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Via Electronic Mail (Markt-G3@ec.europa.eu)

August 29, 2008

European Commission
DG Internal Market and Services, Unit G3
Spa 2 03/079, B-1049
Brussels, Belgium

Re: Submission of public comment pursuant to publication of the Consultation by the Commission Services on Credit Rating Agencies:

Wrongful Actions of the International Credit Rating Agencies

COMPLAINT alleging enforcement failure in reference to the commission of fraud by the three primary international credit rating agencies involving the deliberate misstatement of risk and the propagation of deceptive credit ratings arising from the following wrongful actions:

- a) Intentional misapplication of published metrics (e.g., willingness to pay);
- b) Intentional misapplication of published definitions of ratings classifications;
- c) Intentional violations of the U.S. Investment Advisers Act;
- d) Intentional violations of codified NRSRO standards; and
- e) Application of a reckless standard of care.

Dear Commission Services Staff,

We are pleased to submit a public comment in response to the Consultation by the Commission Services on Credit Rating Agencies.¹ We address our comment to reference the matter of intentional misapplication of published metrics and published definitions by the three primary international credit rating agencies in the instance of the contrived sovereign credit rating assigned to China, an instance which exemplifies the shameless pursuit of self-serving gain in an overt bid to reap windfall profits from the increased debt issuance capabilities of Chinese corporates owing to the assignment of an artificial “investment grade” sovereign benchmark. Moody’s Investors Service has even gone so far as to advertise a conference for Chinese corporates to learn how to exploit the phony sovereign rating assigned to China, through the issuance of greater amounts of company debt (to be rated for a fee by Moody’s).² It is time to put an end to such egregious abuses of the financial markets by the credit rating agencies.

¹ Consultation by the Commission Services on Credit Rating Agencies (CRAs); IP/08/1224 Brussels, 31 July 2008.

² <http://globalsecuritieswatch.org/Moody%27s-Promotion.pdf>

The prevailing sovereign credit rating classifications assigned to the government of China by Standard and Poor's, Moody's Investors Service and Fitch Ratings conceal the fact that the Chinese government is presently in default on approximately \$260 billion of full faith and credit sovereign debt, which it has repudiated and refuses to repay to American bondholders, although China did enter into an exclusionary repayment settlement with British bondholders in 1987. The successor government doctrine of settled international law affirms continuity of obligations among internationally-recognized successive governments. The People's Republic of China ("PRC") is the internationally-recognized successor government to the internationally-recognized predecessor government of the Republic of China, which contracted full faith and credit sovereign debt of the Chinese government, and which loan agreement states that such debt is intended to be "a binding engagement upon the Republic of China and its successors."

The prevailing Chinese government sovereign credit ratings maintained and distributed by the three primary Nationally Recognized Statistical Rating Organizations ("NRSROs") do not conform to their published metrics nor to their published definitions, and ignore the following specific actions of the rated government (the PRC):

1. Selective Default;
2. Repudiation of China's full faith and credit sovereign debt;
3. Discriminatory and preferential payments to selected creditors;
4. Exclusionary settlement with Great Britain in 1987; and
5. Rejection of the successor government doctrine of settled international law.

By concealing the above actions of the rated government, the published ratings in the instance of China clearly trespass on the claims of defaulted bondholders and enable China to access large-scale capital financing without incurring any penalty or premium for its actions of selective default and repudiation.³

How are the three primary NRSROs, which control 95% of the credit ratings industry, able to escape an enforcement action in the immediate instance for knowingly publishing false, misleading and injurious ratings in the instance of China? Simply because they are not regulated by the United States Securities and Exchange Commission ("SEC") nor any other regulatory body. In response to a written request in 2005 for an investigation into the practices of the credit rating agencies by the Honorable Jim Saxton, Chairman of the United States Congress Joint Economic Committee, the SEC explicitly disclaimed any jurisdiction over the activities of the credit rating agencies in an internal memorandum dated July 29, 2005, a copy of which we subsequently obtained.

³ It is extremely and overtly disingenuous for the three primary NRSROs to attempt to claim that they rate the actions of the present Chinese government while excluding the predecessor government's full faith and credit sovereign debt, as this liability is the repayment obligation of the present government, which continues to engage in the actions described above in violation of international law, and which actions of the rated government are concealed by the prevailing false ratings assigned by the primary NRSROs. Attempts to rationalize such actions in the form of supplemental disclosure without a change in the prevailing ratings is both inadequate and disingenuous as supplemental disclosure is not imbued with the force of law with which the actual rating classifications are empowered by virtue of extensive international prudential and regulatory codification.

In order to ensure that the credit rating agencies are able to continue to operate free from even the slightest modicum of regulatory supervision, the SEC rejected the adoption of a proposed rule requiring NRSROs to use "systematic procedures designed to ensure credible and reliable ratings." In order to remain free from the constraint of issuing "credible and reliable" ratings, Standard and Poor's and Moody's reportedly spend an estimated \$2 million each year on lobbyists to ensure that the U.S. Congress does not introduce any federal legislation which might act to impose a regulatory regime over the activities and business practices of the credit rating agencies.⁴ Even a casual observer may readily ascertain the unenviable credit rating results produced by the unregulated primary NRSROs:

Recurrent Theme: Credit Raters' Pattern of Deception⁵

2007	Misstated the risk and misled investors re: U.S. sub-prime mortgage meltdown
2002	Misstated the risk and misled investors re: Worldcom collapse
2001	Misstated the risk and misled investors re: Enron collapse
1997	Misstated the risk and misled investors re: Asian debt crisis, including the governments of Thailand and Korea
1994	Misstated the risk and misled investors re: Orange County debt crisis
1992-present	Continue to misstate the risk and mislead investors re: true sovereign credit risk of the Chinese government and its state-owned enterprises by concealing the action of selective default (e.g., the prevailing false rating classifications ignore the "willingness" metric as applied to the Chinese government's evasion of its repayment obligation of its defaulted sovereign debt and its practice of making preferential and discriminatory payments to selected creditors)
1983	Misstated the risk and misled investors re: Washington State Public Power Supply System default
1975	Misstated the risk and misled investors re: New York City financial crisis
1970	Misstated the risk and misled investors re: Penn Central debt default

It is also noteworthy that the SEC explicitly refuses to enforce the provisions of the U.S. Investment Advisers Act on the NRSROs, even though each of the three primary NRSROs is registered under the Act as a Registered Investment Adviser, and which Act explicitly prohibits registrants from engaging in actions involving conflicts of interest, as well as other prohibited

⁴ http://www.egan-jones.com/publicdocs/welling_egad_egan.pdf

⁵ Primary source: Article entitled, "Unchecked Power", *Washington Post* (November 22, 2004); article entitled, "Shaping the Wealth of Nations", *Washington Post* (November 23, 2004); article entitled, "Flexing Business Muscle", *Washington Post* (November 24, 2004).

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acts engaged in by the three primary NRSROs.⁶ We note further that the failure to amend the prevailing false sovereign credit ratings in the instance of China subsequent to express notification evidences the application of a reckless standard of care by the three primary NRSROs.

An examination of the evidence reveals that at Standard and Poor's invitation, China bought and paid for a sovereign credit rating from S&P which concealed the facts of both default and of repudiation of China's full faith and credit sovereign debt and which provided a basis upon which to increase the rating over time. It is the proclivity of the credit rating agencies to self-servingly manipulate the rating assigned to a particular issuer in order to maximize profits that contributed directly to the present global financial crisis. Evidence of this manipulation is nowhere more obvious than in the case of China's artificial credit rating. Such blatant disregard for the truth in pursuit of windfall ratings profits must be halted and at least a modest degree of integrity be restored to the credit rating process in light of the laughable credibility and abject failure of the IOSCO voluntary code of conduct.⁷ Thank you for allowing us the opportunity to submit the foregoing comment to the attention of the Commission Services on the Credit Rating Agencies.

Sincerely,



Kevin O'Brien, President
KO:jwc

Enclosures

⁶ http://www.globalsecuritieswatch.org/GAO_LETTER.pdf

⁷ See the revealing comment communicated via email by a ratings analyst at one of the primary NRSROs to a colleague, as recently reported by the *New York Times*: "Let's all hope we are wealthy and retired by the time this house of cards falters." Link: http://www.globalsecuritieswatch.org/SEC_Report_to_Post_on_GSW_Website.pdf

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