaluate the ability of each SFOC to pay amounts owed counterparties, given its capital and collateral models, legal structure and operations.
- Capital and collateral models centered on dynamic determination of potential payouts that an SFOC may owe under each derivative contract as a result of market volatility, credit events, termination payments and transaction costs.
- Legal review focused on non-consolidation, creation of security interest on behalf of counterparties and ISDA documents.
- Operating Guidelines specify operating procedures both for normal and exceptional periods, restrict non-counterparty distributions and trading activities, detail approved derivative products, indices, currencies and eligible investments.
- Spearheaded methodology revisions that addressed issues that arose with respect to the Lehman and Bear Stearns DPCs, including mitigating the risk of voluntary bankruptcy, hedging market risk and strengthening the role of contingent managers.

Representative Accomplishments: Non-SFOC Products

- Reviewed and commented extensively on the two iterations of the JPMorgan guarantee that was issued in March 2008 on behalf of certain affiliates of Bear Stearns & Co., including Bear Stearns Financial Products, a DPC and significant counterparty under swaps with U.S. RMBS securitizations.
- Led successful negotiation with Merrill Lynch in 2008 regarding its implementation of a CSA for $8 billion PARCS/PYXIS program. CSA restricted eligible collateral to U.S. dollar cash and U.S. treasury bonds, despite repeated proposals by Merrill Lynch to include broader types of collateral, such as asset-backed securities.

- Led extensive series of committees in 2009 and 2010 to consider novation of AIG lending swaps with cashflow CDOs and other securitizations to Merrill Lynch Derivative Products.
- Served on 20+ sovereign committees in 2009-2010 as senior outside member.

2003 – 2006 Structured Credit Committee – Moody's Worldwide

- Co-developed methodology used worldwide by counterparties when providing interest-rate and currency hedges to structured finance transactions.
- Methodology specifies rating triggers, procedures for determining and posting collateral, a mechanism to effect assignment, events of default, additional termination events and priority of payments both under normal circumstances and following hedge termination.
- Adapted existing ISDA procedures to reflect the potentially limited universe of replacement counterparties and to facilitate collateral posting.
- Reviewed implementation by individual counterparties and law firms.
- Identified residual counterparty risks not addressed by methodology and developed approaches to assess their impact on the ratings of individual transactions.
- Highlighted areas of conflict with structured finance entities such as DPCs that sought to provide hedges to securitizations.
- As background, designed and conducted worldwide review of hedge issues within structured finance. The review entailed examining existing practices in each sector, conducting face-to-face interviews with counterparties in North America and Europe and soliciting views from interested parties by authoring a Call for Comment on two separate occasions.

1992 – 1998 MERRILL LYNCH & CO. *New York, NY*
Vice President

- Global Swaps Trading Group. Structured, traded and marketed OECD fixed-income derivative trades to liability managers, institutional investors and hedge funds.
- Foreign Exchange. Traded options on major currencies, cross-rates and hybrid products, such as government bonds denominated in second currency.

1987 – 1990 THE WEFA GROUP, Wharton Econometric Forecasting Associates *Bala Cynwyd, PA*
International Economist

- Produced monthly forecasts of foreign exchange and interest rate trends in OECD economies.

EDUCATION

1990-1992 The Wharton School, University of Pennsylvania *Philadelphia, PA*

1979-1983 University of Pennsylvania *Philadelphia, PA*

PUBLICATIONS

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